

ORAL ARGUMENT REQUESTED

No. 24-5205

United States Court of Appeals
For the District of Columbia Circuit

KALSHIEX LLC,

Appellee,

v.

U.S. COMMODITY FUTURES TRADING COMMISSION,
Appellant.

On Appeal from the U.S. District Court for the District of
Columbia

Case No. 1:23-cv-03257-JMC (Hon. Jia M. Cobb)

**JOINT APPENDIX
VOLUME I**

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1 IN THE UNITED STATES DISTRICT COURT
2 FOR THE DISTRICT OF COLUMBIA

3 KALSHIEX LLC,

4 Plaintiff,

5 vs.

6 COMMODITY FUTURES TRADING
7 COMMISSION,

8 Defendant.

Civil Action

No. 1:23-cv-03257-JMC

May 30, 2024

1:00 p.m.

Washington, D.C.

9 TRANSCRIPT OF THE MOTION HEARING
10 BEFORE THE HONORABLE JIA M. COBB
11 UNITED STATES DISTRICT JUDGE

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Official Court Reporter

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P R O C E E D I N G S

1
2 MR. ROTH: Good afternoon, Your Honor. Jacob Roth
3 from Jones Day on behalf of Kalshi. And with me at counsel
4 table is Amanda Rice, Josh Sterling, John Henry Thompson and
5 Sam Lioi.

6 THE COURT: Good afternoon.

7 MS. STUKES: Good afternoon, Your Honor. My name is
8 Anne Stukes for the Commodity Futures Trading Commission. And
9 with me at counsel table is Raagnee Beri, Margaret Aisenbrey,
10 and Conor Daly.

11 THE COURT: Good afternoon, everyone. So we are here
12 on the parties' cross motions for summary judgment. I don't
13 typically have oral argument, although I thought this was a
14 case where argument would be helpful to me in resolving the
15 motions.

16 I don't know who's arguing for plaintiff. Is there a
17 time sensitivity in this case? I know there's not a PI that's
18 been filed, but I'm just trying to understand.

19 MR. ROTH: It was actually the first thing I was going
20 to say was thank you for hearing argument on motions. We
21 haven't asked for a preliminary injunction but there is time
22 some time sensitivity because the contracts are tied to the
23 November elections. So what we would like, ideally, is a
24 resolution that would allow, if needed, for appellate
25 intervention so that the contracts can be listed prior to that

1 election.

2 THE COURT: That was my preliminary question.

3 All right, I will start with plaintiff. I may
4 interrupt with some questions, but otherwise will try to
5 restrain myself to listen to your presentation.

6 MR. ROTH: Great. Thank you so much, Your Honor.

7 So as Your Honor knows we filed this case because the
8 Commission blocked Kalshi from listing its event contracts that
9 turn on partisan control of the House and the Senate. And the
10 question for the Court is whether that agency action complies
11 with the Commodity Exchange Act and the APA. And we've
12 reproduced on a slide here the text of the key statutory
13 provision from the Commodity Exchange Act. And as you'll see,
14 it authorizes the Commission to block, prohibit the listing of
15 event contract if two elements are satisfied.

16 First, the contract has to involve one of the six
17 enumerated categories of activities, and then if it does, the
18 Commission may determine that the contract is contrary to the
19 public interest, in which case it's prohibited. So far, I
20 don't think that's a point of dispute. That's just what the
21 statute says.

22 Following that framework, our challenge here has two
23 basic components. First, we do dispute that Kalshi's contracts
24 fall within the scope of those six -- any of those six
25 enumerated categories. And that's really just a matter of

1 statutory interpretation.

2 Then the second piece is that we argue that even
3 assuming the contracts did fall within one of those categories
4 that Commission's public interest analysis was arbitrary or
5 capricious.

6 THE COURT: I know I said I was going to restrain
7 myself, but can I ask just a preliminary question? I
8 understand your argument to be because of this two-step
9 framework that the statute sets forth, that if it's not in --
10 and I'll say enumerated, although the last one is a catchall --
11 but in not one of these categories then you don't even get to
12 public interest.

13 I noticed in your brief you had outlined some of the
14 safeguards that your client has put in into place with respect
15 to this contract in particular. For example, paid members of
16 congressional staff aren't permitted to trade, other
17 safeguards. I'm assuming that your client thought those were
18 important to maintain integrity of the process.

19 MR. ROTH: Correct.

20 THE COURT: But under your argument, because elections
21 don't fall, according to you in these categories, there's no
22 occasion for CFTC to even reach those safeguards. So
23 presumably someone could post an event contract similarly to
24 what your client does, another DCM could do this without any of
25 those safeguards, and it's my understanding that under your

1 framework, CFTC would not have any interest in that.

2 MR. ROTH: I agree that it wouldn't be relevant to
3 whether it falls within one of these statutory categories and,
4 therefore, this provision would not capture it. What I'm not
5 sure about and what I can ask is whether there are other
6 regulations or provisions that may --

7 THE COURT: Come into play.

8 MR. ROTH: Yeah, that may speak to issues like that,
9 like who's allowed to trade on it, are there certain
10 restrictions beyond this, sort of, in-or-out provision. Which
11 is just it's either allowed or it's not allowed.

12 THE COURT: On a similar vein, I understood one of
13 your positions to be, look, this is a contract involving
14 control of the House; it's not talking about a discrete
15 election between two candidates, there are so many intervening
16 factors that have to occur before -- not even intervening
17 factors but it's not often dispositive of one election, who
18 controls the chamber. Under your framework, though, would a
19 DCM be able to post an event contract for a presidential
20 election?

21 MR. ROTH: Yes.

22 THE COURT: Okay. So that piece is responsive or
23 relevant to what? Your point about this being a House, about
24 control of the House and that it's not, you know, a two-party
25 or two-candidate election, there's a lot of moving parts, what

1 is that relevant to?

2 MR. ROTH: Let me try to answer it this way.

3 THE COURT: Okay.

4 MR. ROTH: If you imagine that there was a category on
5 this list that said elections --

6 THE COURT: Okay.

7 MR. ROTH: -- then I think one could still say that
8 these contracts involve elections even though it's one step
9 removed from the election itself.

10 THE COURT: Okay.

11 MR. ROTH: Which goes to an issue that was sort of
12 debated in the briefs, which is does it have been to be
13 literally the underlying event or does it have to -- does this
14 underlying event just have to relate to the category.

15 We agree it's enough that it relates to the category.
16 So if you had the category that said "elections," even though
17 this was a couple steps removed, I think you could say it would
18 relate to elections and, therefore, fall within the scope. Our
19 main argument, though, is it doesn't say elections.

20 THE COURT: All right. Continue please.

21 MR. ROTH: Okay. What I was going to say before
22 moving on was I'm going to be speaking to the statutory
23 interpretation piece of the argument, and my colleague, Amanda
24 Rice, is going to be speaking to the arbitrary and capricious
25 piece when I'm done.

1 Looking to the enumerated categories, we can sort of
2 simplify by taking four of them off the list right off the bat.
3 The last one, as Your Honor noted, is a catchall. The
4 Commission is essentially allowed to add categories by rule if
5 they're similar to the listed five. The Commission hasn't done
6 that, so we can sort of cross that one off the list for now.

7 And then, obviously, the Commission does not argue
8 that these contracts involve terrorism, assassination or war.
9 They do think "involve" is very broad, but not broad enough to
10 get them quite that far. So we can strike two, three and four
11 from the list as well.

12 And that leaves the two enumerated categories that the
13 Commission focuses on, which are, number 1, unlawful activity
14 and then number five, gaming. And I'd like to take them in
15 that order, which is the order they appear in the statute.

16 THE COURT: Okay.

17 MR. ROTH: So starting with the unlawful activity, the
18 way we understand that is that it refers to contracts where the
19 underlying event relates to some unlawful act. Okay? So for
20 example, if you had a contract on whether the D.C. murder rate
21 in 2024 is going exceed a certain level, if you had a contract
22 on whether a particular piece of art in the National Gallery is
23 going to be stolen within a period of time, those are unlawful
24 acts. If you had a contract on those events, it would fall
25 within the scope of number one.

1 I think it fits the text and I think it fits the
2 context of the statute, and that's sort of an important point.
3 It aligns it with the terrorism, assassination and war
4 provisions that immediately follow it. If you think about
5 terrorism, assassination and war, the common denominator is
6 they're bad. Those are things we don't -- they're bad things.
7 Congress is concerned about people profiting from bad things
8 and about incentives to do bad things. Right?

9 Using my hypothetical of the D.C. murder rate, you
10 don't want somebody to go hire a hit man to get the rate above
11 a level so you can make money. Bad incentives. It also just
12 feels offensive to have people profiting from, you know, there
13 was a terrorist attack, I'm going to make a lot of money from
14 that. That's sort of the gist of 2, 3 and 4.

15 If you read 1 the way we read 1, it lines up perfectly
16 with that. We don't want to incentivize crime, we don't want
17 to have people profiting from crime, so it's all parallel.

18 And, of course, that interpretation doesn't sweep in
19 Kalshi's contracts. Elections are not unlawful. They don't
20 even relate to unlawful activity. So now let's consider the
21 Commission's interpretation.

22 As I understand it on this prong, what they're saying
23 is some states prohibit betting on elections, either as part of
24 their gambling statutes or in stand-alone provisions. And the
25 Commission admits that those state laws don't directly apply in

1 the sense that they can't prohibit trading on a regulated
2 exchange because of preemption principles. But the way I
3 understand what they're arguing is that they say, well, buying
4 and selling those contracts sort of amounts to a betting on an
5 election because you're staking something of value on the
6 electoral outcome. If you did that outside the context of a
7 regulated exchange, then it would violate these state laws and
8 therefore the trading of the contract relates to unlawful
9 activity.

10 So a couple problems with that. Number one, unlike
11 our interpretation, it doesn't align with the three that follow
12 it, because the key move that they're making there is instead
13 of looking at the underlying event and whether it is related to
14 the enumerated activity, they're looking at the trading of the
15 contract and whether it's related to the underlying activity.
16 That is a, sort of just a different focus of the analysis, and
17 it makes 1 sort of stand out relative to 2, 3 and 4.

18 THE COURT: Can I ask you about that, because I think
19 that this defendant made this point -- the government made this
20 point. Where it says "agreements, contracts or transactions
21 involved," what work do you argue "transactions" is doing in
22 the statute as it relates to involve?

23 MR. ROTH: As I understand it, the agreement, contract
24 or transaction sort of triplet, it appears throughout the
25 statute. It's just the way they refer to these types of

1 instruments when they define it. So I don't think that they
2 have independent significance. I think they're just capturing
3 any different way you might structure the arraignment.

4 THE COURT: So you're not reading transactions to
5 refer to the act of trading the thing, it's another way to say
6 contract agreement; it is the contract, itself.

7 MR. ROTH: It's the instrument, and I think that
8 follows from the fact that this is how it's used throughout the
9 statute, the three together.

10 And just to be clear, we're not saying that you
11 couldn't have a statute that said transaction involving X,
12 where what it meant was the act of contracting, it involves
13 that activity. It's not that that's semantically impossible.
14 It's grammatically appropriate, it makes sense; it's just that
15 it doesn't line up with the way the statute works for 2, 3 and
16 4, and so it makes it just an unusual, sort of strange way of
17 speaking.

18 The hypothetical I was thinking about as I was
19 preparing, you could say, my lunch generally involves a
20 sandwich, a salad, a pastry or robust conversation with my work
21 colleagues. You could say that, and yes, it could involve
22 those things, but putting them together in that way is weird.
23 It's not the way people normally speak.

24 But I actually don't think that's the most problematic
25 aspect of the Commission's reading of the unlawful category. I

1 think the most serious problem with it and the one that really
2 is, I think, fatal is that it proves way too much, because as
3 the Commission observes elsewhere in the briefing, there are a
4 whole lot of states that prohibit betting on any contingent
5 event.

6 If we go to the second slide -- we've collected
7 them -- there's at least 29 that we've found that prohibit
8 staking something of value on an uncertain event or
9 contingency, and of course, that defines an event contract. It
10 would mean that every event contract falls within the scope of
11 Roman I and would involve unlawful activity, and that just
12 can't be right because it makes the other five enumerated
13 activities superfluous. And it defeats the whole purpose of
14 having enumerated activities in the first place because it
15 would allow the Commission to subject every event contract to
16 public interest scrutiny.

17 So every kind of interpretation tells us that's wrong,
18 and so does the statutory history, because sort of notably,
19 prior to 2000, that is how the statute worked. If we go to the
20 next slide, we have that language. They actually have to make
21 this public interest determination for every contract. That
22 was repealed in 2000, and then in 2010 Congress enacted this
23 more limit provision that singles out the categories. So I
24 think anything that covers the waterfront is necessarily an
25 erroneous interpretation. I think the Commission actually

1 admits that. They say on page 11 of their final reply brief
2 that, sure, you can't read any of these to cover everything,
3 that would not be tenable.

4 And so they try to explain why their interpretation
5 doesn't do that. And just to be candid, I don't really
6 understand what they're trying to do there. To me, if Kalshi's
7 contracts involve unlawful activity because some states
8 prohibit betting on elections, then all event contracts involve
9 unlawful activity because some states ban betting on contingent
10 events. So I think the bottom line on number 1 is our
11 interpretation is the only one that sort of makes sense in
12 context that gives this provision real work to do without
13 swallowing everything else.

14 THE COURT: Can you respond -- and apologies if it's
15 in your reply, the Commission gave an example of a circumstance
16 in which they would say a contract involved war without the
17 underlying event actually being about war. And I think the
18 example they gave is whether the Ukrainian military will
19 acquire certain munitions in 2024. Can you speak to that
20 example? They're saying, well, that would be, under their
21 broader reading, involve something that relates to war, but the
22 underlying event in the contract is not, itself, an act of war.

23 MR. ROTH: That may have been our example. I'm not
24 sure, because I think we agree with that. It may have been
25 theirs.

1 THE COURT: Maybe it was your example, sorry.

2 MR. ROTH: I'm not sure it's a point where the parties
3 disagree. I think it goes to the difference between "involve"
4 and "based on."

5 THE COURT: I think that was your example.

6 MR. ROTH: So "based on" would speak literally about
7 the underlying event. That's too narrow for this, this says
8 involve, so there's this broader scope. Our point is that the
9 broader scope is tethered around the event.

10 THE COURT: Okay.

11 MR. ROTH: So you're still looking at the event and
12 saying does the event relate to unlawful activity, does it
13 relate to war, does it relate to terrorism. So you can sort of
14 game it by circumventing -- by sort of making it technically
15 something that's just a proxy, it would capture this.

16 THE COURT: I just wanted you to flesh that out.
17 Okay.

18 MR. ROTH: Okay.

19 THE COURT: So when they say that you're reading or
20 using the word involved too narrowly, you would dispute that.
21 You're not disputing that involve means relate to -- all those
22 other dictionary definitions of involve. It's just relates to
23 the underlying event in the contract.

24 MR. ROTH: It's what has to involve. We don't
25 actually disagree on what involve means; we disagree on what

1 has to involve what. Right? It's a subtle but important
2 point.

3 Okay, that takes us through Roman I. Unless Your
4 Honor has further questions about unlawful activity, I'll move
5 to gaming, which is the second one that they argue. Again, the
6 fight is about what does gaming mean in this statutory context.

7 Our core point is really simple: Gaming requires a
8 game. So if there's no underlying game, there's no gaming.
9 And so for example, if you have a contract on who's going to
10 win the Kentucky Derby, that's a game. It's a horse race, it's
11 a game. If you have an event contract on who's going to win
12 the Super Bowl or the point spread in the Super Bowl, it
13 involves a game. There's an underlying game. Same thing with
14 the lottery. They have an underlying game that forms the basis
15 for the contract. And if you read it and you understand it
16 that way, I think there are a number of benefits to that.

17 Number one, going back to what we were talking about
18 earlier, it lines it up with the others in the sense that there
19 is this connection back to the underlying event rather than
20 just talking about the act of trading in isolation.

21 Number two, I think is most consistent with the text.
22 The root word of gaming is game. I think it aligns with the
23 legislative history, the famous colloquy that gets a lot of
24 discussion in the briefing between Senators Feinstein and
25 Lincoln -- which by the way, if Your Honor wants to watch it on

1 C-SPAN, you won't be able to find it. I think it was inserted
2 in writing after the fact.

3 It wasn't literally a colloquy, but you can see it in
4 the congressional record, and they give three examples of
5 gaming contracts: Football, horseracing and golf. They're all
6 games. I don't think that's an accident. I think that
7 interpretation makes sense too, because what is a game? It's
8 something that has no inherent economic significance. It's
9 something that is done for amusement. It may be done for
10 sport. It may be done purely to facilitate the betting itself,
11 right, for its own sake.

12 So I think it makes sense for Congress to have thought
13 about that category. Contracts that involve games are probably
14 not the type of contracts that we want to be listed on an
15 exchange, because they don't have any real economic value to
16 them. But again, what's tying that together is the existence
17 of the game because the game is the thing that doesn't have
18 intrinsic economic significance.

19 Now, of course, elections are not games. They're not
20 done for amusement; they're not done for sport; they're not
21 done to facilitate betting. Elections matter. They determine
22 our government; they determine our governance. Nobody would
23 really call them games. So in our view a contract relating to
24 an election is not gaming.

25 THE COURT: I have never before this case considered

1 the difference between gaming and gambling, but I'd love to
2 hear more about your position on that, because I did look at
3 the various dictionary definitions just to understand what
4 these words mean that I have used many times. And there are
5 some definitions that you would say "cross reference" and they
6 say "define as" gambling.

7 So I understand your position to be, sure, gaming is
8 part of gambling, but gambling is not gaming -- or gaming is a
9 subset of gambling; gambling is not synonymous with gaming.

10 MR. ROTH: I do think that's the better understanding
11 of the way the terms relate. I think gaming has this more
12 close tie to the game, whereas gambling can have a broader
13 meaning.

14 I will say when I went through the dictionary
15 definitions closely, what I found was -- I think this is
16 important. Even if you look at the definition of gambling,
17 there's generally two different definitions that are offered in
18 the dictionaries. There's a narrower one and there's a broader
19 one.

20 So for example, the Merriam-Webster, the first
21 definition of gamble is "to play a game for money or property."

22 The second definition is "to stake something on a
23 contingency or take a chance." Okay?

24 So you've got one definition that is tied to a game
25 and then one definition that is not tied to a game. And the

1 same is true of the Concise Oxford English Dictionary -- which
2 I think is also cited in the briefs -- two definitions of
3 gamble. Number one: Play games of chance for money.

4 Number two: Take risky action in the hope of a
5 desired result.

6 I think that's sort of fair, there are two different
7 ways of understanding gambling. One is tied to the existence
8 of a game, and one is just colloquially sort of broader, right,
9 a betting. I think what's important here is that the broader
10 definition does not work for the same reasons we talked about
11 earlier. If you sort of adopted and imported the broader
12 definition of gambling and treated any contract that involves
13 staking something of value on a contingency or an uncertain
14 outcome, then you've covered the waterfront of event contracts.
15 And so that can't be the right interpretation of gaming in the
16 statute. And I think that leaves us with the narrower
17 interpretation in the dictionary, which incorporates the
18 concept of a game.

19 Now the CFTC, they recognized this problem with the
20 broader definition and actually not -- I didn't fully
21 understand this from the order, but from the briefing it became
22 clear. They're sort of disclaiming the broader definition,
23 because they understand that that doesn't work in context. And
24 so instead they're sort of offering a intermediate approach
25 where they say, well, it does require betting on a game or a

1 contest, and then they say an election is a contest. So voila,
2 there we go. It fits.

3 In the brief we walk through each step of that logic.
4 What I'd like to here is offer a few higher-level observations
5 on that argument, because when you take a step back,
6 especially, I think it's just too clever by half. It's sort of
7 this lawyerly attempt to parse it and get it in. It's not
8 really a serious attempt at statutory interpretation. I'll
9 just offer a few reasons for that.

10 Number 1, if Congress was really trying to get at
11 election contracts, the easy way to do that would have been to
12 have a Roman VI or VII that said "elections." Very easy. One
13 word.

14 To say that they were trying to do it by saying
15 gaming, which some definitions cross reference gambling, which
16 you could say involves a game or contest, it's the most
17 attenuated way of getting at this. So strained that I don't
18 think it's very credible.

19 Second point is there's no support for this in the
20 legislative history. The colloquy, again, it's all games,
21 nothing about politics.

22 Third, if you look at where they're getting the word
23 contest from, it's really instructive because they pull it from
24 a few state statutes. And if we pull up -- we've got the text
25 of a couple of the samples of those. But it's very clear when

1 you look at them that they're talking about contests that are
2 like games.

3 So for example, this is the Delaware -- their version
4 which is also materially identical to Florida -- and they talk
5 about betting or wagering on the result of any trial or
6 contests wherever conducted of skill, speed or power, of
7 endurance or human or beast.

8 I suppose there are some candidates for office who may
9 be described as beasts, but it's really not -- I just don't
10 think anyone would say in this context of the statute contest
11 means election, just like you wouldn't say in the context of
12 the statute that trial means a trial in this courtroom. That's
13 not what this is about.

14 Same thing if you look at the next -- this is the
15 Louisiana version, talks about conducting as a business any
16 game, contest, lottery or contrivance. When you put game and
17 lottery next to contest it, I think, implies a certain meaning,
18 and treating that as including elections is really a stretch.
19 I think we wouldn't -- we don't dispute that you can refer to
20 an election as a contest, just like you can refer to a
21 corporate board fight as a contest. You could refer to a
22 lawsuit as a contest. But in the context of these gambling
23 statutes, that's not what they are talking about.

24 And then the final point on this is I think it just
25 leads to some really arbitrary results, because if you focus on

1 gaming as involving a game, then there's a certain sense to it,
2 right? As I said earlier, like games don't have any external
3 economic significance, generally speaking, so as a category it
4 makes sense for Congress the carve that out.

5 If you treat it as games plus elections, it's very
6 strange because it means you could have event contracts on the
7 weather, on whether somebody's going to be nominated for a
8 cabinet role, on what color dress Taylor Swift is going to wear
9 next week. Any of those are fine, but elections would be swept
10 up by the gaming category. It's just weird because even if you
11 think, look, elections are different and should be treated
12 differently. And I know my colleague is going to try to
13 explain why that's misguided, but even if you accepted that, it
14 has nothing to do with the word "gaming."

15 So I think the, sort of, takeaway is the Commission is
16 latching onto this word as sort of a convenient way to squeeze
17 its desired policy outcome into the statute, but it's not a
18 serious attempt to really understand what Congress meant by
19 this term in this context.

20 THE COURT: When you're saying, and I would agree,
21 that a game doesn't have any external economic significance,
22 how does that -- how is that relevant for the specific argument
23 you're making? What exactly do you mean by that?

24 MR. ROTH: What I mean is if we're trying to think of
25 what was Congress trying to get at with gaming --

1 THE COURT: Okay.

2 MR. ROTH: If we understand gaming to mean a contract
3 that involves an underlying game, then there's a certain policy
4 sense to treating that category differently, because Congress
5 could have been thinking about it and saying well -- there is
6 some of this in the legislative history, the colloquy, if you
7 look at it -- well, games don't matter in the real world;
8 they're games. So we don't want people essentially gambling,
9 right, on something that doesn't matter in a CFTC-regulated
10 exchange. So it gives some sense to the categorization that
11 Congress laid out. And the problem I have with the alternative
12 interpretations is they don't have that, sort of, unifying
13 policy rationale behind them. Right?

14 Again, the really broad version sweeps up everything;
15 that doesn't work. And then games plus elections, what is
16 tying those things together? It's not, it doesn't seem to me,
17 a line that you could really seriously draw from this word. So
18 that's what I'm trying to get at.

19 THE COURT: Okay.

20 MR. ROTH: Okay. So that takes care of Roman V, and
21 so our position is that is then the end of the analysis and
22 there's no need to go any further, but I will turn it over to
23 my colleague, if Your Honor has no further questions on this
24 piece, to address the arbitrary and capricious issue.

25 THE COURT: There are a lot of references by the

1 Commission about kind of representations on your client's
2 website about what it does. Do you want to respond to that?

3 MR. ROTH: I think it's a page that just pulls press
4 articles.

5 THE COURT: Okay.

6 MR. ROTH: So it's just like a collection of links to
7 articles that have mentioned Kalshi. It's not like a
8 representation by the client about what --

9 THE COURT: What its business is.

10 MR. ROTH: It's like here, people are talking about
11 us. Here's a list of stories.

12 THE COURT: Okay.

13 MR. ROTH: Thank you, Your Honor.

14 MS. RICE: Good morning, Your Honor. My name is
15 Amanda Rice, and I'm here to talk briefly about the
16 Commission's public interest analysis. As my colleague
17 explained, we think the statutory issue is dispositive, so you
18 don't have to go this far, so I'll try to keep it pretty quick.
19 But even if you disagree with us on the statutory argument,
20 they are still required here because the Agency's public policy
21 analysis was arbitrary and capricious.

22 I'll start with just a brief note on the standard of
23 review. There was some back-and-forth on this issue in the
24 brief, but as I think the Commission acknowledges in the end,
25 the arbitrary and capricious standard applies to all final

1 agency actions regardless of their form. That's a deferential
2 standard for sure, but it has some real teeth. It means
3 agencies have to engage in reasoned decision making, and agency
4 actions are arbitrary and capricious if they apply the wrong
5 standard or ignore relevant considerations or they don't
6 explain themselves reasonably.

7 Those are the kinds of arguments we're making here.
8 And they go to both sides of the public interest analysis, the
9 sort of benefits on the one hand and the alleged harms on the
10 other. So I'll take those two points in turn starting with the
11 benefits.

12 (Court reporter clarification.)

13 MS. RICE: I was trying to be quick but don't want to
14 speak too quick.

15 THE COURT: Take your time.

16 MS. RICE: So the economic benefits all follow, I
17 think, from one simple proposition, which is that partisan
18 control of Congress has economic implications. I think that's
19 pretty commonsensical, but there's a ton of evidence in the
20 record to support that point. I've just got a couple of points
21 highlighted on the slides here. The first one is from Harvard
22 professor, Jason Furman who's a former chairman of President
23 Obama's Council of Economic Advisors. He explains that
24 Congressional control impacts legislation, policy and the
25 business environment in ways that have direct economic

1 consequences to businesses and workers. He says this risk is
2 conceptually identical to climate risk, business interruption
3 risk and other risks that can be managed using financial
4 markets.

5 On the next slide we've got managing director of
6 JPMorgan, so coming from a different perspective, who explains
7 that election risk is one of the largest risks that their
8 clients face, that the frequently engage proactively on how to
9 minimize it or to hedge it. Hedging is a word, as I understand
10 it, for minimizing risk.

11 Mr. Lisboa gives the example of specifically the coal
12 industry, but there are a lot of other examples in the record
13 that stand out on different sides. So there's a software
14 company serving green energy businesses. It's at page 1597 of
15 the record. There's a recycling robotics firm. That's at 1533
16 of the record. These are just sort of common sense examples of
17 businesses that have direct control of partisan control of
18 Congress.

19 And then take it from Sam Altman who's the CEO of
20 OpenAI. He explains here the different risks that biotech
21 companies face. Those are direct and they're predictable. He
22 explains they involve everything from the FDA and different
23 approvals to research, funding and legislation. So it's not
24 just legislation, there's all kinds of other things that
25 Congress is doing here.

1 Because these risks are so significant, financial
2 institutions already offer projections on the economic impacts
3 of elections, and there's instruments for hedging against those
4 risks. You've already seen it from JPMorgan. There's more
5 examples of that on pages 42 to 44 of the record, if that's
6 helpful.

7 And then there are the noneconomic benefits.
8 Researchers, policymakers, the public, everyone benefits from
9 market-based data about elections. These markets already
10 exist. I know Your Honor is familiar with in nonprofit forms
11 because this information is so valuable. So these are just a
12 few examples from the record. But that's really just tip of
13 the iceberg. I thought pages 40 and 41 of our opening brief
14 and 68 to 70 of the record really tell this story of the
15 noneconomic benefits.

16 So the agency doesn't have much to say about either of
17 those two points, so they respond mostly by trying to move the
18 goal post. They make what I understand to be two primary
19 arguments. The first one is about direct effects. They say
20 that the economic effects of elections, sure, that they exist
21 but they're not direct enough. I think Your Honor is using the
22 language of too many intervening events to make a difference.

23 We explained in our brief that the record says
24 otherwise. You've already seen some examples today. I think
25 more important and more fundamental is the idea that the whole

1 point of having hedging with event contracts is to account for
2 diffused risks. This is not a one-to-one kind of hedging
3 product like the way insurance works. If there's a hurricane,
4 for example. That example helps me because you can see both
5 the direct and indirect effects of a hurricane, right? It
6 might destroy property, but it does other stuff too. It deters
7 tourists. You can't always predict exactly what those effects
8 might be, but it's a feature, not a bug of these contracts.
9 They allow you to capture anything that might follow from an
10 event like this.

11 THE COURT: If I can just stop you right there. So
12 what I understood the argument on the other side to be is
13 certainly if a hurricane hit, the extent of the damage or
14 effect on tourism or property, that might not be able to be
15 predicted in advance. So whatever your worst fear might not
16 materialize, but whatever effect there is will be direct.
17 Meaning to the extent that there is property damage, you can
18 trace that directly to the hurricane. So maybe the result
19 doesn't materialize in the way that it was predicted, but there
20 is a direct effect.

21 And my understanding is that, at least they would
22 argue, with elections, particularly in this context where we're
23 talking about control of a chamber of Congress by a party that,
24 sure, whatever thought about what might happen may not
25 materialize, but to the extent there is an effect, you may not

1 be able to trace it directly to who controls a party at a given
2 time or a chamber of Congress at a different time because there
3 are so many variables: Who's in office as president, kind of
4 what the split is, if it's a more even split, kind of what the
5 priorities are of Congress. Despite control, legislation
6 doesn't always get passed or become a priority.

7 So what would you respond to their point about this
8 not being the kind of direct economic effect that some of the
9 other trading contracts have?

10 MS. RICE: I think you're right about what their
11 argument is, but I think both pieces of it are wrong. And
12 starting with the hurricane example, I think hurricanes do have
13 very similar indirect effects, so you're talking about property
14 damage. But that's not it. There might also be decreases in
15 tourism that might also have to do with other features of the
16 weather, did an amusement park get built nearby. Things like
17 that might also affect tourism. It's not going to be
18 one-to-one. There's actually a pretty helpful chart on pages
19 53 to 55 of the record that identifies some other event
20 contracts and tries to explain exactly that point: Here are
21 the ways in which the economic impacts are not direct; they're
22 indirect. And that's true of temperature fluctuations. So is
23 it going to be hot in California this month, that might have
24 some direct effects and then some indirect effects. That's the
25 first piece of it the way other contracts work.

1 The way Congress works, there's also a lot of evidence
2 in the record that there are direct effects here. That just
3 the election, a change of control in Congress affects stock
4 prices immediately, affects the valuations of entities
5 immediately without any legislation passing; that legislation
6 passing is, of course, a piece of this, but these economic
7 impacts happen even if no legislation passes.

8 So I thought the discussion at 40 to 46 of the record
9 is pretty helpful on that. It has some examples. I'll point
10 to 1397, which shows that the green energy sector surged as a
11 result of the democratic party senate takeover. Again, before
12 anything happened, it's just control of Congress that has these
13 direct effects.

14 So to circle back to your question, I think direct
15 effects is a strange question to be asking for these contracts
16 but not others when all event contracts have these sort of
17 indirect economic effects. But even if that were the question,
18 I think it's pretty clear that there are direct effects here,
19 if that answers your question.

20 THE COURT: Maybe you're about to get to this. I
21 don't want to distract you from your presentation, but can you
22 speak to the manipulation and integrity piece, because I do
23 think -- and obviously I'm going to look very closely at the
24 statute and follow what it says, but I do think there is kind
25 of a -- just to be honest, a gut reaction that people might

1 have that, wow, betting on elections doesn't seem like a good
2 idea. It seems like there's a lot of room for manipulation,
3 for kind of unsavory things happening.

4 Can you speak to that directly and what your position
5 is as it relates to the public interest concern? Because I
6 understand a significant part of the Commission's view that
7 this is against public interest has to do with some of those
8 concerns.

9 MS. RICE: Absolutely. I'll skip right there. I
10 think you're right that that's what the Commission said, that
11 it sort of feels icky or that there's a risk of election
12 manipulation in some form. And I think starting with the risk
13 of manipulation, which I think is the more serious public
14 interest analysis, the icky feeling I think is misguided, but I
15 think it stems from the misunderstanding that these contracts
16 could influence elections in some way or people will be buying
17 votes or things like that.

18 So I guess I'd start by pointing out that political
19 event markets have existed forever, in unregulated forms but
20 also in other democracies. And I don't think there's a feeling
21 in those places that somehow the existence of these markets
22 affects the integrity of elections. Then there's good research
23 in the records showing that this kind of manipulation is not
24 remotely plausible.

25 I found the comment from the Center for Effective

1 Altruism particularly helpful at this point. That's at pages
2 1427 to 1436 of the record. Kind of take each aspect of the
3 election manipulation arguments and unpack them one at a time
4 and explain why they're wrong.

5 At that time most basic level I think the key point is
6 that people try to influence elections because they matter.
7 They matter for our lives, they matter for their economic
8 effects, but for lots of other reasons. And so there's lots of
9 money and effort spent on influencing elections. That's what
10 campaign finance fights are all about.

11 And there's a way in which you might think that some
12 of that's icky, or you have the same reaction that spending
13 money to try to get elections is icky, but I think it's
14 important here to point out how much money and how many
15 incentives there are in these elections because it makes
16 manipulation seem pretty darn unlikely, particularly as Your
17 Honor pointed out at the beginning, that this is a contract
18 about control of Congress. I think this is another place where
19 that point is relevant. So it's not particularly relevant to
20 the statutory analysis, but on the public interest piece, if
21 you're asking what's the public interest here, we're looking at
22 this specific contract and asking whether there's a serious
23 public interest harm on the other side, if there's some
24 possibility that having a regulated event contract market as
25 opposed to the unregulated ones that already exist could result

1 in manipulation of control of Congress.

2 It's just pretty hard to imagine -- I think if there
3 were a way to manipulate control of Congress, someone would
4 have tried. It's hard to imagine that the event contract
5 market could change all of the profound incentives that already
6 exist. It sort of circles back to the initial point that
7 elections matter, they have real life consequences and that's
8 why people try to impact elections. I think the record is
9 pretty clear that the possibility of manipulation is just pure
10 speculation; that there's not evidence supporting that sort of
11 intuition that you came up with at the beginning that there's
12 something that feels a little bit strange about that.

13 One last point, I think the Commission suggested, too,
14 it would have to police elections if it approved these
15 contracts. My response to that is just the Agency regulates
16 contracts that have underlying events of all kinds. So an
17 event contract on power plant emissions doesn't mean the CFTC
18 has to become the EPA all of a sudden and regulate power plant
19 emissions. In the same way that an event contract that has to
20 do with stock prices doesn't turn it into the SCC, all the
21 Agency does is the same thing it does in any other context, it
22 just regulates the market, not the underlying activity. So
23 insomuch as that's the other aspect of this, that there's a
24 concern about manipulation and there's a concern about the
25 Agency and what it would have to do as a result, I think

1 there's no real reason to worry that its role would be any
2 different here than it is in any other context.

3 THE COURT: Do you have anything to add to what your
4 colleague was saying when I asked the question about the
5 particular safeguards that your client has put into place and
6 obviously deemed important? For example, the one that sticks
7 out is, well, if you're a paid member of a congressional staff
8 then you obviously cannot trade these contracts. And there are
9 other safeguards that were put into place, but as I understand
10 your position, the Commission wouldn't reach that because it's
11 not enumerated in the statute so there would be no public
12 interest inquiry, and so those kind of conditions or safeguards
13 would not be required, nor is the fact that this is an election
14 contract involving control of the House particularly relevant.
15 A DCM could have this event contract for the upcoming
16 presidential election, right? So those things that you point
17 to as evidence of, well, there are safeguards in place and this
18 is about control of Congress, that's not really relevant to the
19 statutory question, correct?

20 MS. RICE: You're right that it's not part of the
21 statutory question. It is relevant to the public interest
22 analysis, if you get that far. If you assume that we lose on
23 the statutory analysis, which we don't think is the right
24 answer here, but if you get to public interest so this is a
25 gaming contract or unlawful activity contract, then you're

1 looking at the public interest and it is relevant the kinds of
2 safeguards we have in place and the fact that this is a
3 contract involving --

4 THE COURT: I guess that's my point, if under your
5 reading you wouldn't get to the public interest, so that's my
6 point, the Commission would have no ability or interest in
7 considering the fact that a contract didn't have such a
8 safeguard.

9 MR. ROTH: I didn't want to cut you off, but I had to
10 ask my colleague who actually knows the statutory framework
11 better.

12 THE COURT: Okay.

13 MR. ROTH: What he clarified for me was that there are
14 separate antifraud provisions, anti-manipulation provisions and
15 what they call the core principles that you have to comply
16 with. And so that's where some of these other safeguards come
17 from. It's just not from this particular statute.

18 Sorry, I didn't mean to --

19 MS. RICE: No, no, no.

20 THE COURT: Let me just make sure I understand.
21 You're saying it's not implicated by this statutory provision
22 that's at issue in the lawsuit, but as part of this scheme,
23 generally, there's other safeguards. And these are statutory
24 from the Commission, meaning that you have to comply with these
25 provisions?

1 MR. ROTH: Right. That's right.

2 THE COURT: Okay.

3 MS. RICE: That's all consistent with my
4 understanding, and there's some stuff in the record on this,
5 too. Pages 80 to 88 of the JA and 99 to 100, we talk about the
6 core principles and the kind of background rules in place just
7 to be a regulated market that this CFTC regulates, you have to
8 have these protections. You listed out the specific people
9 that aren't allowed to trade, and all of that is exactly right,
10 but there is separately and for all contracts a prohibition on
11 any insider with any non-public information trading on these
12 contracts. So that's in addition to the
13 specifically-enumerated categories.

14 THE COURT: That makes sense. And that applies to any
15 of these event contracts?

16 MS. RICE: Exactly. To everything. So where there is
17 insider trading or manipulation, the Agency has the tools to go
18 out and investigate those things. They're just not relevant to
19 the statutory analysis in the first instance, if that makes
20 sense.

21 Unless you have anything further, Your Honor, I'll
22 just wrap up by reiterating that I don't think you need to get
23 to public interest, but if you do, you still should vacate the
24 order as arbitrary and capricious.

25 THE COURT: I do have another question. I don't know

1 whose, so I will let whoever answer this. There is something
2 in the Commission's brief that I thought was -- it's this
3 point: Unlike many hedging and risk management contracts, the
4 payout on the contract at issue here is not in any way tied to
5 actual or estimated losses incurred elsewhere and a loss on the
6 contracts is not offset by a gain elsewhere. I just thought
7 that was interesting and wanted your response to that.

8 MS. RICE: I don't think that's as unusual as the
9 Commission makes out. The example that comes to mind
10 immediately is the temperature-related contracts. I think that
11 works in the same way, that that's not a gain or a loss
12 necessarily. It's not clear even which way that cuts. There
13 may well be other examples, but my immediate reaction to that
14 is I don't think that's particularly unusual in this context.

15 THE COURT: I'm learning more about this market
16 through this case, but this whole futures market, it seems to
17 me it's grown beyond the days in which only those who are
18 interested in the commodity or directly affected are
19 participating. I mean, that's the case for all these
20 contracts, right?

21 MS. RICE: That's true of all the contracts. In fact,
22 I think as the Commission's order, I think, acknowledges, some
23 amount of speculation or people who are investing in these
24 instruments to make money is actually necessary for the markets
25 to be liquid, because if it was just hedgers, if it was

1 100 percent hedgers, you don't actually get someone willing to
2 balance out the price and sell you or buy from you at the other
3 side.

4 So there are people in all of these market who don't
5 have a direct hedging interest, but the hedging piece of it is
6 certainly meaningful, and potentially more meaningful in this
7 context than many of the others.

8 THE COURT: Is there anything else you want to say
9 about their economic purpose test? I'm trying to see what the
10 daylight between the two parties is with respect to that test
11 and how it's applied.

12 MS. RICE: So I think we agree that the Commission has
13 discretion to consider the economic impacts of these contracts,
14 that this statute and these instruments are about economic
15 benefits. I think where we diverge is the Commission's focus
16 on, sort of, two things. One is direct effects as opposed to
17 indirect effect, we talked about.

18 And the other is this predominately hedging or more
19 than occasional hedging.

20 THE COURT: That's what I meant.

21 MS. RICE: The language shifts in the order, and I
22 think the difference probably matters. Occasional sounds to me
23 like something less than predominant. I'm not entirely clear
24 which one the Commission is advocating for. So I think part of
25 the problem with that standard is that it's not clear what it

1 means, whether it means a certain number of uses, how many
2 dollars are going to be spent in a hedging way, is it a
3 proportion of uses, is it some combination of the two and how
4 much is occasional. I don't know that you need to get into
5 that, Your Honor, because I think by any metric, the record
6 shows there will be more than occasional uses here. But I
7 think those are the two points on which we really disagree, not
8 on whether economic benefits are relevant.

9 THE COURT: The same question. I don't really
10 understand there to be a dispute about my standard of review
11 here and what the applicable review framework is.

12 MS. RICE: I agree with that, Your Honor. There was
13 some back and forth about rule-making cases versus adjudication
14 cases. Ultimately the standard is arbitrary and capricious for
15 both. There are more rule-making cases, and this proceeding is
16 a bit unusual in that there were formal comments accepted and
17 considered, which doesn't turn it into a formal rule-making.
18 That's never been our argument. But it looks a little bit more
19 formal than informal adjudication does, but you're right that
20 the standard is the same.

21 THE COURT: All right. Thank you.

22 MS. STUKES: Good afternoon, Your Honor. To
23 reintroduce myself, I'm Ann Stukes on behalf of the Commodity
24 Futures Trading Commission. As we did in our briefs, I'm going
25 to refer to my agency today as the CFTC, or the Commission.

1 And I'll refer to the plaintiff simply as Kalshi.

2 I have about an hour's worth of remarks for Your Honor
3 today, if that is okay with you.

4 THE COURT: We may take just a court reporter break at
5 some point, so I'll let you get started.

6 MS. STUKES: Thank you. Any time you want me to jump
7 to an issue, please just let me know.

8 THE COURT: Could I just ask you something I'm curious
9 about to start?

10 MS. STUKES: Absolutely. Sure.

11 THE COURT: With respect to this catchall category,
12 the Commission specifically didn't make an argument that this
13 contract falls within the catchall, and I was just curious as
14 to -- I'm not saying it does, I'm just curious as to why that
15 wasn't the position of the Commission.

16 MS. STUKES: In considering the case that was before
17 it, the Commission examined these contracts and determined that
18 two categories applied, enough to bring it within the statute
19 and therefore didn't reach any further categories.

20 THE COURT: Okay.

21 MS. STUKES: So as the Court is aware, the CFTC's
22 order that's at issue in this case determined under CEA section
23 5CC5C -- I call it 5CC5C, I'm talking about the same statutory
24 language that's codified at 7 U.S.C. 78-2. The CEA is, like
25 many statutes, sort of odd where sometimes our statutory

1 sections don't line up with the codification.

2 In any event, the order at issue here determined under
3 CEA 5CC5C, that Kalshi's proposed Congressional control
4 contracts should not be offered on Kalshi's platform because
5 the Commission determined that those contracts were contrary to
6 the public interest. And we submit that this Court should
7 conclude that the Commission's decision was not arbitrary or
8 capricious.

9 The Commission's decision addressed four principle
10 issues that the parties have briefed and I will discuss today.
11 First, how does the word "involve" apply to activities
12 enumerated in the statute.

13 Second, do these proposed contracts involve the
14 enumerated activity of gaming.

15 Third, do the contracts involve the enumerated
16 activity of activity unlawful under state or federal law.

17 And four, are the contracts contrary to public
18 interest.

19 Before I get into the substance of each of these
20 issues, I want to emphasize that the Commission's order is an
21 informal adjudication, and Your Honor just asked about the
22 standard of review. This is not a rule-making and it's not
23 even a formal adjudication, and that means in practical terms
24 that the Commission was deciding just one issue, whether these
25 particular proposed contracts should be listed on Kalshi's

1 event contracts platform. And the Commission didn't purport to
2 address any other question larger than that. So for instance,
3 the order doesn't establish the full metes and bounds of how
4 the statute might apply to any other event contract other than
5 the ones that were before it.

6 THE COURT: And just for my own information, is it
7 typical for the Commission to solicit comment in a circumstance
8 like this?

9 MS. STUKES: It's not required. It did so, I think,
10 in an abundance of caution.

11 THE COURT: Is that an unusual event or not unusual?

12 MS. STUKES: I don't want to say something misleading,
13 especially without talking to my colleagues about how
14 frequently have we done this. I wish I had a better answer for
15 Your Honor.

16 THE COURT: It's more out of my curiosity.

17 MS. STUKES: I can see why. I think the Commission
18 did it really in an abundance of caution because of public
19 interest associated with this topic generally.

20 THE COURT: Okay.

21 MS. STUKES: I'm emphasizing that this is an informal
22 adjudication, because when Your Honor considers the question
23 before you, which is rather the Commission ran afoul of what's
24 required under the Administrative Procedures Act, the standard
25 of review is a lenient one.

1 The law requires only that the Agency acted within a
2 zone of reasonableness. Here the CFTC reasonably considered
3 the relevant issues and reasonably explained its position and
4 no more was required under the APA. The APA gives the Agency
5 deference on its predictive judgments and on its public
6 interest determination.

7 Now, there are questions of statutory interpretation
8 in this case. And Your Honor finds herself maybe in the
9 unenviable position of having each party in this case tell you
10 the statute is unambiguous, that the plain meaning advocated by
11 each side supports each side.

12 I submit that the Commission has the better of the
13 argument on what the statute means and how it applies on
14 involve, gaming and unlawful under state law, that the Court's
15 review on the statutory interpretation questions is de novo.

16 I'll get into now the first of the four issues that
17 are before the Court that are briefed in the party's papers,
18 and that is the Commission's reading of the word "involve" to
19 have its ordinary meaning to relate to or affect, to relate
20 closely, to entail or to have as an essential feature a
21 consequence.

22 These are the ordinary dictionary definitions of the
23 term, and that is the definition that applies because the term
24 involved is the -- the term involve is not defined in the
25 statute. And so case law has held for a long time that when

1 there's -- when the statute doesn't define the term, its
2 ordinary meaning applies and that means the ordinary meaning in
3 dictionaries.

4 So what that means for the statute here is that the
5 plain meaning of "involve" when we're talking about the
6 categories enumerated in the statute that would render an event
7 contract eligible for public interest review, the word
8 "involve" is broad enough by its plain meaning to cover event
9 contracts whose underlying, meaning the event on which the
10 contract is premised, here the outcome of congressional
11 elections. The statute is broad enough to cover contracts
12 where whose underlying involved the enumerated activity, as
13 well as contracts that relate closely, entail or have as their
14 essentially feature or consequence the enumerated activity.

15 THE COURT: I don't understand the plaintiff to
16 necessarily disagree with the definition that you've set
17 forward, but I think when you say that closely relates to or
18 entails, they're saying yes, to the subject matter or
19 underlying activity of the contract.

20 So can you just speak to that? Because I had thought
21 initially that there was some difference with how you were
22 defining involve. And now having heard from plaintiff and
23 going back and reading their brief, reviewing those portions of
24 the brief, I now see more clearly what they were saying, that
25 those definitions have to relate to the activity at issue

1 underlying the contract.

2 So if you could just speak directly to that.

3 MS. STUKES: That is generally my understanding of the
4 dispute between the parties here. And that is, as I understand
5 the plaintiff's -- and not to mischaracterize, but as I
6 understand the plaintiff's position, they're saying involve, if
7 it means anything, it has to mean that the underlying event
8 involves an enumerated activity and it can't be a broader
9 relationship involving the contract itself.

10 So when we look at the statutory language and whether
11 a contract is in the scope of the -- pardon me, of the statute
12 at all, it's a two-step inquiry. So the first step in the
13 statutory language is, does the agreement, contract,
14 transaction, or swap in an excluded commodity that is based
15 upon, based upon -- that means the underlying, based upon the
16 extent of an occurrence or contingency.

17 So step one in other words asks, is the contract based
18 on, does it -- is it based on -- is the underlying an event.
19 Because this -- pardon me -- this statute applies only to event
20 contracts. So step one under the plain language of the statute
21 which uses "based upon," meaning "underlying," in the same
22 sentence that it uses "involve."

23 Step one is is this an event contract at all, is the
24 underlying an event. If so, we're in the statute, at least
25 this far.

1 Step two is whether the agreements, contracts or
2 transactions involve the enumerated activity. And that's a
3 broader question than whether just the underlying event
4 involves the enumerated activities.

5 "Based on," as used in the statute, unambiguously
6 refers to the underlying event. It must be an event, that's
7 all.

8 "Involve" is broader. Any aspect of the contract,
9 transaction or agreement, if it involves an enumerated
10 activity, we submit that by the plain meaning of the word
11 involve it's in the statute. At least it gets you so far as to
12 be eligible -- that's the relationship between the contract and
13 the enumerated activities. If the contract, transaction or
14 agreement involves the enumerated activity, we're in the
15 statute. Underlying, what the contract is based upon, what the
16 actual event is can be, can -- the underlying can involve the
17 enumerated activities. They're fairly easy to think of
18 examples.

19 If the event contract is based upon whether a war will
20 break out, it's in an enumerated activity.

21 THE COURT: Is there an example of a contract that
22 under this broader definition that you're advocating for would
23 involve war where the underlying activity in the contract
24 doesn't speak to war, itself.

25 MS. STUKES: The examples are -- the examples of how a

1 contract could involve war but not involve an act of war have
2 to do, and I think both parties cite this kind of example,
3 will -- I hate to give these real world examples, will a
4 foreign body be able to use U.S. weapons on its enemy's soil,
5 something like that. That involves -- oh gosh, I don't want to
6 get too in the weeds -- will funding be allocated to a country
7 that's at war, that involves war.

8 THE COURT: I think they would say yes --

9 MS. STUKES: I actually don't think we're too off base
10 on that. I think the real dispute between the parties is what
11 are you looking at, what has to involve the enumerated
12 activities, and the real rub here is that the Commission
13 interprets the plain language of this statute to say if
14 transacting in the contracts, if the feature or purpose of
15 these contracts is one of the enumerated activities, gambling
16 is the one -- gaming, pardon me, is the one that comes to mind.
17 Is transacting in the contract, is that essential feature
18 gaming. And the Commission here said yes for gaming and for
19 unlawful under state law.

20 THE COURT: So what is your best argument for their
21 response that there are a lot of states, and they listed them
22 for me, that make any type of betting stakes on any contingent
23 event unlawful under state law such that that's what these
24 event contracts are? So every event contract should
25 theoretically -- if the transaction of the contract in and of

1 itself is what involve means and not the underlying activity at
2 issue in the contract, than just the mere transacting event
3 contracts would violate state law; how do you respond to that?

4 MS. STUKES: I want to say two things about that, and
5 I can jump to the discussion of how we analyzed unlawful under
6 state law. The Commission is not saying that involve in every
7 instance means anything other than its plain meaning. Let me
8 say that in a little more -- with a little better articulation.

9 Involve is a broad term. It's broad enough to cover
10 event contracts whose underlying is one of the enumerated
11 activities, and it's broad enough to cover an event contract
12 whose essential feature is one of the enumerated activities,
13 and here an essential feature of these contracts is betting or
14 wagering on elections.

15 THE COURT: But an essential feature of some other
16 contract could be betting or wagering on, fill in the blank.

17 MS. STUKES: Right. So your Honor's concern, I think,
18 is the plaintiff's argument: What do we do with this, what I
19 interpret as an extrapolation from what the Commission actually
20 said, to say, well, that would be absurd in another context
21 because other state laws say it's unlawful -- there are state
22 laws that say it's unlawful to wager on any contingent event.
23 And that would sweep in every event contract to a public
24 interest review.

25 THE COURT: Right.

1 MS. STUKES: So I'm just getting to my notes where I
2 have this.

3 THE COURT: Sure. Take your time.

4 MS. STUKES: The Commission had before it the question
5 of whether these contracts, which involve wagering on
6 elections, involve activity under state law. Here we have
7 numerous state laws that forbid wagering on elections, and that
8 was sufficient for the Commission to say state law forbids
9 wagering on elections. That's the essential feature of these
10 contracts, and we can stop there.

11 What the Commission didn't do is say state law forbids
12 or makes unlawful wagering on any contingent event. That was
13 not the basis of the Commission's reasoning, and even if you
14 can say if A is to B then C is to D, like some logical
15 extrapolation, that's not what the Commission did here. It
16 just said we see under state law that wagering on elections is
17 unlawful. And that's the essential feature of these contracts,
18 and that's enough. That's enough that we're in the zone of the
19 statute.

20 THE COURT: Right, but --

21 MS. STUKES: And it's not unreasonable -- I'm sorry,
22 I've interrupted Your Honor.

23 THE COURT: I just wanted to -- because right now I
24 think we're talking about what the meaning of the terms in the
25 statute are, and their argument, as I understand it, is that

1 the Commission's reading doesn't make sense; this is otherwise
2 unambiguous and they're applying this word in a way that kind
3 of means one thing in one subsection and another in another
4 subsection.

5 And what they're saying is elections is not on this
6 enumerated list and that's full stop, end of case. And you're
7 saying, well, no, it fits under the first category because
8 betting on or wagering on elections violates many state laws.

9 And their response is wagering on any contingent event
10 violates many state laws. And if that were the reading, if
11 that's how the statute was read, that would mean that every
12 event contract would be subject to this two-step review, which
13 was not the intent when the statute was amended to streamline
14 this process and not make the DCM have to make an initial
15 showing that the contract was in the public interest.

16 So I'm just speaking more about the unlawful under
17 state law. What does that mean? Does that mean that the act
18 of trading the contract is unlawful under state law, in which
19 case that would -- might relate to many contracts or all event
20 contracts, or does the underlying activity -- for example, I
21 think plaintiff gave an example whether or not some crime was
22 going to occur, whatever it is, some specific criminal
23 activity, where the subject of the contract relates to,
24 involves something that is unlawful.

25 So I just want to understand the difference -- your

1 response to that, that your reading would put every event
2 contract under this inquiry.

3 MS. STUKES: Respectfully, I don't believe that what
4 the Commission held in this order would subject every event
5 contract because what the Commission said is only that
6 examining these contracts, whose essential feature is to bet on
7 elections, that involves activity that many state laws
8 prohibit.

9 What the Commission did not say is these contracts
10 involve wagering on a contingent event and many state laws make
11 wagering on a contingent event unlawful. Therefore, it is.

12 THE COURT: Hypothetically, let's say I'm a plaintiff,
13 I'm a DCM, I want to post my event contract about whether or
14 not a hurricane will hit in Florida. And the Commission came
15 back and said this is against public interest and it also falls
16 under -- I'm doing this out of order. It falls under category
17 one because in Florida and elsewhere the state law prohibits
18 people from posting or making bets or wagering on contingent
19 events, and a hurricane is a contingent event and this contract
20 involves a wager on a contingent event, so we're not going to
21 allow it. Would that be allowed under this statute? Would
22 that work?

23 MS. STUKES: I think it would be an unusual reading of
24 the statute.

25 THE COURT: And why?

1 MS. STUKES: And it's because this statute sets forth
2 in broad terms the categories that are the subject of public
3 interest review, and none of those categories on their face
4 suggest that Congress intended to capture all event contracts.
5 And it --

6 THE COURT: Right, that's their point. I think that's
7 exactly what they're saying.

8 MS. STUKES: I think, actually, the parties agree. I
9 think where we're off is the Commission doesn't agree that
10 that's what it concluded in this case. It concluded that state
11 laws forbid wagering on elections, and that's an important
12 state interest that Kalshi is asking the Commission to
13 undermine by allowing these contracts to trade on a
14 federally-registered exchange -- a federally-regulated
15 exchange.

16 To be clear, the Commission's order didn't find
17 that -- like if these contracts were allowed, it didn't find
18 that purchasing one of Kalshi's congressional control contracts
19 would be illegal in jurisdictions that prohibit betting on
20 elections by statute or common law.

21 Kalshi argues that the Commission was arbitrary and
22 capricious or fell afoul of the law because it can't be illegal
23 under state law to offer the contracts on a market regulated by
24 the CFTC because Fransa (ph.). But that, as the Commission
25 held in its order, misses the point.

1 The CEA is a federal statutory regime for the
2 regulation of commodities derivatives markets, and it does
3 preempt state laws that prohibit the trading of commodities
4 contracts. No state law can ban a contract that's lawfully
5 listed on a CFTC-regulated market. But what Kalshi asks the
6 Commission to do here and what Kalshi is asking the Court to do
7 is to order the CFTC to permit these contracts, when Kalshi's
8 own website cites news articles that characterize them
9 repeatedly as election gambling, betting on elections, when
10 under state law it's illegal to gamble on elections.

11 And this, by the way, is the reason we're here. If
12 Kalshi could lawfully offer election-betting contracts on CFTC
13 markets, it could ignore any state law that disallows election
14 gambling. Even states that allow gambling prohibit betting on
15 elections. And that indicates that the concern is not so much
16 gambling but election integrity. You can't place a bet on an
17 election in Las Vegas or Atlantic City.

18 For the CFTC to allow the contracts, it would have had
19 to undermine these important state interests. And so when the
20 Commission concluded in its order that, in considering whether
21 a contract involves activity under state law, it considered
22 whether the activity is unlawful under state laws that are not
23 otherwise preempted by the CFTC, laws that go to state interest
24 that are not overlapping with the CEA's regulatory authority.
25 And when the Commission considers that it can consider whether

1 the CFTC's exclusive jurisdiction over federal commodities
2 markets, federal commodities derivatives markets, should be
3 used to subvert important state interests.

4 So this question of -- well, it's frustrating to me --
5 well, I'm an advocate, I should be frustrated by my opponent's
6 arguments. But what's frustrating to me about that is this
7 concept that the Commission's interpretation of the statute
8 doesn't make sense because some state laws make it illegal to
9 place a wager on any contingent event, it's a distraction.
10 It's not what the Commission held here.

11 The Commission went as far as it needed to go because
12 this is an informal adjudication. It's one case. Under a
13 different set of facts and a different proposed contract, it
14 might look to that language. It would be an unusual reading of
15 the statute to say because many state laws prohibit wagering on
16 any contingent event, that all event contracts are unlawful, it
17 would be an usual reading of a statute that sets forth only
18 enumerated categories.

19 THE COURT: I think they would agree with that.

20 MS. STUKES: Right. I think we agree on that.

21 THE COURT: Well, I don't think you want to agree
22 on -- if you do want to agree on that, I think you want to
23 distinguish that from the election.

24 MS. STUKES: No. What I am saying is the Commission
25 didn't base its decision on the existence of state laws that

1 make wagering on any contingent event unlawful. The Commission
2 based its decision on the existence of state laws that make
3 election wagering unlawful. It didn't consider in its decision
4 and it didn't base its decision on the existence of these other
5 broader state laws.

6 And so it doesn't even factor in to the review here.
7 Whether they exist or not, it wasn't the basis for the
8 Commission's decision. And even if you can extrapolate what
9 the Commission was not doing here -- the Commission wasn't
10 ruling here. It went only as far as it needed to go to decide
11 the issue before it. I hope that that is coming through to
12 Your Honor.

13 So here, because these contracts have as their
14 essential feature not that they're wagering on any contingent
15 event but they are wagering on the outcome of elections, and
16 wagering on elections is unlawful under numerous state laws,
17 the Commission was reasonable in its determination that these
18 contracts fit within that category of unlawful under state law
19 to render them at least in the statute in subsection I.

20 I can move on to talk about gaming, unless you want to
21 talk about --

22 THE COURT: Let's talk about gaming.

23 MS. STUKES: Okay. Again, with the term "gaming," the
24 Commission applied the ordinary meaning of the term "gaming" to
25 conclude that these contracts would fall within that enumerated

1 category. Again, "gaming" is not a defined term in the
2 statute.

3 And so what the Commission did reasonably is look to
4 its ordinary meaning as defined in dictionaries and in ordinary
5 meanings as defined in state law and federal law -- well, I'll
6 talk about that in a second. And concluded that it falls
7 within the ordinary -- that those proposed contracts, which
8 wager on the outcome of congressional elections, fall within
9 the meaning of "gaming."

10 First, the Commission looked at that the ordinary
11 dictionary definition of gaming and found that gaming in its
12 ordinary dictionary meaning is synonymous or interchangeable
13 with gambling. And that's actually supported in the
14 congressional record when we see that colloquy between Senators
15 Feinstein and Lincoln, where the first thing, I think, that
16 Senator Lincoln's comment says is this section of the CEA,
17 5CC5C, is intended to prevent gambling, using the futures
18 markets for gambling.

19 THE COURT: How do you define "gambling"?

20 MS. STUKES: Let me come back to the definition. So
21 "gaming" in ordinary dictionary definitions is synonymous with
22 "gambling." There's actually a Supreme Court case that we
23 cite. in our brief, also, for that proposition. They're
24 interchangeable terms.

25 THE COURT: Okay.

1 MS. STUKES: So what's gambling? The Commission
2 looked at various definitions under state law of how "gambling"
3 is defined. And a common thread in many state law definitions
4 of "gambling" is to stake something of value on a contest of
5 others. It's within a common thread, a frequently used
6 phrasing included in the definition of "gambling," staking
7 something of value on a contest of others. A number of states
8 linked the terms "gaming" or "gambling" to betting or wagering
9 on elections.

10 The Commission also looked at this Unlawful Internet
11 Gambling Enforcement Act, which has the definition of "to bet"
12 or "wager." Betting or wagering is a common definition of
13 "gambling." And in that statute wagering on a contest --
14 staking something of value on a contest of others is included
15 in the definition.

16 THE COURT: Can I ask you a question.

17 MS. STUKES: Yeah, absolutely.

18 THE COURT: Besides elections, in your view, is there
19 a contest of others that doesn't involve a game as plaintiff
20 would define what game means?

21 MS. STUKES: I actually thought the horse race wasn't
22 a game. But there are contests, Academy Awards, award types of
23 things that doesn't seem like a game, just seems like a
24 contest. So --

25 THE COURT: Okay. So an event contract on something

1 about one of these awards would fall under the gaming or
2 gambling prong?

3 MS. STUKES: First of all, I don't want to get ahead
4 of my Commission which -- the Commission didn't define it --
5 didn't define -- didn't talk about whether the -- in this order
6 didn't get into other examples because it was sufficient to
7 determine that elections fall within this ordinary definition
8 of staking something of value on a contest of others.

9 THE COURT: Right. I'm trying to make sure that I
10 understand what the terms mean in the statute. So it's
11 certainly relevant for me to understand how this would apply
12 even beyond this case, while I know I'm only looking at the
13 order in this case.

14 So based on what you said, an event contract about any
15 kind of contest, like an award show, Academy Award, Grammy's --

16 MS. STUKES: It's not a game. It seems like a
17 contest.

18 THE COURT: That would fall under the gaming prong.

19 MS. STUKES: Wagering on it, it sounds look it might,
20 yeah.

21 THE COURT: Keep going.

22 MS. STUKES: So one of the criticisms that Kalshi
23 levies at the Commission's decision here is they say that the
24 definition is gerrymandered because it includes only wagering
25 something or staking something of value on a contest of others.

1 And gaming can be so much more than that. Gaming can be games,
2 gaming can be so much more than that.

3 What the Commission did, however, is it looked at what
4 are these contracts. These contracts are staking something of
5 value on the outcome of elections. Does that fit in an
6 ordinary definition of gaming? We submit yes. Because gaming
7 is interchangeable with gambling and ordinary meaning of
8 gambling is to stake something of value on a contest of others,
9 and an election is a contest by its plain meaning.

10 Dictionary definitions define "contest" to include
11 elections. The examples that we cite in our brief talk about
12 the presidential election as a contest, the presidential
13 contest, meaning an election.

14 So "gaming" reasonably and plainly includes by its
15 plain meaning staking something of value on the outcome of the
16 contest of others. This might not be to the exclusion of other
17 types of gaming and gambling that were not at issue in this
18 particular matter. But these contracts are designed to wager
19 on the outcome of congressional elections.

20 THE COURT: But the definitions don't change based on
21 the contract at issue, right? The statute says what it says.

22 MS. STUKES: The statute says what it says.

23 THE COURT: And it's your role to determine whether --
24 if you undertake this type of review under the statute, then
25 you decide or make a decision as to whether or not the contract

1 fits the definition. So the definition doesn't change; it's
2 whether the contract fits the definition.

3 So it can't be -- I'm not going to find gambling means
4 contest here and then in another case be given a different
5 definition from the Commission about what gambling might mean
6 based on the contract at issue there. That's not what you're
7 suggesting.

8 MS. STUKES: What I am suggesting is that because this
9 is not a rule making, that the Commission's determination of
10 whether these contracts fit within the ordinary meaning of
11 "gaming" did not require the Commission to define "gaming's"
12 entire universe for it to determine that these contracts fit
13 within an ordinary meaning of "gaming."

14 THE COURT: I guess that's what I'm having difficulty
15 with because what I'm hearing you say is that there could be
16 many definitions and we pick the one applicable here. If there
17 are many definitions -- I hope no one is asking me to find this
18 is an ambiguous statute. This is not the time to deal with
19 ambiguities in statutory interpretation.

20 So I guess -- I mean, I hope that the Commission is
21 taking the position that "gaming" means X and that this
22 contract fits X because of whatever argument. You're not
23 saying that you're adding a contest here, but in other
24 circumstance you'd use another dictionary definition. There
25 should be a definition that applies that's unambiguous.

1 MS. STUKES: What the Commission found here is an
2 ordinary definition of "gaming" includes wagering on a contest
3 of others, because -- and that's not, as Kalshi puts it,
4 gerrymandering.

5 THE COURT: I can accept that.

6 MS. STUKES: That's deciding what's before it.

7 THE COURT: I can accept that in the dictionary there
8 may be one, two, three, and if it fits any of those prongs. I
9 just want to know the extent of what the definition of
10 "gambling" is under the Commission's view. So what you're
11 saying is it includes this contest of others. And so because
12 an election, in your view, is a contest of others, then betting
13 or wagering on that violates that provision of the statute.

14 MS. STUKES: Or at least brings it into that
15 enumerated category of the statute, yes.

16 THE COURT: Okay. But if there are other definitions
17 of gambling -- and I'm losing track of whether I saw it myself
18 or whether it's in the papers, but that would just say, for
19 example, you might have said it earlier, betting or wagering on
20 a contingent event.

21 MS. STUKES: On any contingent event.

22 THE COURT: On any contingent event. Would that mean
23 that every event contract involves gambling and, thus, gaming?

24 MS. STUKES: That's not what the Commission held here
25 and it's unlikely to be what the Commission would hold in

1 another context if it came up. But that wasn't the question
2 presented here.

3 So what was presented here was: Do these contracts,
4 which are routinely characterized as election-betting
5 contracts, fall within the ordinary meaning -- an ordinary
6 meaning of "gaming," where gaming is synonymous with gambling
7 and gambling includes wagering on a contest of others and a
8 contest of others includes elections. And that was enough --

9 THE COURT: Okay.

10 MS. STUKES: -- to be a reasonable interpretation of
11 the plain meaning of the statute.

12 We've talked about gaming and unlawful under state law
13 and involve, and unless Your Honor wants to talk further about
14 any of those subissues, I can move on to the public interest.

15 THE COURT: Sure. Yes, please.

16 MS. STUKES: Okay. So having determined that Kalshi's
17 proposed contracts involve two enumerated activities under the
18 statute, the Commission proceeded to determine that the
19 contracts are contrary to public interest and, therefore, are
20 prohibited from trading. And in making this determination, the
21 Commission considered the contract's economic purpose as well
22 as other factors. So I'll start with the economic purpose
23 evaluation.

24 So the parties point this out in our briefs, but our
25 statute here, the CEA, codifies two public interests in

1 commodities markets, hedging and price discovery. So hedging,
2 in general, means to use the commodity derivatives markets to
3 manage risk of price fluctuations in commodities. For example,
4 we put in our brief an example of an airline. They have to buy
5 jet fuel to operate their business and they have a price
6 sensitivity to movements in the price of jet fuel.

7 So a market participant who wants to hedge their risk
8 of price fluctuations, and they're worried that the price of a
9 commodity will go up, will hedge that risk by entering into a
10 commodity derivatives contract whose value will go up if the
11 price of that commodity increases. So in other words, hedging
12 means you can enter into a derivatives contract in a
13 CFTC-regulated market that will move in your financial interest
14 if the commodity that you're sensitive to moves against your
15 financial interest. That's hedging.

16 Price discovery, which is the other enumerated public
17 interest in the CEA and in commodity derivatives markets
18 generally, means to determine a price level for a commodity
19 based upon its pricing in a CFTC-regulated market. So for
20 instance, futures contracts on, like, agricultural commodities
21 can be used -- the trading on futures contracts can be used to
22 discover the price of the actual commodity in the cash market.

23 As noted in the order, the Commission considered the
24 public interest of Kalshi's proposed contracts and considered
25 their economic purpose. So this statute, 5CC5C, doesn't define

1 what it means to consider the public interest but because the
2 CEA itself codifies economic interests, in the years before
3 2000, when the CFTC examined every derivatives contract for
4 public interest, it looked at an economic purpose test that
5 asked whether a contract can be reasonably expected to be or
6 has been used for hedging or price basing on more than an
7 occasional basis. That was the test.

8 And the CFTC looked at that test in considering
9 whether these proposed contracts have an economic purpose, and
10 the CFTC also mentioned this colloquy between Senators
11 Feinstein and Lincoln in which Senator Feinstein asked if the
12 Commission would have the power to determine that a contract is
13 a gaming contract if the predominate use of the contract is
14 speculative as opposed to hedging or economic use.

15 So the Commission cited both of these formulations of
16 considering the economic purpose of the contracts in evaluating
17 these proposed contracts.

18 And it considered comments that Kalshi highlighted for
19 Your Honor that congressional control has economic effects.
20 And it considered comments from commenters that said they would
21 use these contracts to hedge.

22 But, as the Commission found, the economic effects of
23 one chamber of Congress or another are -- the word the
24 Commission used is diffuse and unpredictable. The price of
25 these contracts is not correlated to the price of any

1 commodity, and so the price of the contracts couldn't
2 reasonably or predictably be used to establish commercial
3 transaction prices for hedging or discovery.

4 THE COURT: Can I get a clarification? Is the test --
5 is it the more than occasional language or is it the
6 predominantly for commercial purpose?

7 MS. STUKES: The test -- the Commission evaluated
8 both. It looked at both and found that even considering the
9 comments that suggested -- pardon me, that these contracts
10 would be used for hedging purposes, most of the comments
11 suggested that the hedging uses were not really related to the
12 control of a single chamber of Congress, but rather the
13 ultimate changes in law or policy that could be affected many
14 steps down the line from control of a single chamber of
15 Congress.

16 So even taking all the commenters together who stated
17 an intent to hedge economic risk by trading these contracts, it
18 didn't establish that the contracts would be used for hedging
19 on more than an occasional basis.

20 But even if there were robust economic purposes for
21 these contracts, the economic purpose of the contracts was just
22 one aspect of the evaluation here, because a contract with
23 economic purpose, an event contract, even if it has an economic
24 purpose, it doesn't make it per se in the public interest.

25 There's an example actually in the colloquy of the

1 congressional record. You can have a contract on whether a
2 terrorist event will occur and it could be used for hedging,
3 even. If you're going to suffer an economic consequence from
4 that, it doesn't make it in the public interest. It doesn't
5 make it a good idea.

6 So the Commission here considered the alleged economic
7 purposes of these contracts and it found that these contracts
8 could not -- because control of a single chamber of Congress,
9 the impact for economic hedging is so diffuse, there are so
10 many steps that are involved between the election and actual
11 enactment of legislation, that the economic purpose of these
12 contracts did not weigh in favor of their public interest, but
13 it considered other aspects too.

14 I want to address one thing, that Kalshi argues that
15 the Commission imposed an arbitrary and capricious
16 direct-effects test. Stating that these contracts don't have a
17 direct economic effect, simply because a single chamber of
18 Congress doesn't itself have the power to enact law, is not an
19 arbitrary test. It's a description of the limited hedging
20 utility that these contracts would have.

21 But again, even if these contracts had a robust
22 economic purpose, other factors play in to the public interest
23 determination, and they did here. So I'll talk about election
24 integrity, unless Your Honor would like to talk about the
25 economic purpose --

1 THE COURT: I guess the only question is plaintiff
2 made an argument in their briefs, and I talked to them a little
3 today, about even putting aside any legislation that's passed,
4 just the mere fact of elections that dictate who is in control
5 of what chamber has maybe impact on the stock market or other
6 direct economic consequences that are real and tangible and
7 that can be observed in the aftermath of elections, and I
8 wanted to know what your response was to that.

9 MS. STUKES: My response is maybe something you've
10 already said, which is even if there are economic benefits to
11 trading these contracts, the Commission determined in its
12 discretion that those were not outweighed by the very serious
13 public interest --

14 THE COURT: So you don't dispute that?

15 MS. STUKES: I find that even if it's true, it doesn't
16 make a difference because the Commission was reasonable and not
17 arbitrary and capricious in its determination that the concerns
18 about election integrity here overwhelmingly are reasonable and
19 not arbitrary or capricious.

20 THE COURT: Okay. Let's go to the election integrity.

21 MS. STUKES: So factors including specific concerns
22 about election integrity supported the Commission's
23 determination that the contracts were contrary to public
24 interest, and the principal concerns that the Commission
25 identified included that these contracts could create monetary

1 incentives for individuals or organized groups to vote for
2 particular candidates for financial gain, to win a bet, not --
3 regardless --

4 THE COURT: And before you said to win a bet, I was
5 thinking you're describing what I think happens now in real
6 life in terms of the financial incentives of people putting
7 money behind elections and what motivates people to vote for
8 certain candidates is often financial in nature, right? But
9 you're saying specifically to collect on these event contracts.

10 MS. STUKES: These event contracts, their very
11 existence would establish -- could establish a financial
12 incentive to vote in a particular way that doesn't presently
13 exist because these contracts are not traded anywhere. You
14 can't gamble on elections. So they can incentivize voting in
15 particular ways that could influence how people vote.

16 THE COURT: How would we ever measure that?

17 MS. STUKES: Well, the --

18 THE COURT: The reason I'm asking is because I think
19 the plaintiff's argument is that concern is so unlikely to
20 happen it's -- and I thought that they made a good argument
21 today that there are already so many incentives, financial and
22 otherwise, behind elections that motivate people to do certain
23 things -- I mean, the point being that if there were some way
24 to get control over a -- if someone could figure out a way to
25 ensure control of a chamber of Congress, that probably would

1 have happened by now, right? So what is your response to that?

2 MS. STUKES: My response is the existence of a
3 federally-regulated derivatives contract on the outcome of
4 elections could incentivize people to manipulate either that
5 contract or the election itself for financial gain.

6 I'll give you some examples to talk about the kind of
7 thing we're concerned about. And I'm skipping ahead to the --
8 the order I was going to talk with you about these things.

9 The Commission is not just a regulatory agency. We're
10 also a law enforcement agency. And we're tasked under the CEA
11 with antifraud authority. And we're tasked under the CEA to
12 ensure integrity in the markets that we oversee. And because
13 of that, the Commission could be drawn in to investigating
14 manipulative conduct in these markets in a way that doesn't --
15 is outside of its ordinary mission.

16 So here's an example. A political activist with a big
17 social media following, they float a rumor on social media
18 damaging to a candidate who is important to one party's control
19 of the Senate. In a couple of weeks, this rumor spins up and
20 spins out and it turns out maybe it's untrue. It turns out to
21 be false.

22 But during the weeks that the rumor was circulating,
23 the congressional control contract on the other party goes up
24 and many people make a lot of money by selling that contract
25 when the market is high. And then the CFTC gets a tip and

1 says, well, that person put that rumor on social media in order
2 to manipulate the congressional control contract.

3 There's a couple of implications here. The very
4 availability of that contract has added one more reason, and
5 maybe a big reason for some people, to disseminate false
6 information about elections. And that's certainly relevant to
7 the public interest.

8 Another thing that the Commission considered here is
9 that it would draw the Commission into investigating these
10 kinds of activities, and that's not farfetched.

11 THE COURT: Is that something that the Commission is
12 tasked with doing now? I'm assuming there are other
13 contract -- I probably could come up with an example of any
14 contract that could be subject to some manipulation where
15 there's money involved. Is that the kind of thing that the
16 Commission would typically investigate if there was an issue
17 with -- okay.

18 MS. STUKES: Absolutely, Your Honor. As a federal
19 regulator of commodities markets, the CFTC, as I said, is in
20 charge of ensuring price integrity on our federally-regulated
21 exchanges. In the ordinary course, there's many ways to
22 manipulate markets.

23 Now, I say this in the same breath that I say I think
24 the markets regulated by the CFTC are among the safest in the
25 rule, but the limit of manipulation is really just the limit of

1 human ingenuity. Manipulation is attempted, and the CFTC, as a
2 law enforcement agency, routinely investigates allegations of
3 fraud and manipulation in the markets that it oversees.

4 THE COURT: I asked that because when I read your
5 brief it sounded like one of the arguments you were making was
6 that if you had to do that in this circumstance it would put
7 you in a position that the CFTC is not equipped to do. But it
8 sound like, if it's part of your regular mission, it wouldn't
9 put you in a position that you're not already required or
10 routinely do.

11 MS. STUKES: My answer to that, Your Honor, is that
12 there are two important differences because this is not a
13 minimal concern. It's not simple enough to say, oh, but you
14 investigate manipulation in markets that you're not an expert
15 in all the time. And it's true, we have a division of
16 enforcement that investigates alleged manipulation in a lot of
17 markets on a lot of commodities.

18 The difference here, there are two important
19 differences. First and most important, any government
20 investigation and enforcement activity involving the political
21 process is inherently sensitive. There's a difference in the
22 CFTC investigating economic activity related to commodity
23 derivatives markets and the CFTC investigating acts that may be
24 political speech or other conduct central to the political
25 process.

1 Second, as we briefed and as the Commission found in
2 its order, most of the markets regulated by the CFTC have
3 objective economic data that may not totally decide a case but
4 at a minimum it provides some objective grounding through the
5 CFTC's investigations of whether manipulation has occurred.

6 The vast potential of these contracts to incentivize
7 misinformation could absolutely draw the Commission into
8 investigations of a vast array of possible manipulation. The
9 pricing of these congressional control contracts would be
10 impacted by such a broad array of information. Anything that
11 could influence the election could influence the price of these
12 contracts. So polls, rumors, news, announcements, faked
13 information, advertisement, I can't even think of it all. And
14 this would be for every congressional race in the country.

15 Kalshi doesn't have jurisdiction to investigate any
16 alleged manipulation on these contracts. It would fall to the
17 CFTC. In its everyday operation, the CFTC receives tips of
18 possible market manipulation and it would be drawn into
19 investigating whether information disseminated about
20 congressional elections illegally manipulated the market in
21 these contracts, and that is not a role for which the
22 Commission is equipped and it would greatly expand the
23 jurisdiction of the CFTC.

24 Assuming the role of an election cop raises very
25 serious concerns about not only the misalignment of that role

1 with the Commission's mission and its history but with election
2 integrity. And it was reasonable for the CFTC to have
3 considered this.

4 As another example, it's not farfetched. It's not a
5 de minimus concern. Kalshi says, oh, it's not a big deal. You
6 do that anyway. Or it's not likely to happen.

7 The Commission's predicted judgment based upon its
8 existence as a law enforcement agency that routinely
9 investigates manipulation and as a regulatory agency that is
10 entrusted with ensuring the integrity of its markets, it was a
11 reasonable predictive judgment to say that that would draw the
12 CFTC into investigating conduct that relates to elections.

13 There's another example. There's another example I
14 wanted to talk with Your Honor about, and that would be you
15 asked Kalshi's counsel about the limits that it proposed to put
16 on who could trade these contracts. As far as I read that
17 list, it wouldn't prohibit people who count the votes from
18 trading in these contracts.

19 So imagine a scenario -- and the position limits,
20 meaning how much can be traded on these contracts, the position
21 limits proposed would allow trading of up to \$5 million if
22 you're a company or entity. So imagine a group of poll
23 workers -- and I don't mean people that are involved in
24 surveys. I mean people that count the votes. They form a
25 company of some kind and they're accused of putting their money

1 together and putting a \$5 million position on these
2 congressional-control contracts. These are the people counting
3 the votes.

4 Someone refers this to the CFTC because they think the
5 vote counting has been manipulated to make a profit in the
6 event contract. So here would be the CFTC being drawn into
7 whether the vote count is accurate.

8 THE COURT: Or whether there was fraud in connection
9 with the event contract, right?

10 MS. STUKES: Correct. Because it would ask the
11 question of whether there was fraud in the event contract.
12 Because that would be manipulating -- manipulative or
13 fraudulent conduct that unduly influenced the event contract.

14 And that's an example of the CFTC's concern. Because
15 these contracts could -- their very existence could incentivize
16 conduct designed to artificially affect the electoral process
17 for the purpose of manipulating the price of the contract for
18 financial gain or they could incentivize the manipulation of
19 the market for the purpose of artificially affecting the
20 election or perceptions of the election.

21 I want to mention one thing that Kalshi talks about
22 and that is -- oh, actually, before I get there, research in
23 the record -- one comment submitted in the record involved the
24 actual manipulation of a political event contract by false
25 information. There was -- it's a bizarre fact pattern. The

1 pop singer Kid Rock was shown to be ahead in the polls in a
2 match-up against a sitting senator before he had ever -- he had
3 not even declared a candidacy for the Senate, but he was shown
4 in a poll to be ahead of a sitting senator, and that caused the
5 price of a corresponding event contract to drop and it caused
6 trading volume to surge, and users were later, on social media,
7 bragging about how that poll trolled the news media and
8 influenced the election event contract.

9 Researchers have theorized that that kind of fake
10 information could be used to generate market movement in other
11 election event contracts. So it's not farfetched to say that
12 this is a serious concern. Over 600 comment letters were
13 received by the agency, including from Senators and members of
14 the House of Representatives, expressing significant concerns
15 about election integrity and the improper commodification of
16 our elections.

17 And I don't say commodification just as rhetorical
18 flourish. When you have an event contract trading on a
19 CFTC-regulated market and the underlying event of that contract
20 is an election, the election is a commodity under the Commodity
21 Exchange Act.

22 Where a large number of states have specifically
23 disallowed gambling on elections by either statute or common
24 law, and that reflects the view of a large number of states
25 that this kind of wagering is against the public interest, the

1 Commission grants significant weight to any threat to election
2 integrity, as well as the threat to the perception of election
3 integrity.

4 And this is especially important at a point in time
5 where so many people question the validity of elections. The
6 Commission is not required to let threats to election integrity
7 happen before recognizing election integrity as a public
8 interest concern with respect to these contracts.

9 There's one other value that Kalshi argues -- that
10 Kalshi and Amici and commenters argue that these contracts
11 have, and that is that they could provide beneficial
12 market-based predictive data. And that that's societally
13 valuable information. The Commission considered that but it
14 didn't find that generation of such data outweighed the very
15 real and grave concerns about the threat to election integrity
16 that these contracts would pose.

17 The CFTC's predictive judgment about possible negative
18 consequences that could arise from these proposed contracts are
19 entitled to deference under APA law. The Commission didn't
20 ignore evidence. It didn't refuse to engage with contrary
21 positions. It found that any economic utility of the contracts
22 didn't outweigh the very serious risks that the contracts could
23 be manipulated and could incentivize the spread of
24 misinformation or be used to undermine election integrity or
25 the perception of election integrity.

1 So for all of these reasons, the CFTC submits that
2 Your Honor should deny Kalshi's motion for summary judgment and
3 grant judgment to the CFTC.

4 THE COURT: Okay. Thank you.

5 Any brief rebuttal?

6 MR. ROTH: Very brief. Very, very brief.

7 THE COURT: Yes.

8 MR. ROTH: I appreciate the Court's time. I will be
9 very, very brief. Three quick points. First Your Honor asked
10 about the catchall category, why they didn't rely on the
11 catchall.

12 THE COURT: Yes.

13 MR. ROTH: The catchall requires a rule making. It's
14 by rule or regulation. They haven't done a rule making. And
15 so that's -- they couldn't rely on the catchall.

16 THE COURT: They could not rely on the catchall.

17 MR. ROTH: Yes. So they would first have to do a rule
18 making to determine some activity is similar to the others.
19 They have not done that. So that's the answer to that.

20 THE COURT: Thank you. I appreciate that.

21 MR. ROTH: On unlawful, I still did not really hear a
22 theory as to why their reading doesn't sweep in everything.
23 What I heard was, you don't have to worry about that because
24 that's not this case. That's not how statutory interpretation
25 works. We need to understand what the statute means. Counsel

1 admitted that's a de novo question for this Court to consider.
2 And, of course, in considering what the statute means, the
3 Court is going to look at how it would apply in other contexts.

4 That doesn't mean you need to figure out the answer to
5 every other hypothetical case that might exist. But the
6 Supreme Court, whenever it's considering a question of
7 statutory interpretation, looks at how it's going to apply
8 elsewhere, and if it's going to be absurd in a wide variety of
9 other cases that means it's a bad interpretation. That, I
10 think, covers unlawful.

11 The only thing I'll say about gaming, to add to
12 earlier, Your Honor asked if their interpretation of contests
13 would sweep in anything that isn't a game other than elections.
14 And counsel's response was potentially awards shows, like who's
15 going to win the Emmy or the Oscar, which I thought was a
16 fascinating example because Kalshi offers those and has offered
17 those for a long time, and they have never subjected those to
18 the review process.

19 And I think that really underscores the sort of
20 outcome-driven aspect of this. It's not a good-faith statutory
21 interpretation. It's an attempt to get it in without a real
22 coherent theory of what the statute means.

23 That's all I have, Your Honor, unless you have further
24 questions.

25 THE COURT: No. Thank you. I appreciate the briefs

1 were very good and helpful and I appreciate your time.

2 Before we leave, I'm going to embarrass Ms. Franklin
3 because -- this is my courtroom deputy, Ms. Franklin, and this
4 is her last in-person hearing. She's going to be retiring
5 after over 30 years on the court.

6 (Applause)

7 So I did not know there were going to be this many
8 people here. I brought cupcakes for the parties and for us. I
9 am sorry to the people in the audience. I do not know if I can
10 accommodate everyone. There's more coming.

11 I'm sad but happy for Ms. Franklin. After 32 years on
12 the court, she certainly deserves to retire but we're going to
13 miss her. And so I just wanted to recognize her for this last
14 hearing of hers in this courtroom. So thanks everyone.

15 (Applause)

16 We're waiting for more cake.

17 There's not a song that we can sing. I don't know if
18 people blow out candles for retirement. We just wanted to say
19 thank you so much. We're going to miss you. Please don't
20 leave us too in the wind, and I hope you come back.

21 (Off-the-record discussion.)

22 THE COURT: I'll take this matter under advisement.
23 Thank you, everyone.

24 (Proceedings concluded at 3:03 PM)

25

C E R T I F I C A T E

I, Stacy Johns, certify that the foregoing is an accurate transcription of the proceedings in the above-entitled matter.

/s/ Stacy Johns

Date: June 3, 2024

Stacy Johns, RPR
Official Court Reporter

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

KALSHIEX LLC,

Plaintiff,

v.

COMMODITY FUTURES TRADING
COMMISSION,

Defendant.

Civil Action No. 23-3257 (JMC)

ORDER

For the reasons stated in the Court's forthcoming memorandum opinion, the Court **GRANTS** Plaintiff's motion for summary judgment, ECF 17, and **DENIES** Defendant's cross-motion for summary judgment, ECF 30. Defendant's September 22, 2023 order prohibiting Plaintiff from listing its congressional control contracts for trading is hereby **VACATED**.

This is a final appealable order.

SO ORDERED.



JIA M. COBB
United States District Judge

Date: September 6, 2024

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

KALSHIEX LLC,

Plaintiff,

v.

COMMODITY FUTURES TRADING
COMMISSION,

Defendant.

Civil Action No. 23-3257 (JMC)

MEMORANDUM OPINION

This lawsuit concerns the interpretation of the Commodity Exchange Act (CEA)’s special rule for the review of event contracts, a type of derivative contract whose payoff is based on the outcome of a contingent event. The special rule authorizes the Commodity Futures Trading Commission (CFTC) to review, and prohibit, event contracts that it determines are contrary to the public interest if, and only if, they involve specific activities, including “activity that is unlawful under any Federal or State law” and “gaming.” 7 U.S.C. §§ 7a-2(c)(5)(C)(i)(I),(V).¹ Plaintiff KalshiEX LLC (Kalshi), a financial services company, tried to offer event contracts that would allow participants to take positions and trade on the outcome of United States congressional elections. The CFTC issued an order prohibiting Kalshi from offering the contracts after it determined that such contracts involve unlawful activity and gaming, and are contrary to the public interest. Kalshi filed this suit challenging the CFTC’s decision as arbitrary, capricious, and otherwise not in accordance with the law under the Administrative Procedure Act (APA).

¹ Unless otherwise indicated, the formatting of citations has been modified throughout this opinion, for example, by omitting internal quotation marks, emphases, and alterations and by altering capitalization. All pincites to documents filed on the docket in this case are to the automatically generated ECF Page ID number that appears at the top of each page.

The CFTC’s order exceeded its statutory authority. Kalshi’s contracts do not involve unlawful activity or gaming. They involve elections, which are neither.

Although the Court acknowledges the CFTC’s concern that allowing the public to trade on the outcome of elections threatens the public interest, this Court has no occasion to consider that argument. This case is not about whether the Court likes Kalshi’s product or thinks trading it is a good idea. The Court’s only task is to determine what Congress did, not what it could do or should do. And Congress did not authorize the CFTC to conduct the public interest review it conducted here.

Accordingly, the Court **GRANTS** Plaintiff’s motion for summary judgment, ECF 17, and **DENIES** Defendant’s cross-motion for summary judgment, ECF 30.

I. BACKGROUND

A. Event Contracts

The CFTC is an independent federal agency that regulates financial derivative markets. A derivative is a financial instrument or contract whose price is “directly dependent upon (i.e.,] derived from)” the value of one or more underlying assets—for example, commodities (like corn and wheat), securities, or debt instruments. *See Futures Glossary: A Guide to the Language of the Futures Industry*, CFTC, <https://perma.cc/63HY-DD7E>. Derivatives take many forms, including “futures, options, and swaps.” *Id.*² These instruments “provide a way to transfer market risk or

² These terms refer to various agreements or contracts. A “future” is “an agreement to purchase or sell a commodity for delivery in the future.” *Futures Glossary: A Guide to the Language of the Futures Industry*, CFTC, <https://perma.cc/63HY-DD7E>. “Option” refers to a “contract that gives the buyer the right, but not the obligation, to buy or sell a specified quantity of a commodity or other instrument at a specific price within a specified period of time, regardless of the market price of that instrument.” *Id.* The CFTC acknowledges that the definition of “swap” is “detailed and comprehensive,” *id.*, but broadly it is “a type of derivative involving the exchange of cash flows from financial instruments.” *Inv. Co. Inst. v. Commodity Futures Trading Comm’n*, 720 F.3d 370, 373 (D.C. Cir. 2013).

credit risk between two counterparties.” *Inv. Co. Inst. v. U.S. Commodity Futures Trading Comm’n*, 891 F. Supp. 2d 162, 168 n.3 (D.D.C. 2012) (citations omitted).

This case concerns a specific derivative called an “event contract.” An event contract is a derivative contract “whose payoff is based on a specified event, occurrence, or value.” *Contracts & Products: Event Contracts*, CFTC, <https://perma.cc/CG2B-3YWY>. For example, an event contract might involve the occurrence of a weather event (e.g., snowfall or hurricanes). *See id.*; ECF 38-2 at 23 (Comment Letter from John A. Phillips to U.S. Commodity Futures Trading Comm’n 3 (Sept. 23, 2022) [*hereinafter* Phillips Comment])). These contracts usually pose a yes-or-no question. The buyer of the event contract, for example, may take a “yes” position on whether the underlying event will happen, *see* ECF 38-1 at 35 (KalshiEX LLC, Commission Regulation 40.2(a) Notification (June 12, 2023) [*hereinafter* Kalshi Notification])—such as whether the level of snowfall in a certain region will exceed a specific amount in a given timeframe. The seller implicitly takes the opposite, or “no,” position. *See id.*

Event contract prices are based upon the current probability that an event will occur and thus, like stock prices, fluctuate. *Id.* at 34–35; ECF 38-2 at 27 (Phillips Comment). The contract specifies the value to be paid on the contract. *See* ECF 38-1 at 34–35 (Kalshi Notification). Event contracts expire at a cutoff date and can be purchased and sold at any time before that date. *Id.* at 40. They are binary. When the contract expires, the seller must pay the buyer if the underlying event on which the buyer took a “yes” position occurs, but the buyer gets paid nothing if it does not. *Id.* at 35.

Like derivatives generally, event contracts can be used to mitigate risk. Kalshi provides an illustrative example in its brief concerning a beachfront property owner who might purchase an event contract predicting that a hurricane will reach landfall in the area. ECF 17-1 at 15. If the

hurricane hits as the owner predicted, the payout from the contract could offset the owner's loss of rental income incurred because of the storm. *Id.* But, like other investments, some buyers trade event contracts simply to seek some financial return.

B. The CEA's Special Rule for the Review of Event Contracts

The CEA, 7 U.S.C. § 1 *et seq.*, provides a “comprehensive regulatory structure” for the trading of commodities and futures. *Merrill Lynch, Pierce, Fenner & Smith v. Curran*, 456 U.S. 353, 355–356 (1982). The CFTC is responsible for administering and enforcing the CEA, and the statute vests it with exclusive jurisdiction to regulate various types of commodities and futures on regulated exchanges, as well as to establish implementing regulations. *See* 7 U.S.C. § 2(a)(1)(A); 17 C.F.R. § 1 *et seq.* Event contracts are subject to regulation under the CEA as “excluded commodities”,³ and thus by the CFTC. 7 U.S.C. § 7a-2(c)(5)(C)(i). Pursuant to the statute, an entity seeking to offer event contracts must seek and receive CFTC designation as a regulated exchange (a designated contract market or “DCM”) before listing and publicly trading its contracts. 7 U.S.C. §§ 2(e), 7(a); 17 C.F.R. § 38.100.

The statute's requirements for listing event contracts on CFTC-approved and -regulated exchanges have changed over time. From 1974 to 2000, the CEA required DCMs to demonstrate to the CFTC that their contracts satisfied an “economic purpose test” and were not contrary to the public interest before they could trade their contracts. *See* Pub. L. No. 93-463, § 207, 88 Stat. 1389, 1400 (1974) (codified at 7 U.S.C. § 7(7) (1994)); Contract Market Designations, 40 Fed. Reg. 25849, 25850 (June 19, 1975). In other words, the statute required the CFTC to preapprove new event contracts before DCMs could offer them. In 2000, however, Congress amended the CEA to

³ Relevant here, the CEA's definition of an “excluded commodity” subject to the statute's requirements includes “an occurrence, extent of an occurrence, or contingency” that is “beyond the control of the parties to the relevant contract, agreement, or transaction” and “associated with a financial, commercial, or economic consequence.” 7 U.S.C. § 1a(19)(iv).

remove the default rule that all event contracts be subject to a “public interest” review and instead to allow DCMs to self-certify that their proposed contracts complied with the statute and the CFTC’s regulations, with no prior review required for many types of event contracts. *See* 7 U.S.C. § 7a-2(c)(1) (2006). Finally, in 2010, Congress further amended the CEA by enacting a “[s]pecial rule” for the review and approval of event contracts. 7 U.S.C. § 7a-2(c)(5)(C). The special rule, which remains in effect, is at issue in this case.

The special rule authorizes the CFTC to review certain event contracts to determine whether (or not) they can be traded. Under the CEA, as currently amended, DCMs can still self-certify that their contracts comply with the statute and applicable regulations, and can begin publicly trading those contracts within one business day of their certification. 7 U.S.C. § 7a-2(c)(1); 17 C.F.R. § 40.2. Or, DCMs can voluntarily request that the CFTC preapprove their contracts to confirm that they do not violate the CEA or the CFTC’s regulations. 7 U.S.C. § 7a-2(c)(4)–(5); 17 C.F.R. § 40.3. But under the special rule, the CFTC is empowered to review, and prohibit, specific types of event contracts if it determines that those contracts are “contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i). Specifically, the special rule provides:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency . . . by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

Id.

As is apparent from the statute’s text, the special rule applies only to those agreements, contracts, or transactions that involve the activities specifically enumerated in the statute. In other

words, the CFTC may determine that an agreement, contract, or transaction is contrary to the public interest only if it involves unlawful activity, terrorism, assassination, war, or gaming.⁴ If the CFTC makes such a determination, the agreement, contract, or transaction cannot “be listed or made available for clearing or trading on or through a registered entity.” *Id.* §§ 7a-2(c)(5)(C)(i)–(ii). On the other hand, if the agreement, contract, or transaction *does not* involve one of the enumerated topics, the special rule is not implicated, the CFTC has no occasion to make any public interest determination, and the contract should be listed for trading. *Id.* §§ 7a-2(c)(5)(C)(i), (c)(5)(B) (“The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this chapter (including regulations).”).

The CFTC’s implementing regulations set forth its process for reviewing event contracts under the special rule. 17 C.F.R. § 40.11. Pursuant to its regulations, the CFTC “may determine, based upon the review of the terms or conditions of a submission . . . that an agreement, contract, transaction, or swap based on an excluded commodity . . . , which may involve, relate to, or reference an [‘enumerated’ ‘activity’], be subject to a 90-day review.” *Id.* § 40.11(c). During the 90-day review period, the CFTC “shall request that a registered entity suspend the listing or trading” of the “agreement, contract, transaction, or swap.” *Id.* § 40.11(c)(1). By the conclusion of its review period, the CFTC must issue an order either approving or disapproving of the contract. *Id.* § 40.11(c)(2).

⁴ The Court recognizes that the special rule applies to “other” unspecified activities “similar” to those enumerated. 7 U.S.C. § 7a-2(c)(5)(C)(i)(VI). But the CFTC can only designate such activities through formal rulemaking or regulation. *Id.* The CFTC has not exercised its authority to develop and issue any rule or regulation prohibiting event contracts involving any other similar activity. *See* ECF 38-1 at 150 n.16 (Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC’s Political Event Contracts (quoting 76 Fed. Reg. at 44786)) (“The Commission may, at some future time, adopt regulations that prohibit products that are based upon activities ‘similar to’ the enumerated activities. It has determined not to propose such regulations at this time.”). Accordingly, the Court focuses on the statute’s enumerated categories in discussing and interpreting the special rule and has no occasion to consider whether the contracts at issue involve activities that are similar to those enumerated in the CEA.

C. The CFTC's Order Prohibiting Kalshi's Congressional Control Contracts

In 2020, the CFTC authorized Kalshi, a financial services company, to list event contracts for public trading as a DCM. ECF 38-1 at 209 (Comment Letter from Christopher Greenwood to U.S. Commodity Futures Trading Comm'n (Sept. 25, 2022)). The contracts Kalshi has offered on its exchange have involved a broad range of events—from the number of major hurricanes that will form over the Atlantic during a given year, to whether China's GDP growth will exceed a certain rate, and even whether a particular nominee will win in their category at the Oscars. *See id.*; ECF 38-2 at 23 (Comment Letter from Aristotle Intl., Inc. to U.S. Commodity Futures Trading Comm'n 3 (Sept. 23, 2022)). Kalshi has also offered event contracts concerning political events, such as whether the federal government will shut down or if certain nominees will be confirmed by the U.S. Senate. ECF 17-1 at 19 (citing *Events*, Kalshi, <https://perma.cc/3PCC-TLE9>).

The dispute between the Parties concerns a specific product that Kalshi attempted to offer that it refers to as “[c]ongressional [c]ontrol [c]ontracts.” ECF 17-1 at 11. Kalshi's congressional control contracts allow buyers to predict which political party will control the U.S. House of Representatives or Senate on a specific, future date. ECF 38-1 at 33–39 (Kalshi Notification). The congressional control contracts are “yes”/“no” event contracts that pose the question: “Will <chamber of Congress> be controlled by <party> for <term>?” *Id.* at 34–35. The contracts expire on February 1 of the year that the relevant term begins, *id.* at 40, and the payout is determined by the party affiliation of the leader of a specific chamber of Congress (i.e., the Speaker of the House for the House of Representatives or the President Pro Tempore for the Senate), *id.* at 39. Upon the contracts' expiration, buyers who correctly predicted the electoral outcome will receive one dollar per contract purchased, but purchasers who made an erroneous prediction about congressional

control receive nothing in return for their investment. *Id.* at 34–35. To avoid potential conflicts of interest, Kalshi’s congressional control contracts identify categories of prohibited traders to include candidates for any federal or statewide public office and paid employees with various political affiliations, including members of Congress, campaign staffers on congressional campaigns, employees of Democratic and Republican Party organizations and political action committees, and employees of major polling organizations, as well as the immediate family members of any prohibited traders, among other categories. *Id.* at 40–41.

On June 12, 2023, Kalshi filed a self-certification to trade its congressional control contracts, pursuant to 7 U.S.C. § 7a-2(c)(1). *See* ECF 38-1 at 33 (Kalshi Notification). But on June 23, 2023, the CFTC sent a letter to Kalshi representing that it had exercised its authority to initiate a 90-day review of Kalshi’s self-certified submission because it determined that the contracts “may involve, relate to, or reference an activity enumerated” in the CEA and applicable regulations. ECF 38-1 at 152 (Letter from Christopher J. Kirkpatrick, Secretary, U.S. Commodity Futures Trading Comm’n, to Xavier Sottile, Head of Markets, KalshiEX LLC). Consistent with 17 C.F.R. § 40.11(c)(1), the CFTC requested that Kalshi suspend any listing and trading of its congressional control contracts during the review period. ECF 38-1 at 152. The CFTC’s letter also informed Kalshi that it decided to open a 30-day public comment period to assist it with its evaluation. *Id.*; *see also id.* at 153–56 (Press Release, U.S. Commodity Futures Trading Comm’n, CFTC Announces Review of Kalshi Congressional Control Contracts and Public Comment Period (June 23, 2023); CFTC, Questions on the KalshiEX LLC “Will <chamber of Congress> be controlled by <party> for <term>?” Contracts for Public Comment).⁵ The CFTC’s decision to commence a

⁵ The administrative record reflects that the CFTC received many comments from various sectors. *See, e.g.*, ECF 38-1 at 157–236; ECF 38-2 at 8–234; ECF 38-3 at 8–109; ECF 38-4 at 8–132. Some commenters were in favor of the CFTC prohibiting Kalshi’s congressional control contracts, and others urged the CFTC to approve the contracts for trading. *See generally id.*

review of Kalshi’s congressional control contracts was not unanimous. Two of the five commissioners dissented because they did not agree that Kalshi’s congressional control contracts involved any of the special rule’s enumerated activities. *See* ECF 17-1 at 20 (citing Mersinger Dissenting Statement, CFTC.gov (June 23, 2023), <https://perma.cc/XG2U-FNRZ>; Pham Dissenting Statement, CFTC.gov (June 23, 2023), <https://perma.cc/V9VB-Z24S>); *see also* ECF 38-1 at 146-151 (Dissenting Statement of Comm’r Caroline D. Pham (Aug. 26, 2022)).

On September 22, 2023, at the conclusion of the review period, the CFTC issued an order prohibiting Kalshi from listing its congressional control contracts for trading pursuant to the special rule, ECF 38-1 at 8–30 (Commodity Futures Trading Comm’n, Order (June 12, 2023) [*hereinafter* CFTC Order]), with one commissioner dissenting and one abstaining from the decision. ECF 17-1 at 21 (citing Mersinger Dissenting Statement, CFTC.gov (Sept. 22, 2023), <https://perma.cc/2G23-5XNF>; Pham Abstention Statement, CFTC.gov (Sept. 22, 2023), <https://perma.cc/7D8G-C3ET>). In its order the CFTC determined that Kalshi’s congressional control contracts involve two activities enumerated in the special rule—gaming and unlawful activity. *See, e.g.*, ECF 38-1 at 17, 19 (CFTC Order).

To reach its conclusion, the CFTC first considered what it means for a contract to “involve” an enumerated activity under the special rule. 7 U.S.C. § 7a-2(c)(5)(C)(i); ECF 38-1 at 12–14 (CFTC Order). Acknowledging that the CEA does not define the word “involve,” the CFTC looked to its plain meaning derived from cited dictionaries that define “involve” to mean “to relate to or affect,” “to relate closely,” to “entail,” or to “have as an essential feature or consequence.” *Id.* at 12 (citations omitted). Applying these definitions of “involve,” the CFTC rejected Kalshi’s position that a contract “involve[s]” an enumerated activity “only if that activity is the contract’s underlying.” *Id.* at 13. The CFTC reasoned that the definition of the word “involve” in the statute

is broad enough to “capture both contracts whose underlying *is* one of the enumerated activities, and contracts with a different connection to one of the enumerated activities because, for example, they ‘relate closely to,’ ‘entail,’ or ‘have as an essential feature or consequence’ one of the enumerated activities.” *Id.* at 14. The CFTC also reasoned that “the legislative history of [the statute] ... indicates that the question for the Commission in determining whether a contract ‘involves’ one of the activities enumerated in [the special rule] is whether the contract, considered as a whole, involves one of those activities.” *Id.* The CFTC reasoned that considering the contract “as a whole,” *id.*, a contract could “involve” one of the special rule’s enumerated activities “if trading in the contract amounts to the enumerated activity,” *id.* at n.19.

After construing the word “involve,” the CFTC then provided the bases for its determination that Kalshi’s congressional control contracts involve “gaming.” *Id.* at 15–17. Again, because the CEA does not define “gaming,” the CFTC looked to the ordinary meaning of the term according to dictionaries and statutory definitions (specifically, in state statutes). *Id.* at 15–16. The CFTC reasoned as follows to conclude that the term “gaming” in the special rule “includes betting or wagering on elections”: First, the order cited to various dictionary definitions of the word gaming that include, or cross-reference, “gambling” as part of its definition. *Id.* at 15 & n.21. Then, the CFTC found that under “most state laws, ‘gambling’ involves a person staking something of value upon the outcome of a game, contest, or contingent event,” citing numerous state penal statutes. *Id.* at 15 & n.22.⁶ The CFTC then cited the federal Unlawful Internet Gambling

⁶ For example, the state statutes the CFTC cited include: KY. REV. STAT. ANN. § 528.010(6)(a) (“‘Gambling’ means staking or risking something of value upon the outcome of a contest, game, gaming scheme, or gaming device which is based upon an element of chance, in accord with an agreement or understanding that someone will receive something of value in the event of a certain outcome”); MICH. COMP. LAWS § 750.301 (“Any person or his or her agent or employee who, directly or indirectly, takes, receives, or accepts from any person any money or valuable thing with the agreement, understanding or allegation that any money or valuable thing will be paid or delivered to any person where the payment or delivery is alleged to be or will be contingent upon the result of any race, contest, or game or upon the happening of any event not known by the parties to be certain”); and N.Y. PENAL LAW § 225.00(2) (“A person engages in gambling when he stakes or risks something of value upon the outcome of a contest of chance or a

Enforcement Act (UIGEA), 31 U.S.C. § 5361 *et seq.*, which defines 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, 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.” ECF 38-1 at 16 (CFTC Order (citing 31 U.S.C. § 5362(1)(A))). Based upon the UIGEA’s definition of “bet or wager,” the CFTC determined that to “bet or wager on elections is to stake something of value upon the outcome of contests of others, namely, contests between electoral candidates.” ECF 38-1 at 16 (CFTC Order). The order then recognized that “several state statutes . . . link the terms ‘gaming’ or ‘gambling’ to betting or wagering on elections.” *Id.*⁷ Accordingly, the CFTC found that Kalshi’s congressional control contracts involve “gaming,” and are thus subject to the special rule, because “taking a position in the [c]ongressional [c]ontrol [c]ontracts would be staking something of value upon the outcome of a contest of others,” namely “the outcome of Congressional election contests.” *Id.* at 17.

The CFTC also set forth the reason it determined that Kalshi’s congressional control contracts involved unlawful activity under § 7a-2(c)(5)(C)(i)(I). It recognized that many states criminalize betting or wagering on elections. ECF 38-1 at 18 (CFTC Order).⁸ Accordingly, the

future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome”). *See* ECF 38-1 at 15 n.22 (CFTC Order).

⁷ For example, the state statutes the CFTC cited include: 720 ILL. COMP. STAT. ANN. 5/28-1(a)(2) (“A person commits gambling when he . . . makes a wager upon the result of any game, contest, or any political nomination, appointment or election”); NEB. REV. STAT. § 28-1101(4) (“A person engages in gambling if he or she bets something of value upon the outcome of a future event, which outcome is determined by an element of chance, or upon the outcome of a game, contest, or election”); and N.D. CENT. CODE ANN. § 12.1-28-01 (“‘Gambling’ means risking any money . . . upon lot, chance, the operation of gambling apparatus, or the happening or outcome of an event, including an election or sporting event, over which the person taking the risk has no control”). *See* ECF 38-1 at 16 n.24 (CFTC Order).

⁸ For example, the state statutes the CFTC cited include: ARIZ. REV. STAT. ANN. § 16-1015 (“A person who, before or during an election provided by law, knowingly makes, offers or accepts a bet or wager, or takes a share or interest in, or in any manner becomes a party to the bet or wager, or provides or agrees to provide money to be used by another in making the bet or wager, upon any contingency whatever arising out of such election, is guilty of a class 2 misdemeanor”); ARK. CODE ANN. § 7-1-103(20) (“No person shall make any bet or wager upon the result of any election in this state[.]”); and COLO. REV. STAT. ANN. § 31-10-1531 (“It is unlawful for any person, including any

CFTC determined that the congressional control contracts, which allow buyers to purchase and potentially receive a payout based on the results of congressional elections, amounted to activity that is illegal in many states. *Id.* at 19–20.

Finally, the CFTC found that Kalshi’s congressional control contracts were contrary to the public interest. It reasoned that the control of a chamber of Congress does not have “sufficiently direct, predictable, or quantifiable economic consequences” for Kalshi’s contracts to serve an effective hedging or risk mitigating function. *Id.* at 22. The order also identified the impact that such contracts could have on the integrity of elections and the perception of integrity, including, for example, by creating monetary incentives to vote for candidates or incentivizing the spread of misinformation by those trying to influence perceptions of a party or candidate to maximize potential financial gain. *Id.* at 27. Finding that the contracts involved enumerated activities and were contrary to the public interest, the CFTC’s order prohibited Kalshi from listing and trading its contracts. *Id.* at 30.

Kalshi then brought this suit challenging the CFTC’s order as arbitrary, capricious, contrary to law, and in excess of the CFTC’s statutory authority under the Administrative Procedure Act. ECF 1 ¶¶ 86, 87 (citing 5 U.S.C. § 706(2)(A), (C)). Kalshi moved for summary judgment seeking vacatur of the order. ECF 17. The CFTC opposed Kalshi’s motion and cross-moved for summary judgment, requesting that the Court affirm its determination prohibiting Kalshi from listing and trading its congressional control contracts. ECF 30.

candidate for public office, before or during any municipal election, to make any bet or wager with a qualified elector or take a share or interest in, or in any manner become a party to, any such bet or wager or provide or agree to provide any money to be used by another in making such bet or wager upon any event or contingency whatever arising out of such election.”). *See* ECF 38-1 at 18 n.26 (CFTC Order).

II. LEGAL STANDARD

This Court reviews the CFTC’s order under the APA to determine whether it is “arbitrary, capricious, an abuse of discretion, not in accordance with law, or unsupported by substantial evidence.” *Taylor v. USDA*, 636 F.3d 608, 613 (D.C. Cir. 2011) (quoting *Kleiman & Hochberg, Inc. v. USDA*, 497 F.3d 681, 686 (D.C. Cir. 2007)); see 5 U.S.C. § 706(2)(A), (E). When a court reviews agency action under the APA, the summary judgment standard set forth in Rule 56 does not apply. *Ardmore Consulting Grp., Inc. v. Contreras-Sweet*, 118 F. Supp. 3d 388, 393 (D.D.C. 2015). Instead, “the district judge sits as an appellate tribunal” and “the entire case on review is a question of law.” *Am. Bioscience, Inc. v. Thompson*, 269 F.3d 1077, 1083 (D.C. Cir. 2001). The court does not engage in fact finding and its review is “typically limited to the administrative record.” *Kondapally v. U.S. Citizenship & Immigr. Servs.*, 557 F. Supp. 3d 10, 20 (D.D.C. 2021).

At the time this case was originally briefed, the two-step analysis set forth in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), governed the Court’s review of the CFTC’s statutory interpretation. But in *Loper Bright Enterprises v. Raimondo*, the Supreme Court overruled *Chevron* and explained that the role of the reviewing court is “to independently interpret the statute and effectuate the will of Congress subject to constitutional limits.” 144 S. Ct. 2244, 2263 (2024). The Court therefore relies on “traditional tools of statutory construction” to resolve the Parties’ motions. *Id.* at 2268.⁹

⁹ In *Loper Bright*, the Supreme Court recognized that courts may seek aid from an agency’s “body of experience and informed judgment.” 144 S. Ct. at 2262 (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)). Because the CFTC did not argue that the Court should do so here, the Court neither considers nor addresses the scope of deference owed to the CFTC in the wake of *Loper Bright*.

III. ANALYSIS

Relevant here, the special rule authorizes the CFTC to determine that an event contract is contrary to the public interest if it “involve[s]—activity that is unlawful under any Federal or State law” or “gaming.” 7 U.S.C. §§ 7a-2(c)(5)(C)(i)(I), (V). Below, the Court considers two disputes about the statute’s meaning. First, the Court resolves the Parties’ disagreement about the definition of “gaming,” ultimately finding that the word “gaming” in the statute carries its ordinary, plain meaning and involves playing a game. Second, the Court considers the function of the word “involve” in the statute and concludes that it broadly refers to the underlying subject of the event contract or transaction. Because Kalshi’s congressional control contracts involve elections (and politics, congressional control, and other related topics) and not illegal activities or gaming, the Court concludes that the special rule is not triggered, which makes it unnecessary for the Court to determine whether the CFTC was right that these event contracts are contrary to the public interest.

A. Gaming Requires a Game

To determine whether Kalshi’s congressional control contracts “involve” either “activity that is unlawful under any Federal or State law” or “gaming” under the CEA’s special rule, 7 U.S.C. § 7a-2(c)(5)(C)(i), the Court first construes the meaning of the relevant, enumerated categories. The Court need not spend much time articulating a definition of the phrase “activity that is unlawful under any Federal or State law” because its definition is clear. The Parties disagree about what it means for an event contract to “involve” such an activity (which the Court addresses later), but both sides understand this phrase to encompass activity or conduct that is illegal, and no one presses the Court to attach a different meaning to this phrase beyond the obvious.

However, the Parties dispute the meaning of “gaming” as used in the CEA. Kalshi argues that the term “gaming” in the statute must be “defined by reference to ‘games.’” ECF 17-1 at 39.

The CFTC advances a broader definition. Its order equates “gaming” with “gambling,” and observes that “gambling” is often defined as “staking something of value upon the outcome of a game, contest, or contingent event.” ECF 38-1 at 15 (CFTC Order). (Although it only advances a definition of gambling (or gaming) that includes betting on a contest in this litigation. ECF 30 at 39.) After considering the text of the CEA, the statute’s structure and context, and the Parties’ arguments, the Court must agree with Kalshi.

Start with the text. The CEA does not define “gaming.” *See generally* 7 U.S.C. § 1 *et seq.* “When a term goes undefined in a statute, [courts] give the term its ordinary meaning.” *Taniguchi v. Kan Pac. Saipan, Ltd.*, 566 U.S. 560, 566 (2012). To discern that meaning, courts often begin with a survey of dictionaries. *See id.* at 569. Dictionaries define “gaming” as “the practice or activity of playing games for stakes” and “the practice or activity of playing games.” *Gaming*, Merriam-Webster.com, <https://perma.cc/9JZW-SRS2>; *see also Gaming*, Oxford English Dictionary, <https://perma.cc/R99K-A2HD> (defining gaming, in relevant part, as “[t]he action or practice of playing games . . . for stakes.”). The ordinary meaning of the term “gaming” is thus consistent with Kalshi’s position. The Court finds no reason to stray from the ordinary definitions of “gaming,” which are “the practice or activity of playing games” and “playing games for stakes.” Indeed, the statute’s broader context and its structure compel the Court to reject the CFTC’s more expansive definition and, therefore, the reasoning of its order.

First, the CFTC contends that “gaming” is synonymous with “gambling” and should be defined accordingly. ECF 30 at 39; ECF 38-1 at 15 (CFTC Order). The Court finds that definitions of “gambling” that are untethered to the act of playing a game are much too broad in the context of the CEA’s special rule. The Court acknowledges that some dictionary definitions of “gaming” cross-reference gambling, or otherwise define “gaming” to include “gambling.” The

Merriam-Webster dictionary, for example, (which, as observed above, defines “gaming” to include “the practice or activity of playing games”) includes such a cross-reference. *Gaming*, Merriam-Webster.com, <https://perma.cc/9JZW-SRS2>. But it defines “gambling” to include “the practice or activity of betting” without any limitation on what is being bet upon. *Gambling*, Merriam-Webster.com, <https://perma.cc/3FRP-QNBU>; *see also Gaming*, Black’s Law Dictionary (12th ed. 2024) (defining “gaming” as “gambling”); *Gambling*, Black’s Law Dictionary (12th ed. 2024) (defining “gambling” as “[t]he act of risking something of value, especially money, for a chance to win a prize.”). That definition is consistent with the order’s articulation that “gambling” under many state statutes means to “stak[e] something of value upon the outcome of a game, contest, or contingent event.” ECF 38-1 at 15 (CFTC Order), *id.* at n.22.¹⁰ However, it quickly becomes clear that definition is unworkable in the context of this statute.

One glaring issue emerges given the CFTC’s view that the special rule is implicated if the act of trading an event contract “amounts” to an enumerated activity. ECF 38-1 at 14 n.19 (CFTC Order). The Court addresses, and rejects, that reading below, but it is difficult to understand how the CFTC settled on such an expansive definition of gaming (or gambling) given its position. If the Court agreed with the CFTC’s construction, all event contracts would be subject to review under the special rule because they all involve purchasing (and thus risking money on) some contingent event with the hope of receiving a payoff. *See CFTC, Contracts & Products: Event Contracts*, <https://perma.cc/Q4LP-B6UY>. Given that the CEA authorizes the CFTC to review

¹⁰ In further support of its contention that gaming and gambling are interchangeable, the CFTC cites to a Supreme Court case in which the Court equated gaming with gambling. *See Michigan v. Bay Mills Indian Cmty.*, 572 U.S. 782, 792 (2014) (“The ‘gaming activit[y]’ is (once again) the gambling.”). But this Court does not find the CFTC’s argument persuasive, or helpful, in construing the meaning of “gaming” in the CEA. *Bay Mills* involved a question of tribal sovereign immunity under the Indian Gaming Regulatory Act, which required the Court to consider whether and where a tribe engaged in “gaming activities.” *See* 572 U.S. at 791–93. The “gaming activities” at issue involved the operation of casinos, and the quote the CFTC relies on describes “gaming activity” to include “gambling in the poker hall.” *Id.* at 792. Certainly gaming, as this Court has found it to mean in the CEA, can also be gambling. Playing poker is both “gaming” and “gambling.” But that does not mean all forms of gambling are gaming.

event contracts only if they involve specific, enumerated activities, any definition of “gaming” that could be read to subject *all* event contracts to the special rule just cannot be right.¹¹

Nor is the Court persuaded that the order’s discussion of a more limited definition of gambling (and thus gaming) as “stak[ing] something of value upon the outcome of contests of others” should displace the plain and ordinary meaning of gaming that the Court has recognized. ECF 38-1 at 16. (Unless the contest at issue is some sort of game, which many are). That is because the Court does not find that the CFTC’s sources for the definition it advances are particularly relevant. In considering the ordinary meaning of the word “gaming,” the CFTC bypassed dictionary definitions of that term, cited above, which equate “gaming” with “games,” in favor of more expansive definitions of gambling, which is not a term used in the statute. Similarly, it surveyed state statutes that prohibit gambling and cited some of those statutes’ broader definitions of the term, but did not look to state statutes that expressly use or define the word “gaming.” ECF 38-1 at 15–16 n.22 (CFTC Order). Notably, there are many state statutes that define “gaming” as tied to games, consistent with the definition of “gaming” Kalshi advances. *See, e.g.*, Iowa Code § 725.7(1)(a) (“illegal gaming” means “[p]articipat[ing] in a game for any sum”); Mass. Gen. Laws ch. 23K, § 2 (defining “gaming” as “dealing, operating, carrying on, conducting, maintaining or exposing any game for pay”); La. Stat. § 27:205 (defining legal “gaming operations” and “gaming

¹¹ The CFTC argues in its briefing that it did not adopt a definition of gaming that includes staking money on any contingent event. *See* ECF 30 at 38. But after observing that gaming and gambling are synonymous, the CFTC’s order goes on to recognize a definition of gambling that includes “staking something of value upon the outcome of a game, contest, or contingent event.” ECF 38-1 at 15 (CFTC Order). Yes, it ultimately reasoned that Kalshi’s congressional control contracts concerned gaming because gaming means gambling, and gambling involves wagering on a contest, but the order includes numerous citations to definitions of gambling that make reference to betting on contingencies generally. *Id.* at 15–16 n.2. If the CFTC did not agree that the definition of gambling included betting on contingent events, it is not clear to the Court why it referred to definitions of gambling that included such language (and equated “gaming” and “gambling”). The CFTC cannot have it both ways: it cannot synonymize gaming with gambling, but simultaneously argue that only some gambling is gaming.

activities” as “the offering or conducting of any game or gaming device in accordance with” state law).

And while the CFTC’s order also considered and pulled definitions from a federal statute, it did not look to the only one that the Court is aware actually uses the term “gaming”—the Indian Gaming Regulatory Act (IGRA), 25 U.S.C. § 2701. Although the IGRA does not expressly define gaming, it refers to various “gaming” classes that, by statute or regulation, each concern categories of games.¹² Instead, the federal statute discussed in the order is the Unlawful Internet *Gambling* Enforcement Act (UIGEA), 31 U.S.C. § 5361 *et seq.* (emphasis added), which also does not define or use the term “gaming.” That statute, instead, uses the terms “bet” and “wager” and defines those terms 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 [someone] will receive something of value in the event of a certain outcome.” *Id.* § 5362(1)(A). The CFTC borrowed this definition and applied it to “gaming” in the special rule, but the Court cannot understand why it did that. *See* ECF 38-1 at 16 (CFTC Order). The CEA does not use the terms “bet” or “wager” anywhere. *See generally* 7 U.S.C. § 1 *et seq.* The Court can think of no canon of statutory interpretation that counsels toward looking to an unrelated statute that defines a different term in a different context to determine a statute’s meaning.¹³ Accordingly, the Court

¹² IGRA sets forth three classes of gaming activity: “class I gaming” means social games; “class II gaming” means “the game of chance commonly known as bingo” and certain card games; and “class III gaming” is an undefined catch-all “class III gaming” category. 25 U.S.C. § 2703(6)-(8). Regulations define class III by reference to “[c]ard games such as baccarat, chemin de fer, blackjack (21), and pai gow;” “[c]asino games such as roulette, craps, and keno;” “slot machines” and other “game[s] of chance;” “sports betting,” including “wagering on horse racing, dog racing or jai alai;” and “[l]otteries.” 25 C.F.R. § 502.4.

¹³ Even if the Court were to apply the UIGEA’s definition of “bet” or “wager” to “gaming” under the special rule, it would have difficulty finding that an election is a “contest” under that statute. “The traditional canon of construction, *noscitur a sociis*, dictates that words grouped in a list should be given related meaning.” *Dole v. United Steelworkers of Am.*, 494 U.S. 26, 36 (1990). The Court can accept the CFTC’s argument that elections are sometimes referred to colloquially as “contests,” but elections bear little relation to “sporting events” or “games of chance,” which appear alongside the term “contest” in the UIGEA’s definition of “bet” and “wager.” 31 U.S.C. § 5362(1)(A). The Court is persuaded by Kalshi’s argument that, considering the other terms in the definition, “contest” must refer to a similar

does not agree that “gaming” under the CEA includes wagering on contests that do not involve or closely relate to a game of some sort.¹⁴

In sum, the Court finds that “gaming,” as used in the special rule, refers to playing games or playing games for stakes. The Court next considers the special rule’s use of the word “involve.”

B. “Involve” Interacts with the Instrument’s Underlying Event

The special rule authorizes the CFTC to review, and potentially prohibit, event contracts that “involve” one or more of the enumerated categories. 7 U.S.C. § 7a-2(c)(5)(C)(i). The Parties disagree about what this provision means. Kalshi argues that, under the special rule, an event contract “involves” an enumerated activity where the underlying event constitutes or relates to that activity. *See, e.g.*, ECF 17-1 at 25. In its order, however, the CFTC determined that an event contract “involves” an enumerated activity, not only if the contract’s “underlying *is* one of the enumerated activities,” but if the contract has a “different connection to one of the activities,” ECF 38-1 at 14 (CFTC Order), including “if trading in the contract amounts to the enumerated activity,” *id.* at n.19. After carefully scrutinizing the statute and considering the Parties’ arguments, the Court again agrees with Kalshi and finds that its event-focused reading of the word “involve” is the only interpretation that makes sense in the context of this provision.

As always, the Court begins its analysis with the statute’s text. *See, e.g., BP Am. Prod. Co. v. Burton*, 549 U.S. 84, 91 (2006). And because “involve” is left undefined by the CEA, the Court first considers the ordinary meaning of that word. *See, e.g., id.* As a preliminary matter, the Court observes that there is not much daylight between the Parties about what “involve” means in

event for entertainment that might not be characterized as a sporting event or a game of chance—a pageant might fit. *See* ECF 17-1 at 40.

¹⁴ Although not dispositive, the Court observes that the CFTC has not subjected Kalshi’s event contracts about whether certain nominees will win an Oscar to review under the special rule, ECF 41-1 at 7, even though, at least as the Court sees it, the Academy Awards are a contest.

ordinary parlance. The Parties offer definitions of involve from various dictionaries that are largely the same, such as “[t]o contain as a part; include,” “to have as a necessary feature or consequence,” ECF 17-1 at 25 (citing American Heritage Dictionary 921 (4th ed. 2009)), and “to relate to or affect,” “to relate closely,” to “entail,” or to “have as an essential feature or consequence,” *see* ECF 30 at 33 (citing Merriam-Webster, <https://perma.cc/2RS8-ZRBJ>; Random House College Dictionary 703 (rev. ed. 1979); Riverside University Dictionary 645 (1983)); *see also* ECF 38-1 at 12 (CFTC Order). Both sides agree that the term is defined broadly, *see* ECF 17-1 at 25, ECF 30 at 26, and thus, for example, is more expansive in scope than a phrase like “based upon” (which is used elsewhere in the CEA). ECF 30 at 34; ECF 36 at 12. Rather, the real disagreement between the Parties is the function of the word “involve” in the statute and how it interacts with the enumerated activities.

Construing the plain meaning of “involve” does not resolve the Parties’ dispute. As the Supreme Court has recognized, “a statute’s meaning does not always turn solely on the broadest imaginable definitions of its component words.” *Dubin v. United States*, 599 U.S. 110, 120 (2023) (quoting *Epic Sys. Corp. v. Lewis*, 584 U.S. 497, 523 (2018)). Accordingly, the Supreme Court has instructed that where a statute includes terms whose plain meaning is broadly defined, courts should not construe the language “in isolation,” but must “look to statutory context.” *Dubin*, 599 U.S. at 119 (citing *N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 655 (1995) (considering the term “relate to” and recognizing that if “‘relate to’ were taken to extend to the furthest stretch of its indeterminacy, then for all practical purposes” there would be no limits as “really, universally, relations stop nowhere”)). To determine how “involve” operates in the statute, the Court can consider “traditional tools of statutory interpretation—text, structure, purpose, and legislative history.” *In re Sealed Case*, 932 F.3d 915, 928 (D.C. Cir. 2019)

(quoting *Tax Analysts v. IRS*, 350 F.3d 100, 103 (D.C. Cir. 2003)). Considering many of these tools, and related canons of statutory construction, the Court rejects the CFTC’s reading of the statute in favor of Kalshi’s for several reasons.

First, the CFTC’s argument that an event contract “involves” an enumerated activity if the act of trading the contract “amounts to” the activity cannot be applied consistently throughout the statute. “[S]tandard principle[s] of statutory construction provide[] that identical words and phrases within the same statute should normally be given the same meaning” and effect. *Powerex Corp. v. Reliant Energy Servs., Inc.*, 551 U.S. 224, 232 (2007). And where one term in a statute “applies without differentiation to” a set of defined categories, “[t]o give the[] same words a different meaning” for different categories “would be to invent a statute rather than interpret one.” *Clark v. Martinez*, 543 U.S. 371, 378 (2005). Other than with respect to the two categories it claims are implicated here—unlawful activity and gaming—the CFTC’s reading of “involve” does not work for any other activity enumerated in the special rule.

The “act of trading in” an event contract can never “amount to” war. The “act of trading in” an event contract cannot “amount to” terrorism. And no one would formulate a construction of the statute to read that an “act of trading in” an event contract could ever “amount to” assassination. With respect to those categories of the special rule, then, the Court is not remotely confused about how “involve” operates. An event contract can only involve war, terrorism, or assassination if the contract’s subject itself relates in some way (admittedly broadly) to war, terrorism, or assassination. There is simply no other workable construction applied to those categories that the Court can think of. And the Court cannot identify any principled reason, consistent with applicable canons of construction, that it would treat the two enumerated categories at issue in this case any differently. In other words, the Court finds no basis to invite ambiguity into a statutory framework

that is otherwise clear by construing the relationship between “involve” and the unlawful activity and gaming categories—and only those categories—more broadly, and thus differently, than the others.

The CFTC further argues that the special rule is implicated when the act of trading a contract amounts to an enumerated activity, and not just when a contract’s underlying involves an activity, because the special rule applies to “transactions.” Specifically, the statute gives the CFTC authority to review “agreements, contracts, or *transactions*” that “involve” an enumerated activity. *Id.* Because the plain meaning of the word “transaction” includes “the formation, performance, or discharge of a contract,” the CFTC contends that the statute’s authorization of its review of “transaction[s]” that “involve” an enumerated activity is consistent with its reading of the statute—namely, that a transaction “involve[s]” an enumerated activity if the act of trading in the contract amounts to that activity. ECF 41-1 at 3 (citing *Transaction*, Black’s Law Dictionary (11th ed. 2019)). Kalshi argues that “transaction,” as used in this statute, refers to a financial instrument. ECF 42 at 2. The Court recognizes the ordinary meaning of the term “transaction,” but also understands Kalshi’s point. After all, the other terms that are listed alongside “transactions” in the statute—agreements, contracts, swaps—refer to various derivative instruments, which go by many names. 7 U.S.C. § 7a-2(5)(c)(ii). And the statute identifies a transaction as something that can be “list[ed],” further suggesting that it is referring to an actual financial instrument or the product being exchanged. *Id.*

But the Court finds it unnecessary to pick a side because, even using the CFTC’s ordinary definition of “transaction,” the Court still cannot adopt its “involve-means-trading-in-the-product-amounts-to-an-enumerated-activity” construction. A financial transaction on an exchange has an underlying subject just like a contract does. And again, the CFTC’s reading does not lend itself to

a consistent application across the statute. Replacing “transaction” with the term “contract” changes no part of the Court’s analysis. A transaction can only “involve” war, terrorism, or assassination if the offering underlying the transaction relates in some way to war, assassination, or terrorism. No one reading this provision would read the statute to mean that a transaction “involves” war because the discharge of contractual obligations somehow amounts to war, or that a transaction “involves” terrorism because performance on the contract amounts to terrorism, or that a transaction on a DCM can amount to assassination in some way. Indeed, the special rule is not the only provision of the CEA that uses the terms “transaction” and “involve” where it is clear that the statute can only be referring to the underlying commodity or subject of the transaction. *See, e.g.*, 7 U.S.C. § 6c(b) (“transaction *involving* any commodity regulated under this chapter”); *id.* § 23(b)(1) (referencing “transactions *involving* different commodities”); *id.* § 2(a)(1)(D)(i) (“contracts[] and transactions *involving* . . . a security futures product”). Overall, the Court declines to apply a construction of the statute that only works for some, but not all, of the enumerated categories.

Second, the CFTC’s interpretation of the statute would render its reach too broad, and thus does not make sense to the Court in the context of the statute. This point is best illustrated through consideration of the special rule’s “unlawful activity” category. According to the CFTC’s order, Kalshi’s congressional contracts “involve” unlawful activity, not because the subject matter of the contracts (Congress and elections) relates to anything unlawful, but because in many states it is unlawful to stake money on the outcome of an election. ECF 38-1 at 19–20 (CFTC Order). But as the order also recognizes, many states define unlawful gambling as staking money on any contingent outcome. *Id.* at 15 n.22. Event contracts, by definition, involve staking money on some contingent event. CFTC, *Contracts & Products: Event Contracts*, <https://perma.cc/Q4LP-B6UY>.

Accordingly, under the CFTC’s logic, it could presumably review *any* event contract, because (1) a person or entity purchasing an event contract is putting money on the outcome of a contingent event and (2) many states define such conduct as “gambling” and make it unlawful. But no one would contend that reading represents a plausible construction of the statute. Not only because the CEA specifically preempts the application of state law over derivative markets, 7 U.S.C. § 2(a)(1)(A), but because it would swallow the special rule’s provisions authorizing the CFTC to review only event contracts that relate to specific, enumerated topics, *id.* § 7a-2(c)(5)(C)(i); *see also Davis v. Mich. Dept. of Treasury*, 489 U.S. 803, 809 (1989) (recognizing that it is a “fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme.”).¹⁵ Such an interpretation would also effectively undo the Congressional amendment to the CEA that eliminated the CFTC’s across-the-board review. *See* Pub. L. No. 93-463, § 207, 88 Stat. 1389, 1400 (1974) (codified at 7 U.S.C. § 7(7) (1994)); Pub. L. No. 106-554, §§ 110(2), 113, 114 Stat. 2763, 2763A-384, 399 (2000) (codified at 7 U.S.C. §§ 7, 7a-2 (2006)). The only formulation of the interaction between “involve” and “unlawful activity” that actually works, then, is if the contract or transaction’s underlying event relates in some way to activity that is illegal—not if the act of staking money on the contract’s underlying would be unlawful under any state law.

Finally, the legislative history offers no support for the CFTC’s position. The statute’s legislative history is not dispositive to the Court’s analysis, but the CFTC discusses it in its order

¹⁵ The CFTC acknowledges this argument, but contends that preemption would operate as a backstop. It argues that because state laws banning futures contracts are preempted by the CEA, all event contracts would not (and could not) be considered “unlawful activity” and, therefore, the CFTC’s definition of “involve” does not swallow the rule. ECF 31 at 46. The Court has trouble following the CFTC’s argument. The CFTC does not provide a coherent justification as to why it argues that state laws that categorically ban all event contracts are preempted, but those that ban specific types of event contracts are not. To be clear, this Court does not make any decision or judgment on the preclusive scope of the CEA’s special rule. But the friction the CFTC’s interpretation creates further demonstrates why it is wrong.

and briefing here, *see* ECF 31 at 35; ECF 38-1 at 14 n.18 (CFTC Order), so the Court will too. The CFTC argues that the CEA’s legislative history supports its conclusion that Congress was concerned about the overall characteristics of an event contract, and not just whether the underlying subject of the contract involved an enumerated activity. *Id.* In particular, the order cites to a colloquy on the Senate floor, in which one senator remarked that the provision ultimately enacted as Section 5(c)(5)(C) of the CEA was intended to “prevent gambling through futures markets” and restrict “‘event contract[s]’ around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament.” *Id.* (citing 156 Cong. Rec. S5906-07, 2010 WL 2788026 (daily ed. July 15, 2010)). According to the CFTC, under the event-focused reading of the statute Kalshi advances, contracts involving these sporting events would not fall under the statute’s gaming category because events like the Super Bowl themselves are games, not “gaming.” ECF 31 at 35. The Court understands the CFTC to be arguing that these contracts could only be considered “gaming” if one considers the fact that someone bet money on them.

A couple points about the CFTC’s invocation of the statute’s legislative history. First, the order’s point appears to be moot given the Court’s conclusion that “gaming” includes the activity of playing games and playing games for stakes. Applying that definition, event contracts related to any of the sporting events the senator mentioned on the floor could implicate the gaming category. All these events can easily be construed as games; they can even be construed as games played for stakes (cash prizes and trophies, for example).¹⁶ And second, the Court cannot take much from the remarks of one senator to elucidate the meaning of the statute. The D.C. Circuit has

¹⁶ The CFTC argues that if “involve” only related to a contract’s underlying, the gaming category would not include any event contracts at all because it is difficult for the CFTC “to conceive of a contract whose underlying event, itself, is ‘gaming.’” *Id.* The Court has adopted the plain meaning of the word gaming, which is not limited to the act of betting money on a game. But even if the Court were to accept that narrower definition of gaming, it is not hard to think of examples—like an event contract asking buyers to predict who will win the World Series of Poker Tournament.

warned that “judges must ‘exercise extreme caution’” with such floor exchanges. *Tex. Mun. Power Agency v. EPA*, 89 F.3d 858, 875 (D.C. Cir. 1996) (quoting *Gersman v. Grp. Health Ass’n, Inc.*, 975 F.2d 886, 892 (D.C. Cir. 1992)). In fact, if the Court were to take anything from this floor exchange, it would be that the senator would not have intended “gaming” to include elections given the examples offered.

To sum it up, the Court agrees that “involve” should be broadly construed. The Court does not find (nor does Kalshi contend) that the instrument or contract must specifically refer to an enumerated event to “involve” or relate to it.¹⁷ But a contract or transaction “involves” an enumerated activity if the event being offered and traded as part of that contract or transaction relates to that activity. That is the most natural, and only consistently workable, reading of the provision.

* * *

Kalshi’s event contracts ask buyers to take a yes/no position on whether a chamber of Congress will be controlled by a specific party in a given term. That question involves (relates to, entails, has as its essential feature, or any other iteration of the word) elections, politics, Congress, and party control; but nothing that any Party to this litigation has identified as illegal or unlawful activity. Nor does that question bear any relation to any game—played for stakes or otherwise. Accordingly, the Court concludes that Kalshi’s congressional control contracts do not involve unlawful activity or gaming. And thus the Court has no occasion to consider whether they are contrary to the public interest.

¹⁷ Event contracts that “involve” war, for example, could include “whether there will be a war in X country,” but might also cover events related to war, such as weapons trades or military deployments.

IV. CONCLUSION

For the foregoing reasons, the Court finds that Kalshi's congressional control contracts do not involve activity that is unlawful under any Federal or State law, nor do they involve gaming. Accordingly, the Court must **GRANT** Plaintiff's Motion for Summary Judgment and **DENY** Defendant's Cross-Motion for Summary Judgment. A separate order has issued.

SO ORDERED.



JIA M. COBB
United States District Judge

Date: September 12, 2024

**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 1

**JOINT APPENDIX UNDER RULE 7(n)
VOLUME 1**

KALSHIEX LLC v. CFTC, No. 1:23-cv-03257-JMC

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UNITED STATES OF AMERICA
Before the
COMMODITY FUTURES TRADING COMMISSION

In the Matter of the Certification by KalshiEX LLC of Derivatives Contracts with Respect to
Political Control of the United States Senate and United States House of Representatives

ORDER

BACKGROUND

By a submission dated June 12, 2023 (the “Submission”), KalshiEX LLC (“Kalshi”), a designated contract market (“DCM”), filed a certification of congressional control political event contracts (the “Congressional Control Contracts”), pursuant to section 5c(c)(1) of the Commodity Exchange Act (“CEA”) and Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulation 40.2. On June 23, 2023, the Commission commenced review of the Submission pursuant to Commission Regulation 40.11(c), because the Commission determined that the Submission comprised contracts that may involve, relate to, or reference an activity enumerated in Commission Regulation 40.11(a)(1) and CEA section 5c(c)(5)(C)(i). By letter dated June 23, 2023, the Commission informed Kalshi of its determination to commence review of the Congressional Control Contracts pursuant to Commission Regulation 40.11(c), and requested that Kalshi suspend the listing and trading of the Congressional Control Contracts during the pendency of the review period. In addition, on June 23, 2023, the Commission

opened a comment period to request public comments to assist the Commission's evaluation of the Submission. The public comment period ended on July 24, 2023.¹

The Congressional Control Contracts are cash-settled, binary (yes/no) contracts based on the question: "Will <chamber of Congress> be controlled by <party> for <term>?" Kalshi describes the Congressional Control Contracts as event contracts. The settlement values of the Congressional Control Contracts are determined by the party affiliation of the leader of the identified chamber of the United States Congress on the expiration date. In the case of the House of Representatives, the leader is the Speaker of the House ("Speaker"), and in the case of the Senate, the leader is the President Pro Tempore ("Pres Pro Temp"). Upon settlement, an absolute amount is paid to the holder of one side of the contract, and no payment is made to the counterparty. All contracts trading on Kalshi are fully-collateralized.

The Congressional Control Contracts have a notional value of one dollar with a minimum price fluctuation of \$0.01, and must be purchased in multiples of 5,000 contracts per order. The Congressional Control Contracts have tiered position limits, depending on the category of market participant and whether that market participant has "demonstrated established economic hedging need," which may be demonstrated to Kalshi according to means and methods established by Kalshi.

The terms of the Congressional Control Contracts prohibit certain individuals and entities from trading the contracts, namely: 1) candidates for federal or statewide public office; 2) paid campaign staffers on Congressional campaigns; 3) paid employees of Democratic and Republican Party organizations; 4) paid employees of political action committees ("PACs") and

¹ The Commission received 1,378 comments, including four comments that were received after the close of the public comment period but were added to the comment file. See <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7394>.

“Super PACs” (independent expenditure only political committees); 5) paid employees of major polling organizations; 6) existing members of Congress; 7) existing paid staffers of members of Congress; 8) household members and immediate family members of any of the above; and 9) “any of the above listed institutions themselves.”

LEGAL STANDARD

Under CEA section 5c(c)(5)(C)(i), the Commission may determine that contracts in certain excluded commodities, as defined in CEA section 1a(19), are contrary to the public interest if the contracts involve: (1) activity that is unlawful under any Federal or State law; (2) terrorism; (3) assassination; (4) war; (5) gaming; or (6) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.²

CEA section 5c(c)(5)(C)(ii) provides that “[n]o . . . contract . . . determined by the Commission to be contrary to the public interest under [CEA section 5c(c)(5)(C)(i)] may be listed or made available for clearing or trading on or through a registered entity[,]” including a DCM (such as Kalshi).³

Commission Regulation 40.11(a)(1) provides that registered entities, including DCMs, “shall not list for trading or accept for clearing” any contract based upon an excluded commodity, as defined in CEA section 1a(19)(iv), that “involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law. . . .”⁴ Commission Regulation 40.11(a)(2) further provides that registered entities, including DCMs, “shall not list for trading or accept for clearing” any contract based upon an excluded

² CEA section 5c(c)(5)(C)(i); 7 U.S.C. § 7a-2(c)(5)(C)(i).

³ CEA section 5c(c)(5)(C)(ii); 7 U.S.C. § 7a-2(c)(5)(C)(ii).

⁴ 17 C.F.R. §§ 40.11(a)-(a)(1).

commodity, as defined in CEA section 1a(19)(iv), that “involves, relates to, or references an activity that is similar to an activity enumerated in [Commission Regulation] 40.11(a)(1) ... and that the Commission determines, by rule or regulation, to be contrary to the public interest.”⁵

Under Commission Regulation 40.11(c), when a contract that is submitted to the Commission by a registered entity, pursuant to Commission Regulation 40.2 or Commission Regulation 40.3, is based upon an excluded commodity, as defined in CEA section 1a(19)(iv), “which may involve, relate to, or reference” an activity enumerated in Commission Regulation 40.11(a)(1) or Commission Regulation 40.11(a)(2), the Commission is authorized to commence a 90-day review of the contract.⁶ Commission Regulation 40.11(c)(1) requires the Commission to request that the registered entity suspend the listing or trading of such contract during the 90-day review period.⁷ The Commission must ultimately issue an order approving or disapproving such contract by the end of its review or at the end of any extended period agreed to or requested by the registered entity.⁸

⁵ 17 C.F.R. §§ 40.11(a)-(a)(2).

⁶ 17 C.F.R. § 40.11(c).

⁷ 17 C.F.R. § 40.11(c)(1).

⁸ 17 C.F.R. § 40.11(c)(2).

FINDINGS

Having reviewed the complete record in this matter, including the Submission and the public comments received, the Commission makes the following findings and determinations pursuant to CEA section 5c(c)(5)(C) and Commission Regulation 40.11:

The Congressional Control Contracts Involve Enumerated Activities

WHEREAS, the Commission has evaluated whether the Congressional Control Contracts involve an activity enumerated in CEA section 5c(c)(5)(C)(i) and Commission Regulation 40.11(a)(1).

WHEREAS, the term “involve” is not defined for purposes of CEA section 5c(c)(5)(C)(i).

WHEREAS, an undefined term in a statute is generally given its ordinary meaning.⁹ To determine the ordinary meaning of undefined statutory terms, courts typically look to dictionary definitions for guidance.¹⁰

WHEREAS, definitions of the word “involve” include “to relate to or affect,” “to relate closely,” to “entail,” or to “have as an essential feature or consequence.”¹¹

⁹ See *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187, 115 S.Ct. 788 (1995); See also, *Morrisette v. United States*, 342 U.S. 246, 263, 72 S.Ct. 240 (1952) (holding that undefined statutory words that are not terms of art are given their ordinary meanings, frequently derived from the dictionary).

¹⁰ *Sanders v. Jackson*, 209 F.3d 998, 1000 (7th Cir. 2000).

¹¹ See *Involve Definition*, MERRIAM-WEBSTER, <https://www.merriam-webster.com/dictionary/involve> (last visited September 7, 2023); Random House College Dictionary 703 (Revised ed. 1979); Riverside University Dictionary 645 (1983); see also Roget’s International Thesaurus 1040 (7th ed. 2010) (giving as synonyms “entail” and “relate to”).

WHEREAS, the Commission has considered assertions by Kalshi and some commenters that, under CEA section 5c(c)(5)(C)(i), contracts “involve” an enumerated activity only if that activity is the contract’s underlying.

WHEREAS, when the CEA refers to a contract’s underlying, it uses the word “underlying,”¹² or it refers to what the contract is “based on”¹³ or “based upon.”¹⁴

WHEREAS, CEA section 5c(c)(5)(C)(i) itself uses “based upon” to refer to the underlying: it applies with respect to “contracts ... in [certain] excluded commodities that are *based upon* the occurrence, extent of an occurrence, or contingency” (emphasis added).¹⁵ The underlying must therefore be a kind of excluded commodity, but that is all that CEA section 5c(c)(5)(C)(i) says about the underlying.

WHEREAS, in CEA section 5c(c)(5)(C)(i), the requirement that the contract “involve” an enumerated activity is separate:

In connection with the listing of ... *contracts ... in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency ...* the Commission may determine that *such ... contracts ...* are contrary to the public interest *if the ... contracts ... involve* [an enumerated activity] (emphasis added).¹⁶

WHEREAS, in context, “based upon” and “involve” have different meanings for purposes of CEA section 5c(c)(5)(C)(i): “based upon” refers to the contract’s underlying (as it does elsewhere in the CEA), and “involve” refers to the enumerated activities and retains its broader ordinary meaning. In other words, the contract must be “based upon” a type of excluded

¹² *E.g.*, 7 U.S.C. §§ 6c(d)(2)(A)(i), 20(e), 25(a)(1)(D)(ii).

¹³ *E.g.*, 7 U.S.C. §§ 2(a)(1)(C)(i)(I), 2(a)(1)(C)(iv), 6b(e).

¹⁴ *E.g.*, 7 U.S.C. § 2(a)(1)(C)(ii).

¹⁵ CEA section 5c(c)(5)(C)(i); 7 U.S.C. § 7a-2(c)(5)(C)(i)

¹⁶ *Id.*

commodity, and the contract must “involve” an enumerated activity. But the contract need not be “based upon” an enumerated activity.

WHEREAS, Congress’s choice of the broader term “involve” means that CEA section 5c(c)(5)(C)(i) can capture both contracts whose underlying *is* one of the enumerated activities, and contracts with a different connection to one of the enumerated activities because, for example, they “relate closely” to, “entail,” or “have as an essential feature or consequence” one of the enumerated activities.¹⁷

WHEREAS, the legislative history of CEA section 5c(c)(5)(C) supports the plain meaning of the term “involve,”¹⁸ and indicates that the 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.¹⁹

¹⁷ The types of activities enumerated in CEA section 5c(c)(5)(C)(i) – including terrorism, war, and activities that are unlawful under federal or state law – of themselves support a broad reading of the term “involve,” to ensure that the Commission has the authority that Congress intended to prevent trading on Commission-regulated markets that is contrary to the public interest. *See* footnotes 29 and 31, *infra*

¹⁸ In a colloquy with Senator Diane Feinstein on the Senate floor regarding the proposed Dodd-Frank Act provision that ultimately was enacted as CEA section 5c(c)(5)(C), Senator Blanche Lincoln, then-Chair of the Senate Committee on Agriculture, Nutrition and Forestry, stated that, among other things, the provision was intended to “prevent gambling through futures markets” and to restrict exchanges from “construct[ing] an ‘event contract’ around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament.” *See* 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. None of the Super Bowl, the Kentucky Derby, or the Masters Golf Tournament are, of themselves, “gaming.” Rather, the statement of Senator Lincoln, who is identified in the colloquy as one of the authors of CEA section 5c(c)(5)(C), focuses on the overall characteristics of the contract. It does not base the evaluation of whether the contract involves an enumerated activity – here, “gaming” – on the underlying alone. Indeed, it is difficult to conceive of a contract whose underlying event, itself, is “gaming.” If “involve” were to refer only to a contract’s underlying, contracts based on the outcome of sporting events such as horse races and football games would not qualify, because sports typically are not understood to be “gaming” – they are understood to be “games.” In effect, if “involve” were to refer only to a contract’s underlying, the scope of certain prongs of CEA section 5c(c)(5)(C)(i) could effectively be limited to a null set of event contracts, which could not have been Congress’s intent.

¹⁹ For example, giving the term its ordinary meaning, a contract “involves” one of the activities enumerated in CEA section 5c(c)(5)(C)(i) if trading in the contract amounts to the enumerated activity.

Gaming

WHEREAS, the term “gaming” is not defined in the CEA or Commission regulations.

WHEREAS, as discussed above, an undefined term in a statute is generally given its ordinary meaning, and to determine the ordinary meaning of undefined statutory terms, courts typically look to dictionary definitions for guidance. In addition, courts consider the construction of similar terms in other statutes, as well as the purpose of the statute being interpreted.²⁰

WHEREAS, the term “gaming” includes betting or wagering on elections, as demonstrated by the following:

- A. Dictionaries define the term “gaming” to mean “gambling.”²¹
- B. Under most state laws, “gambling” involves a person staking something of value upon the outcome of a game, contest, or contingent event.²²

²⁰ See, e.g., *Sanders v. Jackson*, 209 F.3d 998, 1000-02 (7th Cir. 2000).

²¹ See, e.g., *Gaming Definition*, MERRIAM-WEBSTER.COM, <http://www.merriam-webster.com/dictionary/gaming> (defining the noun “gaming” as “the practice or activity of playing games for stakes: gambling”) (last visited March 14, 2023); *Gaming Definition*, DICTIONARY.COM, <https://www.dictionary.com/browse/gaming> (defining “gaming” as “gambling”) (last visited Sept. 7, 2023); *Gaming Definition*, Black’s Law Dictionary, <https://thelawdictionary.org/gaming/> (last visited September 10, 2023) (refers to gambling as gaming and cross-refers the definition to gambling).

²² See, e.g., GA. CODE ANN. § 16-12-21(a)(1) (West 2020) (“ . . . A person commits the offense of gambling when he . . . [m]akes a bet upon the partial or final result of any game or contest or upon the performance of any participant in such game or contest”); KY. REV. STAT. ANN. § 528.010(6)(a) (West 2023) (“‘Gambling’ means staking or risking something of value upon the outcome of a contest, game, gaming scheme, or gaming device which is based upon an element of chance, in accord with an agreement or understanding that someone will receive something of value in the event of a certain outcome.”); MICH. COMP. LAWS § 750.301 (2023) (“Any person or his or her agent or employee who, directly or indirectly, takes, receives, or accepts from any person any money or valuable thing with the agreement, understanding or allegation that any money or valuable thing will be paid or delivered to any person where the payment or delivery is alleged to be or will be contingent upon the result of any race, contest, or game or upon the happening of any event not known by the parties to be certain”); N.Y. PENAL LAW § 225.00(2) (McKinney 2015) (“A person engages in gambling when he stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.”); TEX. PENAL CODE ANN. § 47.02(a) (West 2019) (“A person commits an offense [of gambling] if he: (1) makes a bet on the partial or final result of a game or contest or on the performance of a participant in a game or contest”); VA. CODE ANN. § 18.2-325(1) (West 2022) (“‘Illegal gambling’ means the making, placing, or receipt of any bet

- C. The Unlawful Internet Gambling Enforcement Act (“UIGEA”), a federal statute, defines 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, 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”²³
- D. To bet or wager on elections is to stake something of value upon the outcome of contests of others, namely, contests between electoral candidates.
- E. Several state statutes, on their face, link the terms “gaming” or “gambling” to betting or wagering on elections.²⁴

or wager . . . of money or other consideration or thing of value, made in exchange for a chance to win a prize, stake, or other consideration or thing of value, dependent upon the result of any game, contest, or any other event the outcome of which is uncertain or a matter of chance”)

²³ 31 U.S.C. § 5362(1)(A). The UIGEA, 31 U.S.C. §§ 5361-5367 (2006), prohibits gambling businesses from knowingly accepting payments in connection with the participation of another person in a bet or wager that involves the use of the Internet and that is unlawful under any federal or state law. Unlike the Wire Act, 28 U.S.C. § 1084 (1961), the UIGEA defines a “bet or wager”, but it criminalizes it only if it is connected with unlawful Internet gambling that violates any federal or state law. *See* 31 U.S.C. § 5362. The UIGEA does not alter the definitions in other federal and state laws and expressly excludes any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the CEA from the definition of “bet or wager.” *See id.* at § 5362 (1)(E).

²⁴ *See, e.g.*, 720 ILL. COMP. STAT. ANN. 5/28-1 (West 2011) (“A person commits gambling when he . . . [m]akes a wager upon the result of any game, contest, or any political nomination, appointment or election”); NEB. REV. STAT. § 28-1101(4) (2011) (“A person engages in gambling if he or she bets something of value . . . upon the outcome of a game, contest, or election”); N.M. STAT. ANN. § 44-5-10 (1978) (“Bets and wagers authorized by the constitution and laws of the United States, or by the laws of this state, are gaming within the meaning of this chapter.”); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011) (“Gambling means risking any money . . . upon . . . the happening or outcome of an event, including an election . . . over which the person taking the risk has no control.”). *See also* GA. CODE ANN. § 16-12-21(a)(2) (West 2011) (“A person commits the offense of gambling when he . . . [m]akes a bet upon the result of any political nomination, appointment, or election”); MISS. CODE ANN. § 97-33-1 (West 2011) (“If any person . . . shall wager or bet . . . upon the result of any election . . . he shall be fined in a sum not more than Five Hundred Dollars”); S.C. CODE ANN. § 16-19-90 (2011) (“Any person who shall make any bet or wager of money . . . upon any election in this State shall be guilty of a misdemeanor”); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011) (“A person commits an offense if he . . . makes a bet on the result of any political nomination, appointment, or election”).

WHEREAS, the Congressional Control Contracts involve “gaming,” pursuant to CEA section 5c(c)(5)(C)(i) and Commission Regulation 40.11(a)(1), because taking a position in the Congressional Control Contracts would be staking something of value upon the outcome of a contest of others. The Congressional Control Contracts are premised on the outcome of Congressional election contests, which ultimately determine the party affiliation of the Speaker and the Pres Pro Temp.²⁵

²⁵ Kalshi argues that elections are not “contests” even if they are at base competitions, and that, if the Congressional Control Contracts constitute gaming, all event contracts are also arguably gaming. Certain commenters agreed, with one arguing that the Congressional Control Contracts are no more like gaming than anything else trading in traditional financial markets, and another arguing that recognizing the Congressional Control Contracts as gaming would imply that all futures contracts are gaming. The Commission disagrees, and notes, first, that it is common parlance to refer to elections as contests. *See, e.g., A Frozen Needle in GOP Contest*, The Washington Post (Sept. 3, 2023); *Biden: Dems revitalizing manufacturing*, Houston Chronicle (Sept. 10, 2022) (discussing the “contest to control Congress”). One commenter similarly stated that elections fall squarely within the definition of a “contest,” citing the following definition in the Cambridge English Dictionary: “a competition to do better than other people, esp. to win a prize or achieve a position of leadership or power: ‘In the last election, he survived a close contest against a political newcomer.’” Moreover, the Commission reiterates that many state statutes, on their face, specifically link the terms gaming and gambling to betting or wagering on elections. As such, unlike all futures contracts (or all financial instruments), the Congressional Control Contracts fall squarely within statutory definitions of gaming. More generally, the Commission notes that a common thread throughout the large majority of definitions of “gaming” and “gambling” is the act of staking something of value on the outcome of a contest of others. To take a position in the Congressional Control Contracts would be to stake something of value upon the outcome of a contest of others, since the Congressional Control Contracts are premised on the outcome of contests between electoral candidates (which ultimately determine the party affiliation of the Speaker and the Pres Pro Temp). By contrast, futures contracts traditionally have not been premised on the outcome of a contest of others. As discussed *infra*, futures contracts traditionally have served hedging and risk management functions, and have therefore been designed to correlate to direct and quantifiable changes in the price of commodities or other financial assets or instruments. As also discussed *infra*, the economic impacts of the outcome of contests for Congressional control are too diffuse and unpredictable to serve the hedging and risk management functions that futures contracts have traditionally been intended to serve.

Activity That Is Unlawful Under State Law

WHEREAS, in many states, betting or wagering on elections is prohibited by statute²⁶ or common law.²⁷

²⁶ ARIZ. REV. STAT. ANN. § 16-1015 (“A person who, before or during an election provided by law, knowingly makes, offers or accepts a bet or wager . . . upon any contingency whatever arising out of [an] election, is guilty of a class 2 misdemeanor.”); ARK. CODE ANN. § 7-1-103 (20) (West) (“No person shall make any bet or wager upon the result of any election . . .”); COLO. REV. STAT. ANN. § 31-10-1531 (West) (“It is unlawful for any person, including any candidate for public office, before or during any municipal election, to make any bet or wager with a qualified elector or take a share or interest in, or in any manner become a party to, any such bet or wager or provide or agree to provide any money to be used by another in making such bet or wager upon any event or contingency whatever arising out of such election.”); GA. CODE. ANN. § 16-12-21(a)(2) (West 2011) (“A person commits the offense of gambling when he . . . [m]akes a bet upon the result of any political nomination, appointment, or election . . .”); IDAHO CODE ANN. § 18-2314 (West) (“Every person who makes, offers, or accepts any bet or wager upon the result of any election . . . is guilty of a misdemeanor.”); 720 ILL. COMP. STAT. ANN. 5/28-1 (West 2011) (“A person commits gambling when he . . . [m]akes a wager upon the result of any game, contest, or any political nomination, appointment or election . . .”); MD CODE, ELECTION LAW § 16-902 (“A person may not make a bet or wager on the outcome of an election held under this article.”); MICH COMP. LAWS ANN. § 168.931 (I) (West) (“A person shall not keep a room or building for the purpose, in whole or in part, of recording or registering bets or wagers, or of selling pools upon the result of a political nomination, appointment, or election.”); MISS. CODE ANN. § 97-33-1 (West 2011) (“If any person . . . shall wager or bet . . . upon the result of any election . . . he shall be fined in a sum not more than Five Hundred Dollars . . .”); NEB. REV. STAT. § 28-1101(4) (2011) (“A person engages in gambling if he or she bets something of value . . . upon the outcome of a game, contest, or election . . .”); NEV. REV. STAT. ANN. § 293.830 (West) (“Any person who makes, offers or accepts any bet or wager upon the result of any election . . . is guilty of a gross misdemeanor.”); N.J. STAT. ANN. § 19:34-24 (West) (“No person shall make, lay or deposit any bet, wager or stake, to be decided by the result of any election . . . or by any contingency connected with or growing out of any election.”); N.C. GEN. STAT. ANN. § 163-274 (“It shall be unlawful . . . [f]or any person to bet or wager any money or other thing of value on any election.”); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011) (“Gambling’ means risking any money . . . upon . . . the happening or outcome of an event, including an election . . .”); OKLA STAT. ANN. TIT. 21, § 181 (West) (“Every person who makes, offers or accepts any bet or wager upon the result of any election . . . is guilty of a misdemeanor.”); OR. REV. STAT. ANN. § 260.635 (West) (“No candidate shall make or become party to a bet of anything of pecuniary value on any event or contingency relating to a pending election” and “[n]o person, to influence the result of any election, shall make a bet of anything of pecuniary value on the result of a pending election, or on any event relating to it.”); 18 PA. STAT. § 5514 (West) (“A person is guilty of a misdemeanor of the first degree if he . . . receives, records, registers, forwards, or purports or pretends to forward, to another, any bet or wager upon the result of any political nomination, appointment or election . . .”); S.C. CODE ANN. § 16-19-90 (2011) (“Any person who shall make any bet or wager of money . . . upon any election in this State shall be guilty of a misdemeanor . . .”); TENN. CODE ANN. § 2-19-129 (West) (“A person commits a Class C misdemeanor if such person makes any bet or wager of money or other valuable thing upon any election.”); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011) (“A person commits an offense if he . . . makes a bet on the result of any political nomination, appointment, or election . . .”); W. VA. CODE ANN. § 3-9-22 (West) (“It shall be unlawful to bet or wager money or other thing of value on any election held in this state”). A number of states also have more limited statutes in place. See, e.g., S.D. CODIFIED LAWS § 12-26-19 (“Any person who shall directly or indirectly make a bet with a voter depending upon the result of any election, with the intent thereby to procure the challenge of such voter or to prevent his voting at an election, is guilty of a Class 2 misdemeanor.”); WIS. STAT. ANN. § 6.03 (West) (“No person shall be allowed to vote in any election in which the person has made or become interested, directly or indirectly, in any bet or wager depending upon the result of the election.”).

WHEREAS, the Congressional Control Contracts involve “activity that is unlawful under ... State law,” pursuant to CEA section 5c(c)(5)(C)(i) and Commission Regulation 40.11(a)(1), because taking a position in the Congressional Control Contracts would be staking something of value upon the outcome of contests between electoral candidates (which ultimately

²⁷ Alabama, *White v. Yarbrough*, 16 Ala. 109, 110 (1849) (“A wager on an election is void as against public policy”); Arkansas, *Williams v. Kagy*, 3 S.W.2d 332, 333-34, 176 Ark. 484, 3 (1928) (“Even before the passage of the statute quoted, this court ruled . . . that wagers upon elections then pending are calculated to endanger the peace and harmony of society and have a corrupting influence upon the morals and are contrary to sound policy”); Colorado, *Maher v. Van Horn*, 60 P. 949, 17-18 (Colo. 1900) (“[W]ager contracts on the result of elections are contrary to public policy and void and will not be enforced by the courts”); Delaware, *Gardner v. Nolen*, 3 Del. 420, 420 (Del. Super. Ct. 1842) (“As within the policy of prohibiting betting on elections, an election wager cannot be recovered though laid after the closing of the polls”); Georgia, *McLennan v. Whidon*, 48 S.E. 201, 202-03, 120 Ga. 666 (1904), quoting *Leverett v. Stegal*, 23 Ga. 259 (1857) (finding that all gambling contracts are illegal but noting that “If there be any class of gambling contracts which should be frowned upon more than another it is bets on elections. They strike at the foundations of popular institutions, corrupt the ballot box, or, what is tantamount to it, interfere with the freedom and purity of elections”); Indiana, *Worthington v. Black*, 13 Ind. 344, 344-345 (1859) (“It has been often decided that wagers upon the result of an election are against the principles of sound policy, and consequently illegal . . .”); Iowa, *David v. Ransom*, 1 Greene 383, 383-85 (Iowa 1848) (“A wager or bet made between parties on the result of an election is void. If the wager is made before an election, illegal votes are often secured, and others induced, contrary to the better judgment of the voter; or if made after an election, the parties interested might be led to exert a corrupt influence upon the canvassing, and returns of the votes”); Kansas, *Reynolds v. McKinney*, 4 Kan. 94, 101 (1866) (“[A bet] involving an inquiry into the validity of the election of a public officer. . . . was therefore, illegal and void on principles of public policy”); Massachusetts, *Ball v. Gilbert*, 53 Mass. 397, 400-02 (1847) (a wager upon the event of an election to a public office - at the federal, state, or local level - is illegal and void on numerous public policy grounds); Missouri, *Hickerson v. Benson*, 8 Mo. 8 (1843) (wagers on the result of public elections and collateral matters are “clearly” against public policy and “sound morality” and consequently illegal and void at common law); Nebraska, *Specht v. Beindorf*, 56 Neb. 553, 76 N.W. 1059 (1898) (promissory note premised on the election of a public official is a wager on the result of an election and void on grounds of public policy); New York, *Rust v. Gott*, 1828 WL 1964 (N.Y. Sup. Ct. 1828) (wager on the event of an election is illegal and void, even where made after the poll of election is closed but before the canvass is complete); North Carolina, *Bettis v. Reynolds*, 34 N.C. 344, 345-48 (1851) (“the practice of betting on elections has a direct tendency to cause undue influence[.]” and even where neither party was a voter, a wager on the result of a Presidential election void as against public policy); Oregon, *Willis v. Hoover*, 9 Or. 418, 419-20 (1881) (wagers on the result of public elections are illegal and void upon grounds of public policy); Rhode Island, *Stoddard v. Martin*, 1 R.I. 1, 1 (1828) (all wagers on elections and judicial decisions “are of immoral tendency, against sound policy,” and therefore void); Tennessee, *Russell v. Pyland*, 21 Tenn. 131, 133 (1840) (a note premised on the outcome of an election is illegal and void under common law principles); Texas, *Thompson v. Harrison*, 1842 WL 3625, at *1 (Tex. 1842) (wagers on the result of public elections are “contrary to good morals” and void on grounds of public policy); Wisconsin, *Murdock v. Kilbourn*, 6 Wis. 468, 470-71 (1857) (wager upon the event of a public election is contrary to public policy, illegal, and void).

determine the party affiliation of the Speaker and the Pres Pro Temp), and in many states such conduct is illegal.²⁸

The Congressional Control Contracts Are Contrary to the Public Interest

WHEREAS, the Commission has evaluated whether the Congressional Control Contracts are contrary to the public interest.

WHEREAS, the legislative history of CEA section 5c(c)(5)(C) indicates Congressional intent for the Commission to consider, among other things, in its evaluation of whether a contract is contrary to the public interest for purposes of that provision, a form of the “economic purpose test” that was applied to determine whether a contract was contrary to the public interest under former CEA section 5(g) prior to its deletion by the Commodity Futures Modernization Act of 2000 (“CFMA”).²⁹

²⁸ Kalshi argues that many state gaming laws carve out exceptions for Commission-regulated products and, relatedly, that the Commission’s jurisdiction over futures and swaps preempts any state gaming laws as to those products. Seen in this context, Kalshi argues, the state laws that prohibit betting or wagering on elections do not and cannot refer to Commission-regulated event contracts, and the Congressional Control Contracts are therefore not unlawful under state law. This misses the point. CEA section 2(a)(1) grants the Commission “exclusive jurisdiction” over futures and swaps traded on a DCM. 7 U.S.C. § 2(a)(1). This “preempts the application of state law,” *Leist v. Simplot*, 638 F.2d 283, 322 (2d Cir. 1980), so transacting these products on a DCM cannot, in and of itself, be an “activity that is unlawful under any ... State law.” On the other hand, these products may still “involve ... activity” that is unlawful under a state law, in the sense, for example, that transactions in the products may “relate closely” to, “entail,” or “have as an essential feature or consequence” an activity that violates state law. *See* Merriam-Webster, available at <https://www.merriam-webster.com/dictionary/involve> (last visited Oct. 12, 2022); Random House College Dictionary 703 (Revised ed. 1979); Riverside University Dictionary 645 (1983). Here, state laws (that are not preempted by the CEA) prohibit wagering on elections. Taking a position in the Congressional Control Contracts would be staking something of value on the outcome of contests between electoral candidates, such that wagering on elections is “an essential feature or consequence” of the contracts. Thus, while transactions in the Congressional Control Contracts on a DCM do not violate, for example, state bucket-shop laws, they nevertheless involve an activity that is unlawful in a number of states—wagering on elections. To permit such transactions on a DCM would undermine important state interests expressed in statutes separate and apart from those applicable to trading on a DCM.

²⁹ 7 U.S.C. § 7(g), as amended by the Commodity Futures Trading Commission Act of 1974, Pub. L. 93-463, 8 Stat. 1389 (1974). In the colloquy between Senator Feinstein and Senator Lincoln on the Senate floor regarding the proposed Dodd-Frank Act provision that ultimately was enacted as CEA section 5c(c)(5)(C), Senator Feinstein referenced the Commission’s pre-CFMA authority “to prevent trading that is contrary to the public interest,” and asked Senator Lincoln whether, with respect to CEA section 5c(c)(5)(C), the intent was to “define ‘public interest’ broadly so that the CFTC may consider the extent to which a proposed derivative contract would be used

WHEREAS, the general “Findings and Purpose” provision of the CEA, at CEA section 3, states that “[t]he transactions subject to [the CEA] . . . are affected with a 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 secure financial facilities,”³⁰ and thus recognizes hedging – and, in particular, price hedging (the “managing [of] price risks”) – as a public interest that transactions subject to the CEA are intended to serve.

WHEREAS, the Commission has the discretion to consider other factors in its evaluation of whether a contract is contrary to the public interest for purposes of CEA section 5c(c)(5)(C), and the legislative history of CEA section 5c(c)(5)(C) supports consideration of whether a contract may threaten the public good.³¹

predominantly by speculators or participants not having a commercial or hedging interest.” Senator Feinstein asked whether the Commission would “have the power to determine that a contract is a gaming contract if the predominant use of the contract is speculative as opposed to a hedging or economic use[.]” and Senator Lincoln replied, “That is our intent.” See 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at <https://www.congress.gov/111/crcc/2010/07/15/CREC-2010-07-15-senate.pdf>. Pre-CFMA Commission guidelines articulated the economic purpose test as an evaluation of “whether [a] contract reasonably can be expected to be, or has been, used for hedging and/or price basing on more than an occasional basis.” 17 C.F.R. § 5, Appendix A- Guideline No. 1 (repealed 2001). The colloquy between Senators Feinstein and Lincoln suggests a modification of the “on more than an occasional basis” standard; it suggests that the Commission should consider whether a contract is used predominantly by speculators or market participants not having a commercial or hedging interest.

³⁰ CEA section 3(a); 7 U.S.C. § 5(a). Section 3 further states that it is the purpose of the CEA to serve such public interests “through a system of effective self-regulation of trading facilities, clearing systems, market participants and market professionals under the oversight of the Commission.” CEA section 3(b); 7 U.S.C. § 5(b).

³¹ In the colloquy on the Senate floor, Senator Lincoln further confirmed for Senator Feinstein that CEA section 5c(c)(5)(C) would empower the Commission to prevent trading in contracts “that may serve a limited commercial function but threaten the public good by allowing some to profit from events that threaten our national security.” Senator Lincoln cited terrorist attacks, war and hijacking as examples of events that “pose a real commercial risk to many businesses in America,” but stated that “a futures contract that allowed people to hedge that risk would also involve betting on the likelihood of events that threaten our national security. That would be contrary to the public interest.” Senator Feinstein thanked Senator Lincoln for this confirmation, concluding that, “[a] futures market is for hedging.” See 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at <https://www.congress.gov/111/crcc/2010/07/15/CREC-2010-07-15-senate.pdf>.

WHEREAS, in light of the foregoing, in evaluating whether the Congressional Control Contracts are contrary to the public interest, the Commission has considered the contracts' hedging utility and price-basing utility.³² Additionally, the Commission has considered the potential impact that trading in the Congressional Control Contracts may have on election integrity, or the perception of election integrity – as well as the extent to which permitting trading in the Congressional Control Contracts could require the Commission to assume a role in overseeing the electoral process.³³

Hedging and Price Basing Utility

WHEREAS, control of a chamber of Congress does not, in and of itself, have sufficiently direct, predictable, or quantifiable economic consequences for the Congressional Control Contracts to serve an effective hedging function.

WHEREAS, the Commission has considered comments from Kalshi and others that state that Congressional control impacts a wide variety of assets and cash flows, for a variety of

³² See footnote 29, *supra*.

³³ In making findings regarding whether the Congressional Control Contracts are contrary to the public interest, the Commission distinguishes two staff no-action positions referenced by some commenters that have been issued by the Commission's Division of Market Oversight ("Division") to two academic institutions. Subject to specified terms, these no-action positions state that the Division will not recommend enforcement action against the academic institutions for operating, without registration as a DCM, SEF, or foreign board of trade, small-scale not-for-profit markets that offer trading in political and economic indicator event contracts for academic purposes. CFTC Staff Letter No. 93-66 (June 18, 1993), issued to the University of Iowa, *available at* <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/93-66.pdf>; CFTC Staff Letter No. 14-130 (Oct. 29, 2014), issued to Victoria University of Wellington, New Zealand, *available at* <https://www.cftc.gov/csl/14-130/download>. The terms of these staff no-action positions contemplate that each market will be operated by the relevant academic institution for academic purposes and without compensation. The terms of the no-action positions also contemplate limitations on, among other things, the number of market participants and the number of contracts that each market participant may hold. In issuing the no-action positions, the Division did not recognize the political event contracts that would be offered by the markets as having hedging or price-basing utility. In issuing each of the no-action positions, the Division explicitly noted that it was not rendering an opinion on the legality of the academic institutions' activities under state law. Kalshi has not submitted that the Congressional Control Contracts would be subject to analogous limitations to those contemplated under the Division's no-action positions, including limitations providing for the market for the Congressional Control Contracts to be operated on a small-scale, not-for-profit basis for academic purposes.

entities, and that market participants already engage in behavior aimed at hedging risks related to Congressional control. Kalshi notes that Congress has extensive powers to influence the economy and that shifts in political power often portend changes in policy.

WHEREAS, the Commission has considered detailed examples provided by Kalshi of statements from private research firms attempting to predict broad-ranging economic impacts of various political outcomes, and academic research indicating that the marketplace generally considers political risks in its operation (citing, for example, links between changes in the price of equities and other assets, and expected changes in Congressional control).

WHEREAS, the Commission has also considered similar assertions from commenters that the effect of Congressional control on the economy is sufficiently predictable and measurable for the Congressional Control Contracts to have a hedging purpose.

WHEREAS, conversely, several commenters expressed the view that the economic effects of Congressional control are too attenuated and unpredictable for the Congressional Control Contracts to serve as an effective hedging tool.

WHEREAS, the Commission finds that while control of a chamber of Congress may ultimately have economic effects, those eventual economic effects are both diffuse and unpredictable. While the likelihood of adoption of a given policy may increase or decrease based on the composition of Congress, many intervening events and variables exist between control of a chamber of Congress and the actual implementation of such a policy.³⁴ Furthermore,

³⁴ There are several steps required to enact legislation. Proposed legislation must be approved by both chambers of Congress and by signature of the president or a Congressional override of a presidential veto. During that process, the nature of proposed legislation can change in dramatic ways. Beyond that, legislation requires implementation and is subject to judicial review. All of these dynamics make it difficult to predict the nature, magnitude, and timing of policy outcomes resulting from a given party's control of a chamber of Congress.

the likelihood of implementation is not dependent on control of a chamber of Congress alone; it also depends upon many other things, including, for example, whether a party controls one or both chambers of Congress, the size of its majority, votes by individual party members, and the political affiliation of the president.

WHEREAS, control of a chamber of Congress could, following a number of independent intervening events, generally affect a wide variety of personal liabilities and economic factors, but that does not establish that the Congressional Control Contracts can be used for specific, identifiable hedging purposes and thus does not establish the hedging utility of the Congressional Control Contracts. Rather, it further indicates that control of a chamber of Congress does not have a direct, predictable, or quantifiable impact on any commodity or other financial asset.³⁵

WHEREAS, the Congressional Control Contracts result, upon settlement, in a payout of either \$1 or \$0, depending on the party in control of the relevant chamber of Congress, with settlement and payout occurring only once every two years, to coincide with the election cycle.

³⁵ Kalshi implies that the Congressional Control Contracts should be permitted to trade because certain other contracts currently trading on Commission-regulated exchanges involve a degree of removal from the actual risk that is intended to be hedged. As a preliminary matter, the Commission notes that an exchange's certification of a product for trading pursuant to CEA section 5c(c)(1) and Commission Regulation 40.2 does not entail or amount to Commission approval of that product. Further, while Kalshi does not cite to specific contracts in most of the examples it provides, the contracts that Kalshi appears to be referring to for comparison generally have more specific and targeted hedging utility than the Congressional Control Contracts and are otherwise materially different from such contracts. For example, Heating and Cooling Degree Day futures contracts that Kalshi appears to reference do not settle based on an overarching nationwide heating degree day/cooling degree day calculation – they settle based on a calculation at a very specific location. Similarly, real estate index contracts that Kalshi appears to reference settle based on the value of the index in a specific metropolitan area, with the index itself based on real estate price values. In contrast, the Congressional Control Contracts are based on which political party will control the relevant chamber of Congress – they are not based on or tied to any actual price or related values. Furthermore, certain of the event contracts that Kalshi appears to reference do not fall within the scope of CEA section 5c(c)(5)(C) and Commission Regulation 40.11 – which apply with respect to contracts in certain types of excluded commodities – and most of the contracts that Kalshi appears to reference are not event contracts at all.

WHEREAS, the payout for the Congressional Control Contracts is not tied in any way to actual or estimated losses incurred elsewhere, and a loss on the Congressional Control Contracts is not offset by a related gain elsewhere, as is the case for contracts with hedging and risk management capabilities.

WHEREAS, the binary payout of the Congressional Control Contracts further limits their utility as a vehicle for hedging any eventual economic effects resulting from which party controls a chamber of Congress, as does their frequency of settlement.

WHEREAS, price-basing occurs when producers, processors, merchants, or consumers of a commodity establish commercial transaction prices based on the futures price for that or a related commodity.³⁶

WHEREAS, the Commission has considered comments from Kalshi and others that the outcome of Congressional elections could affect the pricing of a number of diverse commercial transactions because the outcome could impact the pricing of various commodities underlying those transactions.

WHEREAS, other commenters stated that the Congressional Control Contracts cannot have price-basing utility for the same reason that they do not have hedging utility – namely, that the economic ramifications of an election are indirect and unpredictable, and therefore cannot help determine the price of a commodity or financial asset in a predictable manner.

WHEREAS, even if some level of political risk may be embedded in the pricing of many commercial transactions, that does not, in itself, support a finding that the Congressional Control Contracts serve a price-basing function.

³⁶ See CFTC Futures Glossary, available at <https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/CFTCGlossary/index.htm#P>.

WHEREAS, since the economic effects of control of a chamber of Congress are diffuse and unpredictable, the price of the Congressional Control Contracts is not directly correlated to the price of any commodity, and so the price of the Congressional Control Contracts could not predictably be used to establish commercial transaction prices.

WHEREAS, in light of the foregoing, the Commission finds that it has not been demonstrated that the Congressional Control Contracts could reasonably be expected to be used for hedging and/or price basing on more than an occasional basis or that the Congressional Control Contracts could reasonably be expected to be used predominantly by market participants having a commercial or hedging interest.

Election Integrity and the Commission's Role in the Electoral Process

WHEREAS, more than 600 commenters – a significant proportion of the public commenters on the Submission – expressed concerns about the effect that the Congressional Control Contracts could have on election integrity, including concerns that the Congressional Control Contracts are inconsistent with ideals of democracy and the sanctity of the electoral process.

WHEREAS, these commenters included members of Congress, who expressed concern about the potential impact of the Congressional Control Contracts on the electoral process. A comment letter from six United States Senators stated that “[e]stablishing a large-scale, for-profit political event betting market in the United States ... would profoundly undermine the sanctity and democratic value of elections ... There is no doubt that mass commodification of our

democratic process would raise widespread concerns about the integrity of our electoral process.”³⁷

WHEREAS, the Congressional Control Contracts could potentially be used in ways that would have an adverse effect on the integrity of elections, or the perception of integrity of elections – for example, by creating monetary incentives to vote for particular candidates, even when such votes may be contrary to a voter’s (or an organized group of voters’) political preferences or views of such candidates.

WHEREAS, the Congressional Control Contracts raise concerns that conduct designed to artificially affect the electoral process could also, intentionally or otherwise, manipulate the market in the Congressional Control Contracts, or that the market in the Congressional Control Contracts could be manipulated to influence elections or electoral perceptions. In particular, several commenters (including members of Congress) stated that the Congressional Control Contracts could incentivize the spread of misinformation by individuals or groups seeking to influence perceptions of a political party or a party candidate’s success.

WHEREAS, the public interest in guarding against such misinformation is all the more pressing in the context of contracts rooted in the outcome of United States federal elections.³⁸

³⁷ The signatories to the letter are Senators Jeffrey Merkley, Sheldon Whitehouse, Edward Markey, Elizabeth Warren, Chris Van Hollen, and Diane Feinstein (the “Six Senators”). Senator Amy Klobuchar filed a separate comment letter expressing “concern” with the Submission. The comment letter from the Six Senators underscores differences between a potential market for the Congressional Control Contracts and the markets for political event contracts in respect of which the Division has previously issued staff no-action positions. Kalshi is a for-profit entity seeking to offer a broad-based market in the Congressional Control Contracts. Kalshi has not submitted that the Congressional Control Contracts would be subject to analogous limitations to those contemplated under the Division’s no-action positions. In particular, Kalshi has not submitted that the markets for the Congressional Control Contracts would be operated on a small-scale, not-for-profit basis for academic purposes.

³⁸ Kalshi cites to a paper on the history of election betting in the United States for the premise that such betting did not negatively affect the political process. See Paul Rhode and Coleman Strumpf, “Historical Presidential Betting Markets,” *Journal of Economic Perspectives*, Vol. 18, No. 2 (Spring 2004). The Commission notes that the markets examined in that study existed in a very different historical context – before 1940 – and that the study nonetheless

WHEREAS, the Congressional Control Contracts have no underlying cash market with bona fide economic transactions to provide directly correlated price forming information. Rather, price forming information for the Congressional Control Contracts is driven in large measure by polling, voter surveys, and other informational sources that are unregulated, frequently have opaque underlying processes and procedures, and may not follow scientifically reliable methodologies. This differs from the 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.) used for pricing the vast majority of commodities underlying Commission-regulated derivatives contracts.

WHEREAS, the opaque and unregulated sources of price forming information for the Congressional Control Contracts may increase the risk of manipulative activity relating to the trading and pricing of the contracts, while decreasing Kalshi's and the Commission's ability to detect such activity.

WHEREAS, the Commission has considered assertions by Kalshi and other commenters that the Congressional Control Contracts would serve as a check on misinformation and inaccurate polling, stating that market-based alternatives tend to be more accurate than polling or other methods of predicting election outcomes.

acknowledges both attempts to manipulate the odds and concerns that the betting markets provided a potential means of influencing elections. Several other commenters noted specific examples of manipulation or attempted manipulation incidents on election markets, while others downplayed these incidents.

WHEREAS, there is also research suggesting that election markets may incentivize the creation of “fake” or unreliable information in the interest of moving the market, and a number of commenters also raised this concern.³⁹

WHEREAS, the Congressional Control Contracts prohibit certain individuals and entities likely to have a stake in the outcome of elections from trading in the contracts – including paid employees of political campaigns and major polling organizations. However, these trading prohibitions would not prevent such individuals and entities from engaging in other activity – intended to create the impression of likely electoral success or failure on the part of a particular political candidate or candidates – that could artificially move the market in the Congressional Control Contracts.

WHEREAS, the trading prohibitions for the Congressional Control Contracts also do not exclude all individuals or entities who could have a motivation to create the impression of likely electoral success or failure on the part of a political candidate or candidates.⁴⁰

WHEREAS, if trading in the Congressional Control Contracts were to be permitted, the Commission, as regulator of the markets in those contracts, would be required to investigate suspected manipulation in those markets. By extension, the Commission could find itself investigating election-related activities – potentially including the outcome of an election itself. Several commenters stated that this was not a role for which the Commission is equipped or

³⁹ See Yeagain, Tyler, “Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability,” *Missouri Law Review*, Volume 85, Issue 1 (Winter 2020) *citing* Enten, Harry, “Fake Polls are a Real Problem,” *available at* <https://fivethirtyeight.com/features/fake-polls-arc-a-real-problem/> (Aug. 22, 2017) (noting how a seemingly false or unreliable poll caused significant movement on an event contract market and suggesting that such poll could have been, or at least could be, created to cause such market movement; further arguing that such false polls can have a real and detrimental effect on elections).

⁴⁰ Such individuals and entities could include, for example, Congressional campaign volunteers, consultants to Congressional campaigns, or donors or other supporters of political parties or individual Congressional candidates.

well-suited, with two members of the House of Representative stating in a joint comment letter that “because the CFTC is not equipped or authorized to enforce election laws, the prospect of the Commission assuming the role of an ‘election cop’ raises very serious concerns about the misalignment of such a role with the CFTC’s historic mission and mandate as established by Congress.”⁴¹

Therefore, the Commission FINDS that:

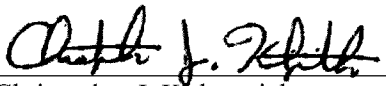
Pursuant to section 5c(c)(5)(C)(i) of the Commodity Exchange Act and Commission Regulation 40.11, the Congressional Control Contracts: (1) involve gaming and activity that is unlawful under State law; and (2) are contrary to the public interest.

Accordingly, IT IS HEREBY ORDERED THAT:

Pursuant to CEA section 5c(c)(5)(C)(ii) and Commission Regulation 40.11(a)(1), the Congressional Control Contracts are prohibited and shall not be listed or made available for clearing or trading on or through Kalshi.

The provisions of this Order shall be effective as of this date.

By the Commission.



Christopher J. Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission

Date: September 22, 2023

⁴¹ Comment Letter of Reps. Sarbanes and Raskin at 3.



DCM Products

UNITED STATES

COMMODITY FUTURES TRADING COMMISSION

Submitter Information	
Organization Name Kalshi	
Organization Type DCM	Organization Acronym KEX
Submitted By xsottile	Email Address xsottile@kalshi.com
Cover Sheet	
Submission Number 2306-1218-0838-36	Submission Date 6/12/2023 6:08:38 PM ET
Submission Type 40.2(a) Product Certification	
Submission Description Will chamber of Congress be controlled by party for term?	
<input checked="" type="checkbox"/> Request Confidential Treatment	
Registered Entity Identifier Code	
Intended Listing Date 6/27/2023	
<input type="checkbox"/> Listing Date Unknown	
Product Information	
Official Product Name Will chamber of Congress be controlled by party for term?	
Product Type Swap (Binary Option)	Settlement Method Cash Settlement
Product Group Event	Product Sub Group Binary Option
<input type="checkbox"/> Novel Product Subject to Jurisdictional Determination	
Product Publication Website	
Documents	
CONTROL CONTRACT for posting.pdf CONTROL CONTRACT confidential.pdf (Confidential Treatment Requested) Additional Materials -- Counsel Letters.pdf Additional Materials -- Pham dissent.pdf	
Request For Confidential Treatment - Detailed Written Justification	

Confirmation Number
2306-1218-0838-36

Submitted
6/12/2023 6:08:38 PM

CFTC Kalshi FOIA Request (contract filing) (latest).pdf

KalshiEX LLC

June 12, 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: KalshiEX LLC - Commission Regulation 40.2(a) Notification Regarding the Initial Listing of the “Will <chamber of Congress> be controlled by <party> for <term>?” Contract

Dear Sir or Madam,

Pursuant to Section 5c(e) of the Commodity Exchange Act and Rule 40.2(a) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi or Exchange) hereby notifies the Commission that it is self-certifying the “Will <chamber of Congress> be controlled by <party> for <term>?” contract (Contract) for Commission review and approval. The Exchange intends to list the contract on a biannual basis (every two years). The Contract’s terms and conditions (Appendix A) include the following strike conditions:

- **<party> (the political party)**
- **<chamber of Congress> (the House or the Senate)**
- **<term> (e.g. the 119th Congress)**

Along with this letter, Kalshi submits the following documents:

- A concise explanation, analysis and background of the Contract;
- Certification;
- Appendix A with the Contract’s Terms and Conditions;
- Confidential Appendices with further information; and
- A request for FOIA confidential treatment.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Xavier Sottile
Head of Markets
KalshiEX LLC
xsottile@kalshi.com

KalshiEX LLC

KalshiEX LLC

KalshiEX LLC
Official Product Name: Will <chamber of Congress> be controlled by <party> for <term>?
Rulebook: CONTROL
Kalshi Contract Category: Political Decision
Control of Congress
June 12, 2023

**CONCISE EXPLANATION AND ANALYSIS OF THE PRODUCT AND ITS
COMPLIANCE WITH APPLICABLE PROVISIONS OF THE ACT, INCLUDING CORE
PRINCIPLES AND THE COMMISSION'S REGULATIONS THEREUNDER**

Pursuant to Commission Regulation 40.2(a)(3)(v), the following is a concise explanation and analysis of the product and its compliance with the Act, including the relevant Core Principles, and the Commission's regulations thereunder.

I. Introduction

The "Will <chamber of Congress> be controlled by <party> for <term>?" Contract (Contract) is a contract relating to the partisan control of Congress.

Further information about the Contract, including an analysis of its risk mitigation and price basing utility, as well as additional considerations related to the Contract, is included in Confidential Appendices.

Pursuant to Section 5c(c) of the Act and CFTC Regulations 40.2(a), the Exchange hereby certifies that the listing of the Contract complies with the Act and Commission regulations under the Act.

General Contract Terms and Conditions: The Contract operates similar to other event contracts that the Exchange lists for trading. The minimum price fluctuation is \$0.01 (one cent). Price bands will apply so that the Contract may only be listed at values of at least \$0.01 and at most \$0.99. The Contract has a one dollar notional value and has a minimum price fluctuation of \$0.01 to be consistent with other Kalshi contracts. Contracts must be purchased in multiples of 5,000 contracts per order. This order size is an appropriate amount for large institutions to mitigate risk and is consistent with other futures and derivatives products. The Exchange has further imposed position limits (defined as maximum loss exposure) as described in Appendix A. As outlined in Rule 5.12 of the Rulebook, trading shall be available at all times outside of any maintenance windows, which will be announced in advance by the Exchange. Members will be charged fees in accordance with Rule 3.6 of the Rulebook. Fees are charged in such amounts as may be revised from time to time to be reflected on the Exchange's Website. Additionally, as

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outlined in Rule 7.2 of the Rulebook, if any event or any circumstance which may have a material impact on the reliability or transparency of a Contract's Source Agency or the Underlying related to the Contract arises, Kalshi retains the authority to designate a new Source Agency and Underlying for that Contract and to change any associated Contract specifications after the first day of trading. That new Source Agency and Underlying would be objective and verifiable. Kalshi would announce any such decision on its website. All instructions on how to access the Underlying are non-binding and are provided for convenience only and are not part of the binding Terms and Conditions of the Contract. They may be clarified at any time. Furthermore, the Contract's payout structure is characterized by the payment of an absolute amount to the holder of one side of the option and no payment to the counterparty. During the time that trading on the Contract is open, Members are able to adjust their positions and trade freely. After trading on the Contract has closed, the Expiration Value and Market Outcome are determined. The market is then settled by the Exchange, and the long position holders and short position holders are paid according to the Market Outcome. In this case, "long position holders" refers to Members who purchased the "Yes" side of the Contract and "short position holders" refers to Members who purchased the "No" side of the Contract. If the Market Outcome is "Yes" (please see Appendix A for the conditions upon which the Market Outcome is "Yes"), then the long position holders are paid an absolute amount proportional to the size of their position and the short position holders receive no payment. If the Market Outcome is "No," then the short position holders are paid an absolute amount proportional to the size of their position and the long position holders receive no payment. Specification of the circumstances that would trigger a Market Outcome of "Yes" are included below in the section titled "Payout Criterion" in Appendix A. The Expiration Date of the Contract is designed to account for multiple possible contingencies regarding the timing of the determination of control of a given chamber of Congress.

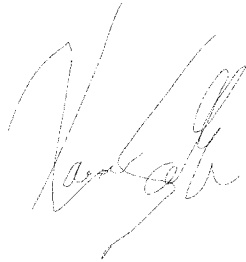
KalshiEX LLC

KalshiEX LLC

**CERTIFICATIONS PURSUANT TO SECTION 5c OF THE COMMODITY EXCHANGE
ACT, 7 U.S.C. § 7A-2 AND COMMODITY FUTURES TRADING COMMISSION RULE
40.2, 17 C.F.R. § 40.2**

The Exchange certifies that this submission (other than those appendices for which confidential treatment has been requested) has been concurrently posted on the Exchange's website at <https://kalshi.com/regulatory/filings>.

Should you have any questions concerning the above, please contact the exchange at ProductFilings@kalshi.com.



By: Xavier Sottile
Title: Head of Markets
Date: June 12, 2023

KalshiEX LLC

KalshiEX LLC

Attachments:

Appendix A - Contract Terms and Conditions

Appendix B - Trading Prohibitions

Index of confidential appendices

Confidential appendices

KalshiEX LLC

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APPENDIX A – CONTRACT TERMS AND CONDITIONS

**Official Product Name: Will <chamber of Congress> be controlled by <party> for <term>?
Rulebook: CONTROL**

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CONTROL

Scope: These rules shall apply to this contract.

Underlying: The Underlying for this Contract is the political party membership of each Member of Congress for <term>, as well as the political party membership of the Speaker of the House and the political party membership of the President Pro Tempore, according to congress.gov. The Exchange will also consider the caucus decisions of Independent members. Revisions to the Underlying made after Expiration will not be accounted for in determining the Expiration Value.

Source Agency: The Source Agency is congress.gov.

Type: The type of Contract is an Event Contract.

Issuance: The Contract is based on the outcome of a recurrent data release, which is issued for each new term of Congress. Thus, Contract iterations will be issued on a recurring basis, and future Contract iterations will generally correspond to the next election cycle.

<chamber of Congress>: refers to a chamber of the United States Congress. It can take the value of “U.S. House of Representatives” or “U.S. Senate”.

<term>: refers to a term of the United States Congress. A term of Congress begins and ends every two years.

<party>: refers to a political party.

Payout Criterion: The Payout Criterion for the Contract encompasses the Expiration Values where the leader of <chamber of Congress> is a member of <party> on the Expiration Date. In the case of the U.S. House of Representatives, this is the Speaker of the House. In the case of the U.S. Senate, this is the President Pro Tempore.

Minimum Tick: The Minimum Tick size for the referred Contract shall be \$0.01.

Position Limit: The Position Limit for the \$1 referred Contract shall be as follows:

- The Position Limit for Individuals shall be \$125,000 per Member; and \$250,000 for those with demonstrated established economic hedging need
- The Position Limit for Entities shall be \$5,000,000 per Member; and \$10,000,000 for those with demonstrated established economic hedging need

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- The Position Limit for Eligible Contract Participants (“ECP”) shall be \$50,000,000 per Member; and \$100,000,000 for those with demonstrated established economic hedging need

Established economic hedging need may be demonstrated to Kalshi according to the means and methods established by Kalshi. Whether a member has demonstrated that it has a sufficiently established economic hedging need is determined solely at Kalshi’s discretion.

Last Trading Date: The Last Trading Date of the Contract will be the same as the Expiration Date. The Last Trading Time will be the same as the Expiration Time.

Settlement Date: The Settlement Date of the Contract shall be no later than the day after the Expiration Date, unless the Market Outcome is under review pursuant to Rule 7.1.

Expiration Date: The Expiration Date of the Contract shall be February 1 in the year that <term> begins.

Expiration time: The Expiration time of the Contract shall be 10:00 AM ET.

Settlement Value: The Settlement Value for this Contract is \$1.

Order Size: Contracts must be purchased in multiples of 5,000 contracts per order.

Expiration Value: The Expiration Value is the value of the Underlying as documented by the Source Agency on the Expiration Date at the Expiration time.

Contingencies: Before Settlement, Kalshi may, at its sole discretion, initiate the Market Outcome Review Process pursuant to Rule 6.3(c) of the Rulebook. Additionally, as outlined in Rule 7.2 of the Rulebook, if any event or any circumstance which may have a material impact on the reliability or transparency of a Contract’s Source Agency or the Underlying related to the Contract arises, Kalshi retains the authority to designate a new Source Agency and Underlying for that Contract and to change any associated Contract specifications after the first day of trading.

Trading Prohibitions: In addition to the general trading prohibitions found in Kalshi’s Rulebook, the following are prohibited from trading this contract:

- Candidates for federal or statewide public office. Please note that this prohibition applies to more than just candidates for Congress.
- Paid campaign staffers on Congressional campaigns.
- Paid employees of Democratic and Republican Party organizations, such as the

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Democratic Congressional Campaign Committee or the Republican National Committee.

- Paid employees of Political Action Committees (PACs) and “Super PACs” (independent expenditure only political committees).
- Paid employees of major polling organizations. This prohibition does not apply to all employees of an organization that contains a polling division (e.g. the prohibition does not apply to all employees of Quinnipiac University despite the presence of Quinnipiac University’s polling division). The Exchange shall determine which polling organizations constitute “major” and may modify that determination at any time.
- Existing members of Congress, including those not running for re-election.
- Existing paid staffers of members of Congress.
- Household members and immediate family members (siblings, children, and parents) of any of the above.
- Any of the above listed institutions themselves.

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APPENDIX B – TRADING PROHIBITIONS

In addition to the general prohibition against trading on material nonpublic information, the Exchange will be instituting additional prohibitions for trading the CONTROL contract. The following individuals and entities will be prohibited from trading:

- Candidates for federal or statewide public office. Please note that this prohibition applies to more than just candidates for Congress.
- Paid campaign staffers on Congressional campaigns.
- Paid employees of Democratic and Republican Party organizations, such as the Democratic Congressional Campaign Committee or the Republican National Committee.
- Paid employees of Political Action Committees (PACs) and “Super PACs” (independent expenditure only political committees).
- Paid employees of major polling organizations. This prohibition does not apply to all employees of an organization that contains a polling division (e.g. the prohibition does not apply to all employees of Quinnipiac University despite the presence of Quinnipiac University’s polling division). The Exchange shall determine which polling organizations constitute “major” and may modify that determination at any time.
- Existing members of Congress, including those not running for re-election.
- Existing paid staffers of members of Congress. Household members and immediate family members (siblings, children, and parents) of any of the above.
- Any of the above listed institutions themselves.

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

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

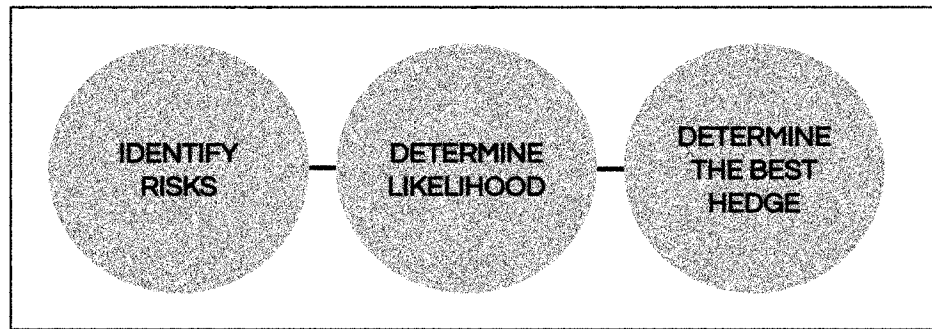
- First, in section A, we will establish how firms generally make risk management decisions and how hedging fits into those decisions;
- Section B sets forth contract specific analysis, which will establish how political control contracts fit into the risk management framework described in section A. 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

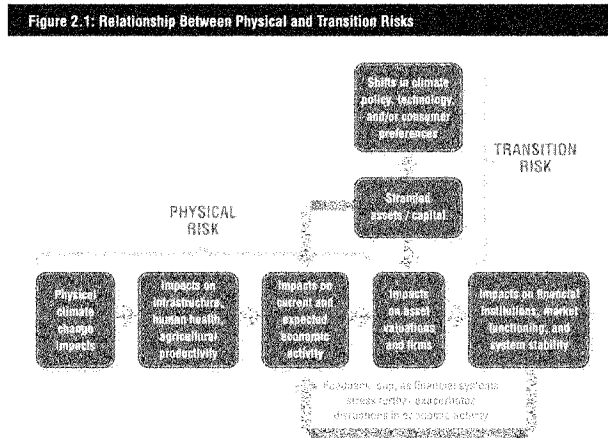
² Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System". <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

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. *State*; 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.

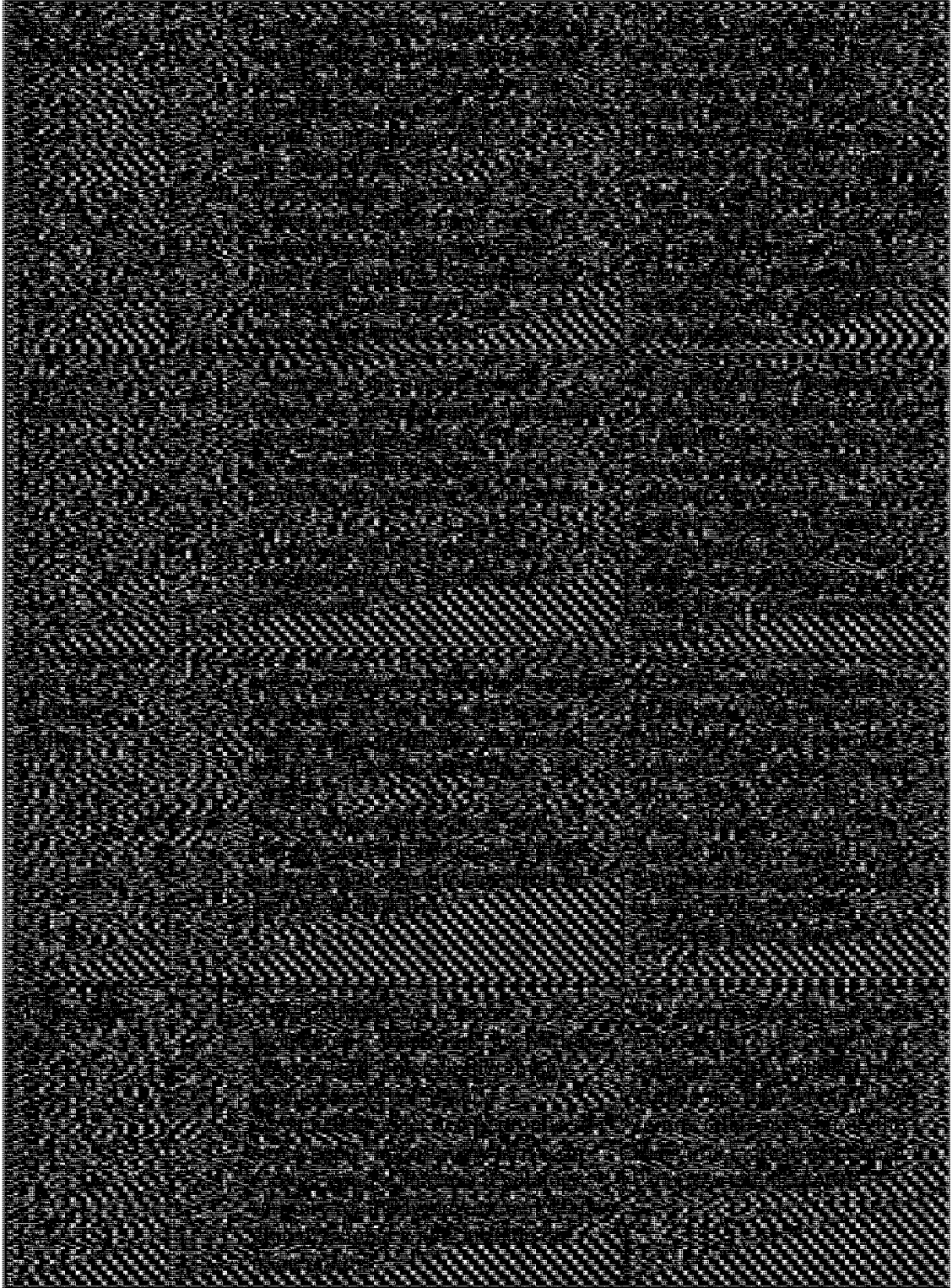
The chart below summarizes this process. [REDACTED] indicate risks that can be mitigated using the CONTROL contract, whereas ~~magenta-colored rows~~ indicate risks that would not be hedged by the CONTROL contract.

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.

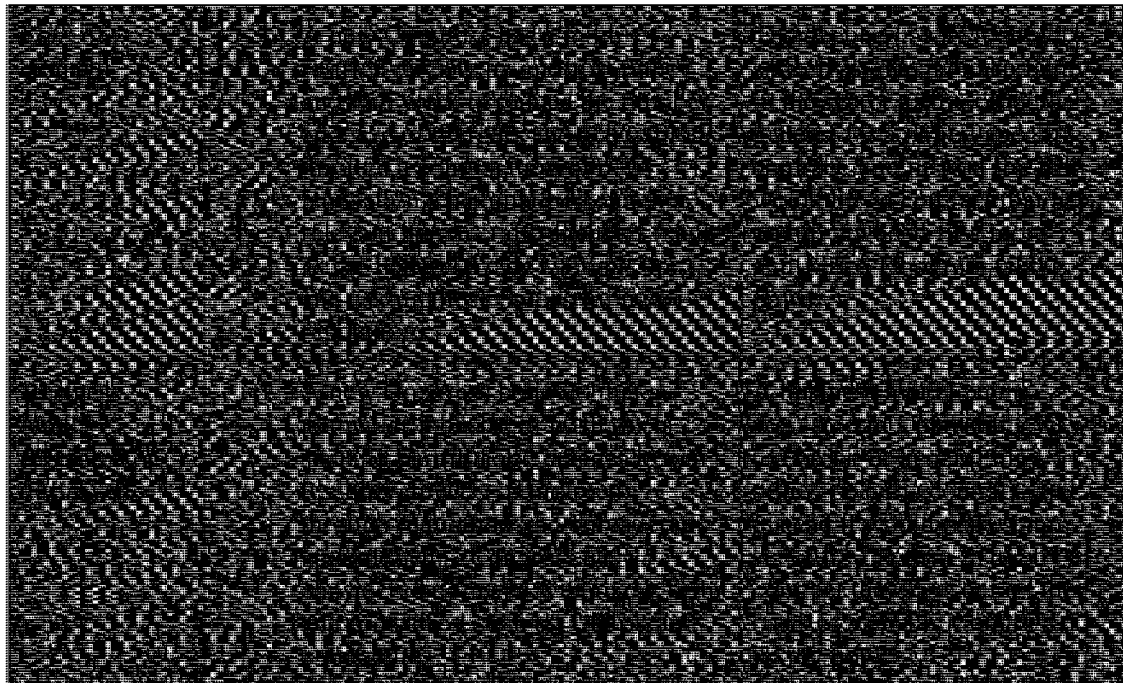
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Loss of expansion opportunities	<ol style="list-style-type: none"> Judicial action strikes down modifications to state-level permitting law reforms, thereby allowing frequent NEPA litigation over site development Interest rates, monetary policy, and 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"> 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

Kalshi

Example of how a lab-developed test company will hedge



Hedging example ECP (cont.)

Kalshi

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.

Downloaded from <https://www.kalshi.com> on 10/16/2024

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	Core fid. hedgers	Supports size
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/ide/groups/public/@otherif/documents/ide/ide_docs/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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APPENDIX D (CONFIDENTIAL) – COMMISSION JURISDICTION AND THE SPECIAL RULE FOR EVENT CONTRACTS

In addition to the details discussed below, Kalshi has attached letters on the matter from former Commission General Counsel Daniel Davis and Jonathan Marcus, as well Commissioner Caroline Pham’s dissent on whether to impose a stay and review pursuant to Regulation 40.11 of Kalshi’s original submission. Additional commenters on this point include, but are not limited to, former Nadex CEO Timothy McDermott, 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.⁵⁰ Kalshi has adopted these comments and they form part of the basis on which Kalshi determined that this contract is consistent with the CEA. Rather than attach all the comments here, which would consume a fair bit of paper, Kalshi has referenced them in the prior footnotes and notes that these comments are all in the Commission’s possession and available on the Commission’s website. However, should the Commission find it convenient to have all of these comments attached, Kalshi will supply them to the Commission.

Commission jurisdiction

Section 2(c)(2)(A)(ii) of the Act provides that the Commission has jurisdiction over swaps. Swaps are defined in section 1a(47)(ii) of the Act to include, among other things, “any agreement, contract, or transaction . . . that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence.” The Contract provides for payments that are dependent on the occurrence, nonoccurrence, or the extent of an event. The Contract is therefore a swap, and the listing and trading of the contract on Kalshi are therefore under the Commission’s jurisdiction. Section 5c(c)(5)(B) and Commission Regulation 40.2(b) create a presumption in favor of approving contracts.

Special rule for the review and approval of event contracts

Section 5c(c)(5)(C) of the Act provides a special rule for the review and approval of event contracts. Under this special rule, the “Commission *may* determine” (emphasis added) that event contracts or swaps (“based upon the occurrence, extent of an occurrence, or contingency”) are “contrary to the public interest” if those contracts “involve” certain enumerated activities.⁵¹ 7

⁵⁰ Public comments 70786, 70771, 69687, 70754, 69737, 70755, 69736, 69723, 70743, 70765, 70752.

⁵¹ 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.

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U.S.C § 7a-2(c)(5)(C)(i).⁵² Those enumerated activities are: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” *Id.* The discretionary use of this special rule for event contracts is implemented in the Commission’s Regulations. 17 C.F.R. § 40.11, which provides that “the Commission *may determine*” that a certain contract “may involve” one of the enumerated activities and subject that contract to a 90-day review period after which it “shall issue an order” with its determination.⁵³ 17 C.F.R. § 40.11(c).

The CEA’s special rule for event contracts applies to contracts that “involve” one of the six enumerated activities: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI). These specific examples demonstrate that the term “involves” in the statute (and application of the special rule) refers to the actual “occurrence, extent of occurrence, or contingency” that forms the underlying basis for the contract to be traded; and not the trading of the contract itself.

The statute’s second enumerated activity is “terrorism,” and thus, a contract that “involves” terrorism is subject to the CEA’s special rule for event contracts. An event contract will involve terrorism if the underlying event that forms the basis of the contract is terrorism; the act of trading on a contract itself is not terrorism. The same is true for the third and fourth enumerated activities. An event contract will “involve” assassination when the underlying event that forms the basis of the contract is assassination; the act of trading itself is obviously not assassination. An event contract will “involve” war when the underlying event that forms the basis of the contract is war; the act of trading itself is obviously not war. This common sense understanding is explicit in the statute. The statute’s first and the sixth enumerated activities are an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added) The noun “activity” makes it clear that the statute is referring to the underlying event, not to the *activity* of trading on the contract.⁵⁴ Thus, the statute is clear that an event contract “involves” an

⁵² If the Commission chooses to review an event contract to determine whether it is contrary to the public interest and finds that a listed event contract is “contrary to the public interest,” that contract may not be “listed or made available for clearing or trading on or through a registered entity.” 7 U.S.C § 7a-2(c)(5)(C)(ii).

⁵³ As interpreted by former Commissioner Dan Berkovitz, regulation 40.11 mirrors the statute, 7a-2(c)(5)(C), and sets forth the process for the Commission to determine whether a specific event contract is contrary to the public interest. 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 (“Berkovitz Statement”).

⁵⁴ Although this is abundantly clear with regard to five of the six enumerated events, an argument might be mounted that it is not true with regard to the fifth of the enumerated activities, gaming. This argument fails, as it is a basic tenet of both semantic and substantive statutory interpretation that a single usage of a word, in this case “involve”,

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enumerated activity when the underlying event that forms the basis of the contract, not the trading on the contract, involves the activity.

The statute's first enumerated activity ("activities that are illegal under federal or state law") further buttresses the conclusion that it is the underlying event that forms the basis of the contract that is relevant to the special rule and not the act of trading itself. If "involves" means that the trading on the contract is the enumerated event, that would mean that CEA's special rule applies to trading on a contract *when the trading on the contract itself already violates federal law*. Recall that the special rule does not prohibit such contracts, it merely authorizes the Commission to make that determination. It would be odd for Congress to make a federal law that makes trading on a certain contract illegal, but nonetheless say listing that contract is prohibited only if the CFTC determines that it is against the public interest. Once Congress made it illegal, it is unlikely it would have turned around and allowed it unless the CFTC agrees that the activity is disfavored.

Instead, it is abundantly clear that the enumerated activity of "illegal under federal law" means that the underlying event that forms the basis of the contract is illegal under federal law, not that the trading on that contract is illegal under federal law. An example of a contract that would fall under this first enumerated activity is a contract on the number of people that commit tax evasion. Tax evasion is a felony under I.R.C. § 7201. Trading on the contract is obviously not tax evasion. Nonetheless, that does not matter. The event in that contract is an activity that is illegal under federal law. The fact that trading on the contract is not illegal under federal law is irrelevant, because whether the CEA's special rule for event contracts applies to an event contract is determined based on whether the underlying event that forms the basis of the contract is an enumerated activity, not the act of trading on the contract.⁵⁵

Because it is the underlying event that forms the basis of the contract that is the only trigger of the CEA's special rule for event contract review, political control event contracts are clearly not included in that rule. The event that underlies these contracts is the political control of the United States Congress by a political party. Political control of government by a political party is obviously not illegal under federal or state law. It is not an activity that the Commission has determined to be contrary to the public interest. Nor is it terrorism, assassination, war, or a game. As such, political control contracts are not included in the narrow reach of the CEA's special rule

will not have two meanings, one for items 1, 2, 3, 4, and 6 on a list, and a second meaning for item 5 on that same list.

⁵⁵ The rare exception to this would be when the act of trading a contract itself is prohibited, as is the case for contracts "for the sale of motion picture box office receipts (or any index, measure, value, or data related to such receipts) or onions for future delivery" which are expressly prohibited in the Act. 7 U.S.C § 13-1. Trading a political control contract, however, is not prohibited by the Act nor is the underlying event illegal.

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for certain, enumerated activities and the rule and relevant regulations (17 C.F.R. § 40.11) does not apply.⁵⁶

Additionally, the activities that are enumerated can be seen as all involving an undesirable activity. Terrorism, war, assassination, illegal activity, and gaming are activities that can be considered “undesirable”. The sixth activity too is essentially any other activity that the Commission considers to be undesirable. Political control is not one of those activities.

However, even if one did believe that the Commission should consider whether trading on the contract itself is part of “involve”, the Contracts would still not involve either gaming or illegal activity.

A. Gaming

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.”⁵⁷ 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.⁵⁸ Many public comments by retail, industry, and academia have confirmed as much.⁵⁹

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

⁵⁶ The Commission in the Nadex order took a very expansive view of the authority that the CEA conferred on it with the special rule for event contracts. The Nadex Order stated simply “the legislative history of CEA Section 5c(c)(5)(C) indicates 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.” However, the legislative history that the Commission pointed to back then is of the weakest kind, a simple colloquy between two senators about preventing contracts on game outcomes, and certainly not enough to override the clear semantic and substantive indications in the statute itself as to what it means. The Commission should not reinforce a flawed legal position from a decade ago.

⁵⁷ Public Comment by Gregory Kuserk. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70754>.

⁵⁸ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to Division of Market Oversight (DMO) March 28, 2022.

⁵⁹ See, for example, 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>.

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determined through or relate to games of chance, or games of skill.⁶⁰ 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.⁶¹

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.”⁶² It further concluded that this is the same as taking a position on a Congressional control contract. 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’.⁶³ This would imply that event contracts themselves violate state gambling laws. This is incorrect. While gambling is illegal in many states and interstate betting is prohibited, event contracts are legal in all jurisdictions. Political control is also not a “contest” even if it indirectly involves competition. Trading on an event contract is also not the same as a “bet” in practice; 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.⁶⁴

B. Illegal activity under federal or state law

Kalshi’s Contract does not involve illegal activity. Taking a position in an event contract is not equivalent to, as states or the federal government may define it, “gaming” “gambling” or “wagering”. 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,

⁶⁰ Kalshi’s Congressional control submission, available at: <https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm001.pdf>. See page 9.

⁶¹ 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>.

⁶² *Nadex Order* at 3

⁶³ 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.

⁶⁴ See Public Comment on Kalshi Contracts from Brian D. Quintenz, available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

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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.⁶⁵

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, and wagering (such as the Wire or Unlawful Internet Gambling Enforcement Act) carve out exemptions for CFTC-regulated products.⁶⁶ This includes the definition of gaming cited by the *Nadex Order*. Many states' gaming provisions also include such exemptions.⁶⁷ States' gaming provisions are preempted explicitly as well by the Commodity Futures Modernization Act ("CFMA").⁶⁸ 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. 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.⁶⁹

⁶⁵ 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>

⁶⁶ 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).

⁶⁷ For example, Washington state RCW 21.30.030 clarifies that CFTC-regulated transactions are not affected by its anti-bucket shop provisions.

⁶⁸ 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.")

⁶⁹ 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

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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.”⁷⁰ 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 these contracts as involving gaming but not those many others, it would be acting contrary to Commission precedent and in an arbitrary manner.

bridge by long permitting market participants to trade such contracts pursuant to no action letters awarded to unregulated markets, such to Iowa Electronic Markets and PredictIt. The notion that allowing a regulated exchange to offer the contracts is what changes the public interest analysis is insupportable.

⁷⁰ 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 . . .”).

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APPENDIX E - OTHER CONSIDERATIONS FOR THE PUBLIC INTEREST

This section will be split into two sections: first, why the Contract is affirmatively in the public interest; and second, addressing objections thereof from the comment file.

A: Kalshi's Contract will provide significant social value

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 economic impacts and are some of the biggest risks that many businesses will encounter. This is detailed at great length in Appendix B and has been validated by dozens of public comments from retail, business, academia, and members of industry.

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 election models. Unregulated exchanges created by the Commission, such as PredictIt, are also very popular for this purpose. 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; 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*.⁷¹⁷²

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

⁷¹ Examples of this include: La Monica, Paul R. "Joe Biden's Fed conundrum: Stick with Jerome Powell or let him go?" *CNN*. 2021; Heath, Thomas. "These gamblers are putting money on the outcome of the impeachment inquiry." *Washington Post*. 2019; Contrera, Jessica. "Here's how to legally gamble on the 2016 race." *Washington Post*. 2016; *The New York Times* search results: <https://www.nytimes.com/search?query=PredictIt>; <https://twitter.com/NateSilver538/status/1242845027014971394>; <https://twitter.com/jasonfurman/status/1460404350975680514>; and <https://twitter.com/paulkrugman/status/1177602108763316227?lang=en>.

⁷² Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

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...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.⁷³

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.⁷⁴

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.⁷⁵

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 party 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.⁷⁶⁷⁷⁷⁸⁷⁹ 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

⁷³ *Ibid*

⁷⁴ Berg & Chambers. *Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement*. 2018. *Journal of Political Science Education*.

⁷⁵ Philip Tetlock. "Expert Political Judgment". 2005.

⁷⁶ Justin Wolfers and Eric Zitzewitz. 2004. "Prediction Markets." *Journal of Economic Perspectives*.

⁷⁷ 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, I Thomas C. Schelling, I 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*.

⁷⁸ 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*.

⁷⁹ Georgios Tziralis and Ilias P. Tatsiopoulos. 2007. "Prediction Markets: An Extended Literature Review." *The Journal of Prediction Markets*.

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futures are better at predicting the weather than meteorologists.⁸⁰⁸¹ Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance.⁸² Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.⁸³⁸⁴

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 his 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?"⁸⁵

The contracts would not serve as threats to either election integrity or the perception thereof; instead, it would improve them both (also discussed at length in Appendix G, as part of Core Principle 3 analysis)

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 the success of a Commission-sanctioned but unregulated market, PredictIt. PredictIt has grown to more than a billion shares traded—with little hedging participants because of the Contract's low position limits—without any claim of, let alone proof of, election impropriety driven by those markets.⁸⁶ Election trading is also common over-the-counter among the largest financial institutions and high net worth individuals.⁸⁷ 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. Several commenters confirmed this, including Eric Crampton, the academic advisor to iPredict, a New Zealand based political prediction market:

⁸⁰ Richard Roll. 1984. "Orange Juice and Weather." *The American Economic Review*.

⁸¹ Matthias Ritter. 2012. "Can the market forecast the weather better than meteorologists?" *Economic Risk*.

⁸² 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*.

⁸³ 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*.

⁸⁴ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2006. "Prediction market accuracy in the long run." *International Journal of Forecasting*.

⁸⁵ *Ibid*

⁸⁶ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJIZGljdGFibGUtbnV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

⁸⁷ Public Comment by Angelo Lisboa. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

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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.⁸⁸

Or Dustin Moskowitz, 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.⁸⁹

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.

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, along with numerous other related political actors. Kalshi is taking especially stringent action here, as detailed in Appendix B. Members of Congress also have a sworn duty to represent their constituents and have strong

⁸⁸ Public Comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

⁸⁹ Public Comment by Dustin Moskowitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

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incentives not to manipulate electoral processes for private gain. This should clarify any claim that this could de-legitimize elections internal to Congress itself.

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. In practice, the information gained by being a vote counter is of near-zero marginal value to determining whether or not a given party wins a given chamber of Congress.

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.”⁹⁰ 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 analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.⁹²

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 on far smaller markets, who have concluded that all attempts at manipulation have failed.

Koleman and Strumpf in a later paper 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.”⁹³ 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

⁹⁰ 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>

⁹¹ Paul Rhode and Koleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

⁹² Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

⁹³ Paul Rhode and Koleman Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

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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.⁹⁴ 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 regarding previous political contracts, "none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase."⁹⁵ This finding was also supported by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi's submission.⁹⁶⁹⁷

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.

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

Americans can also readily access offshore platforms using a virtual private network such as Betfair.⁹⁸ Betfair had more than \$500 million traded on the 2020 election.⁹⁹ 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.

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

⁹⁴ Robin Hanson and Ryan Oprea. 2008. "A Manipulator Can Aid Prediction Market Accuracy." *Economica*.

⁹⁵ Justin Wolfers and Eric Zitzewitz. 2006. "Prediction Markets in Theory and Practice".

⁹⁶ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

⁹⁷ For example, the public comment by David Rothschild and company. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

⁹⁸ Comment letter by policy commentator Matt Bruenig. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69670>.

⁹⁹ Seen at this link: <https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

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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.¹⁰⁰ 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 Contract is not contrary to the public interest; rather, it strongly supports the public interest, as demonstrated by the evidence above. The Contract will improve asset pricing, provide risk management opportunities, enhance election integrity and trust, and shift trading activity to regulated exchanges.

B: Addressing objections

Commenters were overwhelmingly in support of Kalshi’s contract; nonetheless, the Exchange takes concerns seriously. Some commenters also raised concern that price manipulation is possible because of insider information. Kalshi maintains that there are near zero actors with inside information on the result of the totality of the elections in the United States House or Senate; nonetheless, in its new submission, Kalshi is proactively prohibiting a host of political

¹⁰⁰ John Bullock, Alan Gerber, Seth Hill, Gregory Huber. 2013. “Partisan Bias in Factual Beliefs about Politics.”

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actors from participating in the markets along with additional surveillance, as listed in Appendix B.

Another concern raised was that, even if the contract does not genuinely make elections more manipulable, it may increase the perception that they are. The Commission must rely on evidence in this sort of deliberation rather than feeling. This perception problem is not an issue in other nations with large-scale election trading (such as the United Kingdom), and in fact, probabilities created by offshore and unregulated exchanges (and discussions of the hundreds of millions traded) are regularly reported on by the political and financial press.¹⁰¹ Election trading is already significant in the United States among large-scale institutions over the counter (as testified to by commenter Angelo Lisboa) and by Americans using offshore/unregulated exchanges as well as by trading indirectly through traditional asset classes.¹⁰² Rather, as discussed at length in Section A of this appendix, the contracts would promote election integrity rather than harm it

A small number of commenters argued that Kalshi's market could have its price manipulated, thus distorting the public perception of a race. The vast majority of these claims are unsubstantiated, though the letter provided by Dennis Kelleher of Better Markets does try and 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'.¹⁰³

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

¹⁰¹ There are scores of articles which could serve as examples, but some are: Mashayehki, Rey. "Betting markets called the presidential election more accurately than polls." *Fortune*. 2020. Kirshner, Alex. "How Offshore Oddsmakers Made a Killing off Gullible Trump Supporters." *Slate*. 2020; Yakowicz, Will. "Bettors Have Wagered More Money on Trump vs. Biden Than Nevada Collected During the Super Bowl." *Forbes*. 2020; Bumbuca, Chris. "2020 U.S. presidential election expected to involve more than \$1 billion in wagers." *USA Today*. 2020; Reuters Staff. "Betting markets give Trump slightly improved chances after debate." *Reuters*. 2020.

¹⁰² Public Comment by Angelo Lisboa. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

¹⁰³ Public Comment by Dennis Kelleher. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

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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.*
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.¹⁰⁴ They wrote, “Wolfers and Zitowitz (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.¹⁰⁵ 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

¹⁰⁴ Deck, C., Lin, S., & Porter, D. (2010). Affecting policy by manipulating prediction markets: Experimental evidence. ESI Working Paper 10-17.

¹⁰⁵ Hanson, R. and Oprea, R. “A Manipulator Can Aid Prediction Market Accuracy,” *Economica*, 2009, 76, 304-314.

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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.

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APPENDIX F (CONFIDENTIAL) – SOURCE AGENCY

The data which is used to determine the Expiration Value of the Contract is published by the Library of Congress, the official government repository of information for the public since 1800.

Congress.gov is an affiliate of the Library of Congress and contains a record of all members of Congress, their leadership status, and party membership. It updates every weekday morning at 8:00 AM with the complete record of the previous day's activities.

As stated on the Congress.gov website:

Congress.gov is the official website for U.S. federal legislative information. The site provides access to accurate, timely, and complete legislative information for Members of Congress, legislative agencies, and the public. It is presented by the Library of Congress (LOC) using data from the Office of the Clerk of the U.S. House of Representatives, the Office of the Secretary of the Senate, the Government Publishing Office, Congressional Budget Office, and the LOC's Congressional Research Service.

Congress.gov is usually updated the morning after a session adjourns. Consult [Coverage Dates for Congress.gov Collections](#) for the specific update schedules and start date for each collection.

Congress.gov supersedes the THOMAS system which was retired on July 5, 2016. Congress.gov was released in beta in September 2012. The THOMAS URL was redirected to Congress.gov in 2013. The beta label was removed in 2014.

The scope of data collections and system functionality have continued to expand since THOMAS was launched in January 1995, when the 104th Congress convened. THOMAS was produced after Congressional leadership directed the Library of Congress to make federal legislative information freely available to the public.

Congressional documents from the first 100 years of the U.S. Congress (1774-1875) can be accessed through [A Century of Lawmaking](#).¹⁰⁶

¹⁰⁶ <https://www.congress.gov/about>

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The information used to determine the Expiration Value of the Contract is highly visible. Any discrepancy between the true value and the reported values at the Source Agency would be swiftly detected and any individual who engaged in said manipulation of the Source Agency would likely be fired. Importantly, the Exchange has chosen to only use official government sources to determine the Expiration Value of the Contract. The Exchange understands that political control can often be hotly contested, with accusations that an election is improper. Moreover, the Exchange understands that news agencies frequently “call” the results of elections incorrectly. As a result, it does not use any news reporting in our determinations, nor the results of election certifications, as individuals may step down or resign prior to actually taking office. The Exchange thus relies on the official federal government report of who actually took office.

In summary, the data which will be used to determine the Expiration Value of the Contract is prepared by the Library of Congress, the official website of the United States Senate, and the official website of the Clerk of the House of Representatives, in a rigorous manner with multiple layers of checks in place to ensure the highest accuracy possible, and there are robust safeguards against any potential manipulation.

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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 Coleman 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/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJIZGljdGFibGUtbnV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

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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**APPENDIX H (CONFIDENTIAL) – COMPLIANCE WITH THE CONTRACT
VETTING FRAMEWORK**

As part of its registration as a Designated Contract Market, the Exchange submitted a Contract Vetting Framework (CVF) through which all contracts would have to be vetted against in order to be eligible for self-certification. At designation, the CVF prohibited contracts on the outcomes of United States political elections. Since then, Kalshi submitted an amendment to the CVF permitting it to self-certify contracts related to partisan political control of the House and Senate which was approved by the Commission.

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APPENDIX I (CONFIDENTIAL) – DIRECTLY ADDRESSING COMMISSION QUESTIONS

The Commission asked for public input on seventeen questions. These seventeen questions can be broadly categorized into five distinct categories of questions. These are:

1. Whether Kalshi’s contract triggers one of the prongs of CFTC Regulation 40.11 or CEA 5c(c)(5)(C), in particular, “gaming” and “activity illegal under state law”; (questions 1-4)
2. Whether Kalshi’s contract is distinct from Nadex’s 2011 contract submission; (question 5)
3. Whether Kalshi’s contract would provide economic utility to market participants; (questions 6-11)
4. Whether Kalshi’s contract would serve the public interest; and (questions 12-14, 17)
5. Whether and how Kalshi’s contract can be readily subject to manipulation. (questions 15 and 16)

In developing the CONTROL contract, the Exchange carefully considered both the Commission’s questions on the prior submission, as well as the public’s input on the prior submission. The public’s input formed a bedrock of the Exchange’s determination, together with its own analysis, that the contracts are consistent with the CEA and valid Commission Regulations. The Exchange summarizes some of the comments below, and incorporates the entire comment file from the original submission by reference. (The CFTC’s comment file is available here: <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>).¹²¹ The Exchange considered all of the comments in full in developing this contract, and the comment record is an important part of this contract. The Exchange notes that all the comments are in the Commission’s possession, and are in fact electronically searchable on the Commission’s website.

One: does Kalshi’s contract trigger one of the prongs of CFTC Regulation 40.11 or CEA section 5c(c)(5)(C), in particular, gaming and unlawful activity? (questions 1-4)

The public comments largely stated that the answer is no, the proposed contract does not involve, relate to, or reference gaming, or any of the other prongs of CEA 5c(c)(5)(C) or Regulation 40.11. Commenters noted that elections do not involve, relate to, or reference gaming or gambling. Rather, elections are events of incredible and far-reaching economic impact. Kalshi’s

¹²¹ 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 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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contract would also not involve, relate to, or reference unlawful activity. A contract on election outcomes would provide market participants with a powerful tool to hedge political risk.

The underlying assumption of the Commission's question is that in considering CEA 5c(c)(5)(C) or Regulation 40.11, one should consider not only whether the contract's subject involves gaming (e.g. a contract like "Will the roulette ball fall on white or red?"), but rather, whether the act trading on the contract *itself* constitutes gaming. The commenters noted that this is an incorrect application of the statute. This is evidenced by the fact that the other items of the list (assassination, murder, war) are clearly referring to the underlying event, not the act of trading. If that reading were correct, it would make the enumerated categories of terrorism, assassination or war superfluous, as clearly trading on such events would also be gaming. This argument, in particular, is made by comments from both of the last two General Counsels of the CFTC as well as other law firms such as Jones Day and Tabet DiVito & Rothstein.¹²²

With regard to unlawful activity, commenters noted that, unlike gambling offerings, Kalshi's contract is a federally regulated derivative product and is exempted from the federal interstate betting prohibition and state laws that prohibit gambling. Thus, the existence of state laws that prohibit 'gambling' on election outcomes does not confer an involvement with illegal activity on Kalshi's contract anymore than the existence of state laws that prohibit 'gambling' confer an involvement with illegal activity onto any event contract or derivatives product. The letter submitted by Better Markets, arguing that Kalshi's contract does trigger a prong of 40.11/5c(c)(5)(C), relies on the false idea that Kalshi's contracts certified with the Commission are subject to the Unlawful Internet Gambling Enforcement Act, when CFTC products are expressly carved out of such regulations.¹²³¹²⁴ The Exchange rejects this comment as being patently legally incorrect, and the Exchange's position is supported by the legal analysis of the Commission's most recent two general counsels attached as part of Appendix M.

Commenters further informed the Commission that it should not consider the presence of election outcomes in gaming venues such as casinos. They noted that the question is not relevant to the particular contracts as such contracts not available on any legal American sportsbook, and that the Commission precedent contradicts such consideration, as this standard was not even applied by the Commission when considering contracts on the outcomes of sports games in *ErisX* and was not considered in *Nadex*.

¹²² Public Comments 70781, 69737, and 70765.

¹²³ Public Comment by Dennis Kelleher, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

¹²⁴ 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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Commenters also pointed out that there is either a conflict between Regulation 40.11 and the CEA with respect to the breadth of the special rule, as former Commissioner Quintenz noted, or Regulation 40.11 does not prohibit any contracts, as former Commissioner Berkovitz assumed in his statement on *ErisX*.

Commenter Richard Sandor, the “father of futures” who developed the first interest rate products, informed the Commission that financial speculation is not the same as gambling. Gregory Kursek, who led the DMO’s Product Review Branch, did the same.

Some commenters argued that the contract is related to gaming because the contract would not serve an economic purpose. That is addressed in Appendix B.

The foregoing analysis and public comments support the conclusion that the question of CEA 5c(c)(5)(C) or Regulation 40.11 is answered in the negative. In Kalshi’s new submission, it increased the contract order size (to purchases in 5,000 contract multiples) and increased the position limits for parties with *bona fide* hedging need to reduce the ease of low-value speculative behavior relative to hedging behavior. Accordingly, the Exchange has determined that the contract is not inconsistent with either CEA 5c(c)(5)(C) or Regulation 40.11, a conclusion that is strongly supported by the information from the public that the Commission requested.

Two: is Kalshi’s contract distinct from Nadex’s 2011 contract submission? (question 5)

Kalshi has provided a separate document that details the distinctions between Nadex’s contract submission and Kalshi’s new contract. However, even with regards to Kalshi’s original submission, commenters such as former CFTC Chairman Mark Wetjen who was on the Commission when the *Nadex Order* was released, and former CFTC Deputy Director of Product Review Greg Kuserk, noted the changes in circumstances since Nadex’s 2011 submission that also justify looking and considering the contract, its public impact, and the role of gaming, differently. These circumstances include the success of other electoral markets that the Commission has approved of (PredictIt, hosted by Victoria University of Wellington) and the increasing salience of electoral risk on market participants. In light of these changes, they informed the Commission that it would be inappropriate to rotely prohibit the original submission on the grounds of a non-regulatory, contract specific conclusion from a decade ago. The correct conclusion now is for the contract to be allowed by the Commission. In light of these comments, and the material and significant economic differences between the contracts at the subject of the *Nadex Order* and the current contract, among other salient points of black-letter settled administrative law, the Exchange determined that the contract is consistent with the CEA and Regulations and is not in any way prohibited by *Nadex*.

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Three: Would Kalshi's contract provide economic utility to market participants? (questions 6-11)

In its submission, which is publicly available, Kalshi provided evidence—from decades of academic research, business testimony, the public press, and policymakers—that partisan election outcomes have consistent and predictable effects on the values of assets, prices of services, and economic activity more broadly. Commenters overwhelmingly agreed, including (though hardly limited to) academics such as Nobel Laureate Robert Shiller and former Chair of the Council of Economic Advisors Jason Furman; former policymakers former SEC Commissioner Joseph Grundfest and former CFTC Commissioner Mark Wetjen; and members of private industry, such as AB-inBev board member Jorge Paulo Lemann (a major participant in extant agricultural futures), the CEO of Continental Grain Company Paul Fribourg, and Susquehanna International Group Head of Strategic Planning David Pollard.¹²⁵ Angelo Lisboa, a Managing Director of J.P. Morgan argued that large institutions already trade such products over-the-counter.¹²⁶ The public press and private businesses routinely discuss how election outcomes are traded significantly through other exchange-traded assets, like stocks.

In the public comment process, many businesses and business leaders, in industries such as energy, cannabis, and finance, testified to their personal hedging needs and use cases for the contract.

Some commenters argued that the contract would not serve their own hedging needs, or speculated that it would not serve the needs of others. The fact that a contract would not help a particular commenter's hedging needs is not relevant to whether it would serve those of others. The uninformed and speculative bets of commenters cannot form the basis of any reasoned decision making by a government agency. This would be black-letter administrative law in a vacuum. In the face of the overwhelming majority of commenters who informed the Commission about their own hedging utility and the overwhelming evidence that elections have economic consequences, these speculative comments contradict reality.

In one of its questions, the Commission asked specifically if election impacts are sufficiently predictable—even if they have a large impact—to justify a hedging product. Commenters argued that this is not a standard found in law, regulation, or in any previous decision or consideration. They further noted that the question of how to hedge is not the province of the Commission. The job of the Commission is not to determine whether a hedge is a “good” or not; that is for the market and its participants to decide. The Commission does not want to find itself in the business of grading participants' hedging strategies. The Commission would never be called to testify in a

¹²⁵ Public Comments 70761, 69708, 69695, 70771, 69684, 69727, and 70743.

¹²⁶ Public Comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

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shareholder suit against a company because the company's hedging strategy was unsuccessful. Rather, the market should determine whether a given contract is appropriate for their risk.

It is important to acknowledge that the comments did not at all agree that the notional value of the contract impacts the analysis at all, and this is for many reasons. These include the understanding that retail participants have economic needs that the Commission should not discriminate against. Also, the Commission has embraced contracts like micro bitcoin contracts and it is incongruous to assume a different economic reality for these contracts.

Commenters also noted that hedging does not require a 1:1 hedge against a specific asset; hedging is a means of risk management, and the contracts can be used to manage risk from elections. This hedging truth is recognized in the numerous contracts that the Commission has embraced such as weather and many other contracts that either do not have 1:1 hedging use or where 1:1 hedging is overwhelmingly not the primary use of the contract.

Commenters also noted that the contracts have economic utility well beyond hedging. Hedging, after all, is only one of the twin pillars of economic utility. The second pillar is price basing, and the contracts have significant price basing utility. It is nigh axiomatic that there is utility in pricing risk that affects assets, service agreements, and other economic utility. These contracts do exactly that.

Based on the information from the public, as well as the clear evidence of the impact of elections (just watch the news during elections), the Exchange concluded that the contract has economic utility, both hedging and price basing. This is certainly true for the current submission which has a significantly increased order size (to purchases in 5,000 contract multiples) and increased position limits for parties with *bona fide* hedging utility.

Four: Would Kalshi's contract serve the public interest? (questions 12-14, 17)

Commenters agreed that Kalshi's contract would serve the public interest. In addition to the public interest by virtue of its hedging and price basing functions, the Contract will generally provide a valuable forecasting tool that complements existing polling and other forecasting tools. Accurate data regarding the state of elections is very socially valuable and sought after, prompting the development of advanced polling and analytics publications like *FiveThirtyEight*. In addition, former Chair of the Council of Economic Advisors Jason Furman detailed in his comment how political markets, even on a limited basis, had informational value that were used even in the Obama White House.¹²⁷ Eric Crampton wrote about how New Zealand political

¹²⁷ Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

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markets were used by their country's central bank.¹²⁸ By providing an alternative, and possibly more accurate (certainly faster) forecast of an election outcome to polls, Kalshi's contract would enrich the public discourse through an unbiased, decentralized prediction of the future. Others, such as OpenPhilanthropy founder Dustin Moskowitz, emphasized how he could use the market to help influence future decision making with regards to politics.¹²⁹

A small number of commenters argued that Kalshi's contract could distort the electoral process if the contracts were manipulated. These comments ignored PredictIt, which has traded more than a billion dollars—sans hedging—without any such issues; it ignores how banks and financial institutions already trade these products; and how many other nations (such as the United Kingdom, Canada, Ireland, Australia, and other liberal democracies) have large outright gambling on electoral outcomes without any documented harm. Importantly, they ignored both the evidence that markets like the Contract are very difficult to manipulate and the Exchange's surveillance system that would further make manipulation extremely unlikely. Further, as other commenters noted, the Contract would provide a source of information that is much less likely to be manipulated than polling, media, advertising, and social media.

The Exchange notes that the prior submission and the Commission's questions received significant press attention from many different news sites. The commenters included individuals, businesses of all sizes, and many experts in their fields. In light of the commenters support on the Contract's social value, highlighting the real world evidence and utilization of the contracts, and the defects with the few comments that speculated about a public harm, the Exchange has concluded that the public has spoken to its interests, and these contracts are in the public's interest.

Five: Would Kalshi's contract be readily susceptible to manipulation, and how should it protect against it? (questions 15 and 16)

Several commenters, including commenters with extensive expertise in the industry and in detecting fraud and manipulation, noted how there is little to no ability for individuals to either manipulate the outcomes of hundreds of Congressional elections or to manipulate the contract's price because of insider information. There are enormous incentives in the status quo for individuals to try and do so, without any success. American elections are not readily susceptible to manipulation, and neither is Kalshi's contract.

Kalshi, however, takes the threat of even a marginal or unexpected case seriously, and in its new submission has clarified how it will treat politically associated individuals. Kalshi preemptively

¹²⁸ Public Comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

¹²⁹ Public Comment by Dustin Moskowitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

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runs users through a list of politically exposed persons and will ban such individuals from trading. Before being allowed to participate on a political risk market, participants will be required to certify that they are not affiliated with any campaign, PAC, or political party, and do not have any insider information on the matter. Kalshi's surveillance team 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. Kalshi will also provide the Commission with additional reporting that the Commission determines would assist with regulating this specific market.

The letter provided by Better Markets cites two studies which argue prediction markets can be manipulated (though not necessarily readily, which the Exchange notes is the standard of law). One of these cites a manipulation attempt on a small, online exchange in the early 2000s that is swiftly corrected by other traders. The other refers to a market created by academics with only eight participants and fake funds. Unlike many of the underlying markets the CFTC monitors, American elections have dedicated enforcement agencies (such as the Federal Election Commission) and have never been manipulated. Consequently, dozens of economists, including major policymakers and a Nobel Laureate, wrote comments arguing specifically that these contracts are not readily susceptible to either outcome or price manipulation.

In light of the many factual and analytical deficiencies in Better Markets' comment, and the overwhelming information from commenters with actual market and economic experience that the contracts are not readily susceptible to manipulation, and the extra protections that the Exchange will adopt to go above and beyond, the Exchange has determined that the contracts are not readily susceptible to manipulation.

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APPENDIX J (CONFIDENTIAL) – COMPARISON WITH NADEX SUBMISSION

The proposed new terms of the Political Control contract differ significantly and materially from the *Nadex Order* contract, which was disallowed by Commission Order in 2012. The table below highlights those differences by comparing the Nadex contract, the withdrawn Political Control Contract (“CONGRESS”), and the proposed Political Control contract (“CONTROL”). The proposed new terms are designed to provide a tool to shift economic risk tied to political elections and to be utilized by firms, industry, and other traditional participants in derivatives markets.¹³⁰

Contract attribute	Nadex	CONGRESS contract	CONTROL contract
Order size	1 \$100 contract	1 \$1 contract	5,000 \$1 contracts; functionally \$5,000 notional value
Position limit	2,500 contracts	\$25,000	Tiered, up to \$100M for ECPs with a <i>bona fide</i> hedging need

These changes will significantly alter the way that the market will participate in the contract. Even though order sizes are not considered material with regard to the “equivalent swap” analysis under the Position Limits Rule, codified in Regulation 150.1, that analysis is not relevant to the analysis here. The policy and purpose of economic equivalency for position limits is stated by Congress as being necessary to “to (i) Diminish, eliminate, or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for *bona fide* hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted.” Those factors are very different from the factors that were considered in *Nadex*, namely the application of CEA section 5c(c)(5)(C) and Regulation 40.11. The relevant factors that the Commission considered in *Nadex* were the nature of how market participants will use the contract, and the economic attributes of a contract such as notional size is highly material to that question.

In fact, the Commission intuited that economic attributes such as notional size are important to the analysis and specifically asked a number of questions directly and indirectly to the public about the Contract’s size in its questions regarding Kalshi’s CONGRESS submission. The comments in response to the Commission’s question all indicated that the economic attributes of the contract *should* be considered (most argued that the original contract passed any economic

¹³⁰ Although the contract is available for trading by all Exchange members, as required under the CEA and Core Principle 2.

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utility test, of course; *a fortiori* the new contract passes the same tests). Accordingly, the Exchange notes that the current submission is distinguishable from the contracts that were the subject of the *Nadex* order, a point that is strongly buttressed by the public comments that the Commission requested.

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APPENDIX K (CONFIDENTIAL) – ADDITIONAL CORE PRINCIPLE 3 CONSIDERATIONS

The CONTROL contract is not readily susceptible to manipulation. 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 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 in Appendices E and F, 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.¹³¹

Election manipulation is a crime.¹³² 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. 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

¹³¹ <https://www.brennancenter.org/our-work/research-reports/truth-about-voter-fraud>

¹³² <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.>

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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 F, 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.¹³³ 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.

Additionally, concerns regarding policing election fraud are absent from, and foreign to, the CEA's goal of fostering innovation and trading on American markets. 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.

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 B, 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.

¹³³ <https://www.washingtonpost.com/politics/2022/11/01/truth-about-election-fraud-its-rare/>

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APPENDIX L (CONFIDENTIAL) – THE IMPORTANCE AND SALIENCE OF CLIMATE RISK TO POLITICAL RISK CONTRACTS

Climate Risk Exposure

The CFTC’s Market Risk Advisory Committee published a seminal report on managing climate risk in the United State’s financial system (“Report”).¹³⁴ The Report cogently described the urgency for the financial markets, and financial regulators, to enhance the existing climate risk management framework, in part because of the impossibility of predicting with any precision how climate change will impact participants, including economically. The Report explains how participants should translate climate risk into economic terms, and then once translated, derivatives can be used to manage that risk.

As the Report explains, risk is a composite measure of exposure, sensitivity and, in this case, the adaptive capacity of a firm to manage the climate risks of a particular asset. Exposure reflects the presence of financial assets coinciding with climate impacts—namely acute extreme events or recognizable patterns of stress, which includes the likelihood of an economically harmful incident occurring. Exposure is the prerequisite to the transmission of climate risks to financially relevant metrics. Sensitivity reflects a measure of the responsiveness of exposed assets to any given shock or stress. In other words, risk is the product of the potential economic impact of an event and the likelihood of that event occurring. Because risk is technically a probabilistic function of sensitivity and exposure, the novelty of climate change means that there is greater uncertainty and ignorance about the range of possible outcomes and the Report recommends the use of a variety of tools to overcome this uncertainty, such as scenario analysis. This method of risk management is key to effectively managing climate risk. If market participants would wait until they can precisely, or even broadly, quantify the *expected impact* of climate change to manage risk, it would likely be too late. Instead of managing expected impact, market participants manage their *risk*, which is the “what if”, not the “most likely.”

Managing Climate Risk

Based on the understanding of risk as a probabilistic function of the product of two metrics (i) sensitivity of a financial interest to climate change, and (ii) exposure of the financial interest to a climate change event or the likelihood of that event occurring, the Report suggests two methods for managing risk. One method is to decrease exposure, which can be done for example by reducing carbon output or ideally achieving carbon net-neutrality. The decrease in exposure will have the effect of reducing the overall risk. The second method is to decrease the net sensitivity

¹³⁴ 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>

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of the asset, which can be done via financial derivatives that hedge the asset’s sensitivity. For example, a carbon offset future. That decrease in sensitivity will also reduce the overall risk.

Climate Risk/Political Control Risk Similarities

Even though the particular impacts of climate change are not known, and certainly the impacts to any market participant are not known, climate change nonetheless poses risk to market participants, and that risk can and should be hedged. This understanding of risk, and risk management, is equally important and applicable to political control. Like climate change, the precise impact of political control to a market participant is not known. Like climate change, political control nonetheless impacts risk. An asset or financial interest that is sensitive to policy or political change, such as climate change, has exposure to political control, as political control impacts the likelihood of a negative incident occurring. A derivative contract can be used to reduce the net sensitivity, and just like in the case of climate change risk, the reduced sensitivity will effectively reduce risk. The same risk management and climate risk hedging described in the Report applies to political control hedging using derivative contracts.

Characteristic	Climate Change Risk	Political Control Risk
Is a risk because it could lead to negative financial impact	✓	✓
Specific impacts unknown	✓	✓
Risk is the product of (i) potential impact of an event or events (sensitivity), and (ii) likelihood of the event occurring (exposure)	✓	✓
Derivatives can be used to reduce net <i>sensitivity</i> , which reduces overall risk	✓	✓

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APPENDIX M (CONFIDENTIAL) – ADDITIONAL MATERIALS

Letters by Kalshi’s counsel are provided in a separate document attached to this certification. Also attached is a copy of Commissioner Pham’s dissent on a vote favoring review of Kalshi’s original contract pursuant to the special rule.

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September 25, 2022

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. The Exchange welcomes the opportunity to address the Commission’s questions. This comment addresses the first question and the third question that the Commission asked:

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
2. as described in regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?
3. 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?

This comment is divided into two parts. Part 1 discusses the statute. In particular, Part 1 of the comment addresses section 5c(c)(5)(C) of the Commodity Exchange Act (“CEA”), codified¹ at 7 U.S.C. 7a-2(c)(5)(C).² Of particular importance, Part 1 is based on an analysis of the statute

¹ The CEA section designations do not align with the section designations in the United States Code. Because this is a public comment, the Exchange will generally use citations to the United States Code as opposed to the CEA, which will enhance the public’s ability to research and analyze the issues presented.

² The Exchange will address the applicability of the regulations at 17 C.F.R. 40.11 in a separate comment, and also in the appendix to this comment in the Counsel Analyses. However, the Exchange notes here that the regulation cannot exceed the authority in the statute that the regulation implements. This is axiomatically true even under the *Chevron* deference from *Chevron, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Indeed, step one of *Chevron* is to determine whether Congress expressed intent in the statute and, if so, whether or not the statute’s intent is ambiguous. It is black letter law that if the statute is clear, the regulating agency cannot regulate contrary to the statute. Indeed, earlier this year in *Empire Health*, Justice Kagan, writing for the Court, held that the government’s regulation was valid only because the “regulation correctly construes the statutory language at issue.” *Becerra v. Empire Health Foundation*, 142 S. Ct. 2354 (2022). Had that not been the case, Justice Kagan and the Court would have held the regulation invalid.

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irrespective of any rule, including 40.11, which the Commission has issued or may, in the future, promulgate to implement this statutory provision.

As a threshold matter, the Exchange notes that the majority of the Commission's questions for public comment assume that the Special Rule in CEA 5c(c)(5)(C) ("Special Rule") applies or can apply to Kalshi's political control contract ("Contract"), a question that the Commission invites the public to address in questions 1 and 3. If the answers to questions 1 and 3 are no, many of the other questions become moot, at least in regard to the Contract, which is the sole matter under Consideration in this Commission action.³

Part 2 includes analyses from Jonathan Marcus and Dan Davis that directly address Questions 1 and 3. Messrs. Marcus and Davis both served as General Counsel of the Commission prior to assuming their current positions in private practice.

Part 1

Contracts, events, and other important terms

There are several terms that are key to understanding the framework that Congress created for the Special Rule that appear throughout this comment and are helpful to define here:

- "Event Contract"
- The "Event Contract's Event" (also, referred to as the "contract's Event")
- The "contract, considered as a whole" (also, referred to as the "contract, as a whole", the "contract, itself", and the "contract itself, considered as a whole")

An "Event Contract" is a contract that is based on an occurrence, extent of an occurrence, or a contingency. For example, a contract whose terms and conditions specify that the holder of the contract will receive payment based on the occurrence of a hurricane is an Event Contract because it is based on an occurrence, a hurricane. The terms and conditions of Kalshi's Contract specify that holders of the contract will receive money based on the occurrence of political control over Congress.⁴ It is an event contract because it is based on an occurrence, political control.⁵

A contract's "Event" refers to the specific occurrence, extent of an occurrence, or contingency on which the contract is based. A hurricane contract's event is the hurricane. Kalshi's Contract's event is political control

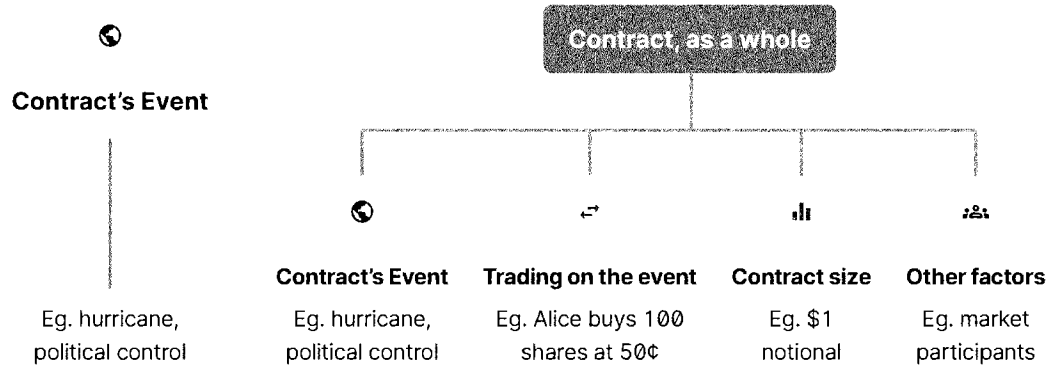
The phrase "contract, considered as a whole" refers to a broad view of a contract and all factors that surround or are a part of the contract. For example, this would include the activity of buying and selling the contract ie. the activity of *trading* the contract, the information embedded in the contract's pricing, and in the case of an Event Contract, the contract's Event.

Accordingly, any suggestion that the Commission's regulation 40.11, which implements the statute at 7 U.S.C. 7a-2(c)(5)(C), applies to a contract to which the statute itself does not apply is specious. If the regulation did, it would be invalid. Regardless, a careful reading of the regulation shows that the regulation does not apply to any contract to which the statute does not apply. We address the regulation in more depth in Part 2.

³ Specifically, if the answers to questions 1 and 3 are no, the following questions would be moot insofar as they would not apply to the Contract: 2, 4, 6, 7, 8, 9, 10, 11, 12, 13, 14, 17. Question 5, which assumes the soundness of the legal reasoning in the Nadex Order, *see infra*, would also be moot.

⁴ Please see the full filing for the full terms and conditions of the Contract.

⁵ Specifically, the contract is based on the party membership of the Speaker of the House and the President Pro Tempore.



The statute

Part 1 of this comment focuses on the correct interpretation of the Special Rule, which is set forth in a statute. The full text of the statute⁶ is included here, for the reader's convenience:

(C) Special rule for review and approval of event contracts and swaps contracts

(i) Event contracts

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve-

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

(ii) Prohibition

No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

General background on the CEA's Special Rule

Under the CEA, contract listing is not a "permission" regime. Contracts do not need Commission approval to be listed, and although the CEA provides a mechanism that exchanges may utilize to put a contract before the Commission for approval, whether or not to utilize that method is solely

⁶ 7 U.S.C. 7A-2(c)(5)(C).

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in an exchange's discretion.⁷ Indeed, the overwhelmingly vast majority of contracts are never presented to the Commission for approval under this mechanism. Even in those rare instances when the Commission is formally presented with a contract for approval, the Commission's discretion over whether to grant or withhold approval is limited; under the statute and the regulations, the Commission must approve every contract that does not violate the CEA or the regulations.⁸ The Commission was not granted authority to conduct a "is this a contract that I am comfortable with" analysis and the Commission was not granted authority to disapprove a contract because it does not like it.⁹

The Commission was also not granted the authority to prohibit any contract on the grounds that it violates the public interest. There is one exception to this rule, where Congress did give the Commission the authority to prohibit a contract that the Commission determines is contrary to the public interest.¹⁰ This exception is the Special Rule in 5c(c)(5)(C) of the Commodity Exchange Act.¹¹ This Special Rule gives the Commission discretion to consider, for very specific types of contracts, whether a contract is contrary to the public interest.¹²

There are two aspects to the Special Rule. The first is the Special Rule's eligibility requirements; the Special Rule does not apply to all contracts. It only applies to a specifically defined subset of contracts, identified through a two-step process described below, that are eligible for the Special Rule. If a contract is determined to be eligible for the Special Rule, it is not automatically prohibited. The Special Rule only prohibits contracts that are eligible for the Special Rule if the Commission determines that the contract is contrary to the public interest. The second aspect of the Special Rule thus is determining whether the contract that is eligible for the Special Rule is contrary to the public interest. Congress laid out the process for the Special Rule in three steps.

The three steps of the Special Rule

There are three steps in the Special Rule.

Step one of the Special Rule ("Step One") is to determine if the contract is eligible for the Special Rule. The statute limits the scope of the Special Rule to contracts that are "based upon [an] occurrence, extent of an occurrence, or contingency" (collectively "Event"). In other words, to be eligible for the Special Rule, a contract must be based on an Event, *i.e.*, the contract must be an Event Contract. If a contract is not an Event Contract, it is not eligible for the Special Rule and the contract fails Step One. The analysis then terminates and the Special Rule does not apply to that contract. If the contract is an Event Contract, the analysis proceeds to step two.

Step two of the Special Rule ("Step Two") is to determine if the Event Contract's Event involves¹³ certain activities that were listed by Congress in the Special Rule. These activities are:

1. an activity that is unlawful under any Federal or State law;

⁷ This process is set forth in 17 C.F.R. 40.3, which the Commission titled "*Voluntary* submission of new products for Commission review and approval."

⁸ 7 U.S.C. 7a-2(c)(5)(B); 17 C.F.R. 40.3(b).

⁹ *Id.*

¹⁰ As explained below and in a second comment letter, even if, *arguendo*, the Special Rule applied to the Contract (which it does not), the Special Rule would still not prohibit the Contract because it is *in* the public interest, and therefore certainly not contrary to the public interest.

¹¹ 7 U.S.C. 7a-2(c)(5)(C).

¹² *Id.*

¹³ Please see *infra* the "A further look at step two of the Special Rule" for more discussion on the correct interpretation of step two and why step two is limited to the contract's Event.



2. terrorism;
3. assassination;
4. war;
5. gaming;

In addition to these five specific activities, Congress included a sixth activity: “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”¹⁴ This sixth activity gives the Commission discretion to identify other similar activities that are contrary to the public interest. If the Event Contract’s Event does not involve any of the six activities that are listed in the Special Rule, the Event Contract is not eligible for the Special Rule. The analysis terminates and the Special Rule does not apply to prohibit the contract. If the Event Contract’s Event does involve at least one of these activities, the analysis continues to step three.

Step three of the Special Rule (“Step Three”) is for the Commission to determine whether the contract itself, considered as a whole, is contrary to the public interest.¹⁵ If the Commission does not determine that the contract is contrary to the public interest, the contract is not prohibited under the Special Rule. If the Commission determines that the contract is contrary to the public interest, the Special Rule applies and the contract is prohibited.¹⁶

The three steps that the Commission follows in applying the Special Rule are therefore:

Step 1: Is the contract an Event Contract? If no, stop. If yes, continue to step 2.

Step 2: Does the Event Contract’s Event involve an activity that was included by Congress in the Special Rule? If no, stop. If yes, continue to step 3.

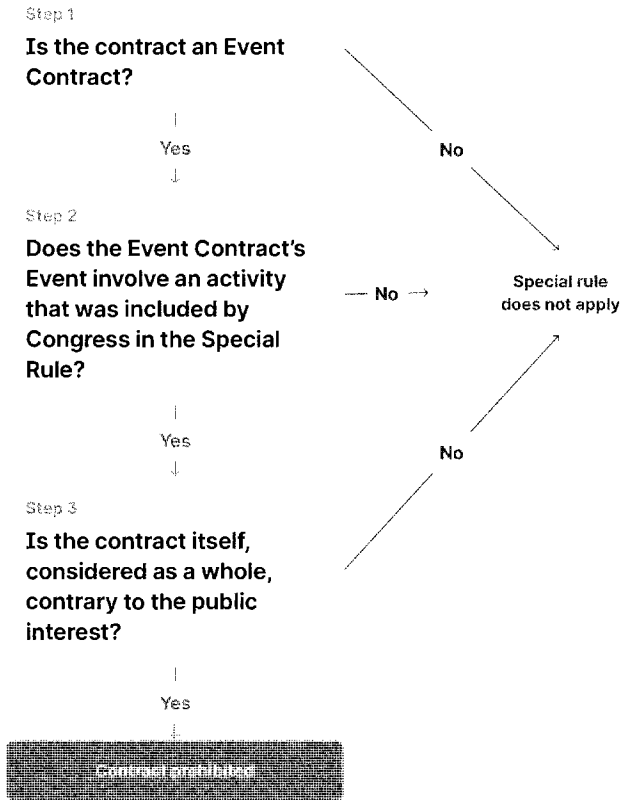
Step 3: Is the contract itself, considered as a whole, contrary to the public interest? If no, the contract is not prohibited. If yes, the contract is prohibited.

Graphically, the flow of the three steps looks like this:

¹⁴ 7 U.S.C. 7a-2(c)(5)(C)(i)(VI).

¹⁵ The phrase “contrary to the public interest” is used three times in the Special Rule. It is used in clause (i) in reference to the sixth activity in the list of activities Congress included in step two of the Special Rule. In this context, it is the *contract’s Event* that is contrary to the public interest, not the *contract itself*. It is also used in clause (i) in step three and in the prohibition in clause (ii) in reference to the *contract itself*.

¹⁶ 7 U.S.C. 7a-2(c)(5)(C)(ii). (“No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.”)



Step One and Step Two limit the scope of contracts to which the Special Rule applies. Step One limits the Special Rule only to Event Contracts. Step Two limits this scope further. Step Two provides that the Special Rule does not apply to *all* Event Contracts, but only to those contracts whose Events involve one of the activities Congress listed in the statute. Step Three provides that even a contract that passes Steps One and Two is not prohibited unless the Commission determines that the contract, considered as a whole, is contrary to the public interest. The following graphic illustrates how each step of the Special Rule functions to narrow the scope of the contracts that are prohibited under the Special Rule.

All Contracts

Step 1 Is the contract an Event Contract?

Step 2 Does the Event Contract's Event involve an activity that was included by Congress in the Special Rule?

Step 3 Is the contract itself, considered as a whole, contrary to the public interest?

To further explain the role of Step Three, Congress did not prohibit an Event Contract whose Event involves an activity listed in the Special Rule.. It is possible that an Event Contract's Event involves an activity listed in the Special Rule but the Commission does not determine that the contract, considered as a whole, is contrary to the public interest. That contract would not be prohibited under the Special Rule. For example, an Event Contract on the invasion of Ukraine would satisfy Steps One and Two because it is an Event Contract (Step One) and the Event Contract's Event involves war, one of the activities that is listed in the Special Rule (Step Two). That does not mean that the contract is prohibited; it moves to step three for the Commission to determine if the Event Contract, considered as a whole, is contrary to the public interest. The Commission may determine that it is contrary to the public interest, in which case the Event Contract would be prohibited by the Special Rule.¹⁷ And the Commission may determine that it is not contrary to the public interest. As Commissioner Johnson recently noted, "Geopolitical events in Europe, specifically, the invasion of Ukraine has led to remarkable disruptions in energy and agriculture markets."¹⁸ Accordingly, the Commission may find that the Event Contract has hedging utility and/or other economic utility or benefits and thus could not determine that the Event Contract is contrary to the public interest. This point, that a contract's event can involve an activity listed in the statute and still be allowed because the contract itself is not contrary to the public interest was made by then-Commissioner Berkovitz in his statement on ErisX's RSBIX contracts.¹⁹

¹⁷ 7 U.S.C. 7a-2(c)(5)(C)(ii).

¹⁸ [Opening Statement of Commissioner Kristin N. Johnson before the Energy and Environmental Markets Advisory Committee | CFTC](#), September 20, 2022.

¹⁹ Commissioner Berkovitz's statement is available here:

<https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>. Commissioner Berkovitz concluded his statement by noting that, "If sporting event contracts with an economic purpose, such as hedging, are allowed to be traded on a DCM, the general public must be able to access and trade those contracts on the exchange. The public cannot be barred from trading a contract listed on a DCM. However, gaming contracts without any economic purpose should not be permitted on a DCM."

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A further look at step two of the Special Rule

Once an Event Contract passes Step One, the analysis moves to Step Two of the Special Rule. Step Two is to determine if the Event Contract involves an activity that was listed by Congress in the Special Rule. For the purposes of step two of the Special Rule, an Event Contract only involves an activity if the Event Contract's *Event* involves that activity.²⁰ For example, an Event Contract can only involve war if the Event Contract's Event involves war. Conversely, if the Event Contract's Event does not involve war, then the Event Contract does not involve war. Similarly, an Event Contract will involve gaming only if the Event Contract's Event involves gaming. For the purposes of Step Two, it is irrelevant if something else surrounding the Event Contract, such as the market activity of trading the contract, involves a listed activity. The only relevant factor for Step Two is whether the Event Contract's Event involves the listed activity, not whether the Event Contract, considered as a whole, involves the listed activity.

There are many reasons why the analysis of whether an Event Contract involves a listed activity in Step Two is limited to the Event Contract's Event, and does not include the consideration of the Event Contract as a whole. Many of these reasons are stated in the letters in Part 2 of this comment, as well as by other commenters.²¹ The Exchange provides two reasons here. (For convenience, this comment refers to the incorrect reading that the analysis under Step Two includes the Event Contract, considered as a whole, and is not limited to only the Event Contract's Event, as the "Contract as a Whole view of Step Two".)

The Contract as a Whole view of Step Two is wrong. An Event Contract cannot be considered to involve a listed activity based on the Event Contract considered as a whole, and not only the Event Contract's Event. If step two were so broad, it would (1) defeat Congress' intended narrowing function, and (2) render the statute internally inconsistent.

The sixth activity illustrates the flaw in applying Step Two broadly, ie. Contract as a whole View of Step Two. Congress included as the sixth activity a "similar activity [to the first five activities, that is] determined by the Commission, by rule or regulation, to be contrary to the public interest." Under the Contract as a Whole view of Step Two, the sixth activity means that the Commission can determine that any factor that is part of an Event Contract is contrary to the public interest.²² For example, the Commission can determine that *trading* contracts on a certain event is a "similar activity" to the listed activities and is contrary to the public interest. These contracts would satisfy Step Two even though the Event contracts are based on Events that are *not* contrary to the public interest because the *trading* on the contract *is* contrary to the public interest per the Commission's determination, and trading on the contract is part of the contract when considered as a whole.

The analysis would then move to Step Three. But Step Three calls for a public interest analysis

²⁰ The analysis of the Event Contract in Step Three is different from Step Two. The analysis in Step Three considers the Event Contract as a whole, and is not limited to the Event Contract's Event. Conversely, the analysis in Step Two is limited to what activities the Event Contract's Event involves.

²¹ See e.g. the comments of Josh Sterling, Timothy McDermott, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, and Railbird Technologies.

²² This is because under the Contract as a Whole view of Step Two, Step Two is not limited only to looking at the Event Contract's Event. The analysis in Step Two looks at the Event Contract as a whole. Accordingly, the activities included in the list in Step Two are not confined to the Event Contracts' Events, and can include anything related to the Event Contract.

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of the Event Contract, considered as a whole, where it has already been determined under Step Two that the *trading itself* is contrary to the public interest, i.e. that the Event Contract, considered as a whole, is contrary to the public interest. This results in two consecutive steps that do the exact same thing:

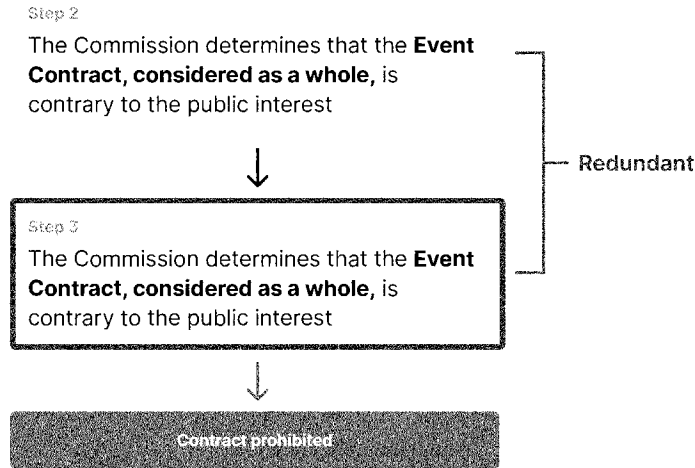
- Step Two: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
- Step Three: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest (*again*)

This illustrates the fundamental flaw in the Contract as a Whole view of Step Two. What Congress clearly designed is a statute that allows the Commission to apply special scrutiny to contracts based on particular events that Congress identified as problematic. Congress did not shut the door to such contracts, but recognized that trading on an Event Contract whose Event is a problematic activity that involves, say, assassination or terrorism might nevertheless have redeeming features (such as hedging utility) that would justify the conclusion that the Event Contract, considered as a whole, is not contrary to the public interest. In this way, Congress clearly differentiated the Event Contract's Event (which may be disfavored), and trading in the Event Contract (permitted where trading on the disfavored activity offers economic and other societal benefits). When trading in the Event Contract *itself* is included in the analysis at Step Two, the distinction Congress sought to draw between the underlying event and trading in the contract is obliterated.²³

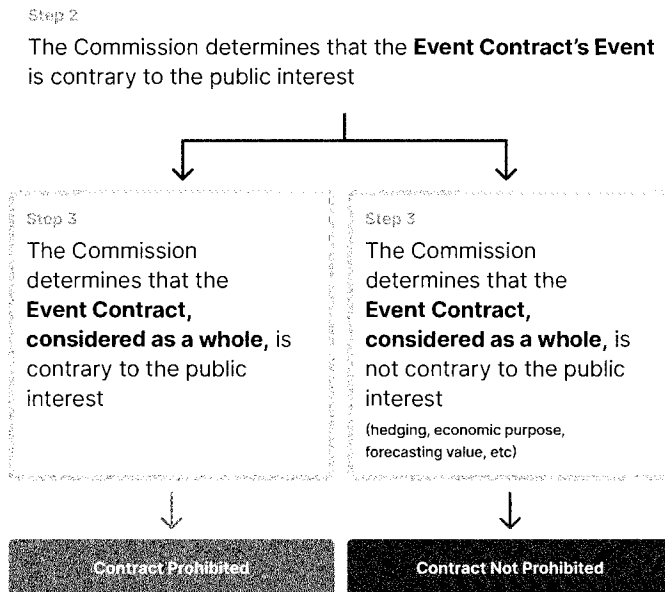
²³ This defect in the statute that emerges from the Contract as a Whole view of Step Two is from the sixth activity. The fact that the defect stems from the sixth activity does not mean that defect is limited to the sixth activity and that the Contract as a Whole View of Step Two is fine with regard to activities one through five. That would misapprehend the way that statutes work. Once it is demonstrated that step two cannot be about the contract, considered as a whole, for even one activity, that view is proven wrong. Therefore, the Contract as a Whole view of Step Two is an incorrect reading of the statute regardless of the activity.



The use of (c)(5)(C)(i)(VI) under the incorrect Contract as a Whole view of Step 2



The use of (c)(5)(C)(i)(VI) under the correct view of Step 2



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Additionally, the Contract as a Whole view of Step Two actually renders all of the first five activities in Step Two superfluous. Once a contract passes Step Two, no matter which activity the contract involves, it must pass Step three to be prohibited by the Special Rule. The analysis in Step Three is for the Commission to determine whether the Event Contract, considered as a whole, is contrary to the public interest. *Any* Event Contract that the Commission determines is contrary to the public interest in step three *necessarily* would also satisfy the sixth activity in Step Two. For example, an Event Contract that involves war will pass Step Two. The analysis of the Event Contract will then move to Step Three, and assume that the Commission finds that the contract is contrary to the public interest. At that point, the Event Contract actually involves *two* of the listed activities: (i) it involves the activity of war, and (ii) it *also* involves an activity that the Commission has determined is contrary to the public interest. It is impossible for an Event Contract to pass Step Three and not involve the sixth activity in Step Two. Accordingly, there is no point in the first five activities listed in Step Two, only the sixth activity. In fact, there would be no point in Step Two at all. As noted, the sixth activity in Step Two and Step Three are identical. Accordingly, if the Contract as a Whole view of Step Two is correct, Congress would have just skipped Step Two altogether. The Special Rule would have been a simple six line statute that said only:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest.

The inevitable collapse of all of the Step Two activities into the sixth activity and the collapse of the sixth activity into Step Three under this expansive interpretation of Step Two shows that the Contract as a Whole view of Step Two is wrong. The correct view of Step Two is that it, like Step One, simply describes what the contract is based on, and the analysis in Step Two is limited to the Event Contract's Event. Accordingly, there is a big difference between Step Two, including the sixth activity, and Step Three. Step Two is focused only on the Event Contract's Event. If an Event Contract passes Step Two because the Event Contract's Event involves any of the listed activities, even the sixth activity, the analysis under Step Two will always be different from the analysis under Step Three. The analysis under Step Two will be whether the Event Contract's Event involves the activity. The analysis under Step Three is very different. Step Three does not only consider the Event Contract's Event alone, it considers the Event Contract, considered as a whole. Thus, all of the anomalies that directly stem from the Contract as a Whole view of Step Two disappear under the view that the analysis in Step Two (like Step One) considers only the Event Contract's Event.

The correct reading of the statute is that the analysis in Step Two, like Step One, is limited to the Event Contract's Event. Steps One and Two work in concert to create the eligibility requirements for the *type* of contract that the Special Rule applies to (*i.e.*, an Event Contract whose Event involves a listed activity), and Step Three serves as an independent step whose analysis considers the Event Contract, as a whole. Together, all three steps form a coherent and cohesive statutory rule that implements Congress's intent to have the Commission review a narrow subset of event contracts whose underlying events involve activities (such as terrorism and assassination) Congress did not want to automatically legitimize via futures and swaps trading on them. Congress nevertheless gave the Commission discretion to allow such contracts to be listed if

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trading them would not be contrary to the public interest.

The Nadex Order's incorrect reading of the Special Rule

In the Commission's 2012 Nadex Order²⁴ ("*Nadex Order*") (see Question 5), the Commission applied the Special Rule to contracts on the occurrences of political control and the election of the President of the United States. These occurrences do not involve any of the activities in step two of the Special Rule. Despite this, the *Nadex Order* concluded that the Special Rule applied and prohibited the contracts. The *Nadex Order* adopted the Contract as a Whole view of Step Two, and assumed that the analysis in Step Two considers the Event Contract as a whole, not just the Event Contract's Event. The *Nadex Order* found that the election contracts involved the activity of gaming even though the contract's Event did not, because the act of trading on the contract was gaming and therefore, those contracts, considered as a whole, satisfied Step Two.

This Contract as a Whole view of Step Two that the *Nadex Order* adopted is wrong, and should be rejected. As discussed at length, it violates the structure and the framework of the statute, and it leads to absurd results. The correct view of the statute is that Step Two, like Step One, relates to what the contract is based on, or the contract's Event.

The Nadex Order's misreading of the statute would apply to every futures and swap contract on an occurrence

The consequence of the Contract as a Whole view of Step Two that the *Nadex Order* adopted is that the Special Rule applies to *all* futures, commodity options, and swap contracts that are based on an occurrence, extent of an occurrence, or a contingency. The *Nadex Order* found that the contracts at issue there were gaming because the act of trading the contracts would fit within state law and federal law definitions of gaming. That same reasoning would apply to *all* futures, commodity options, and swaps that are based on an occurrence, extent of an occurrence, or contingency, because the act of trading these contracts would also fit within definitions of gaming. For example, the *Nadex Order* cited the law in North Dakota that "'Gambling' means risking any money ... upon ... the happening or outcome of an event, including an election ... over which the person taking the risk has no control."²⁵ The *Nadex Order* also cited the New Hampshire law that "'Wager' means a monetary agreement between 2 or more persons that a sum of money ... shall be paid to one of them on the happening or not happening of an uncertain event."²⁶

The approach the Commission adopted in the *Nadex Order* expands the scope of the Special Rule far beyond what Congress intended. Under the *Nadex Order* and in light of the breadth of some definitions of gaming activity, the Commission could deem the staking of value on any type of future event gaming. Alternatively, the Commission could determine via the authority granted in the Sixth Activity, that trading on any type of future event is similar to the other enumerated activities. The vast breadth of such discretion cannot be squared with the specific enumeration of activities, which Congress clearly designed to cabin the Special Rule's scope.

²⁴ CFTC Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts" (Apr. 2, 2012) available here: [CFTC Issues Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts | CFTC](#).

²⁵ *Nadex Order* fn. 1

²⁶ It is true that the *Nadex Order* also cited state laws that were more tailored to elections specifically, but that does not negate the point that there are also state laws that define gaming broadly that would include trading any futures, commodity options, or swap contracts that pass step one. Picking and choosing which state statutes to consider informative in a manner that is expedient for a desired outcome is not the proper way for the Commission to adopt its definitional framework.



This reality illustrates the *Nadex Order's* flaw in going beyond the event underlying the contract -- elections -- to determine whether the contract was gaming.

This argument is addressed in greater detail in Part 2 of this comment. However, the Exchange notes here that this overbreadth is a problem exclusive to the approach to the Contract as a Whole view of Step Two adopted in the *Nadex Order*. Under the more tailored approach where step two of the Special Rule is limited to the contract's Event, this overbreadth disappears..

Applying the three steps of the Special Rule to Kalshi's Contract

Applying the three steps to Kalshi's contract shows that the contract is not subject to the Special Rule.

Kalshi's Contract passes Step One. It is a contract based on the occurrence of political control. The Contract is an Event Contract, meeting the eligibility requirements in Step One, and the analysis proceeds to Step Two.

Step Two is whether the Event Contract's Event involves an activity that was listed in Step Two. The Contract's Event is political control, specifically the dual occurrences of the party membership of the Speaker of the House and the President Pro Tempore. These do not involve any of the listed activities.

- The occurrence of political control does not involve activity that is illegal under either Federal or State Law.
- The occurrence of political control does not involve the activity of terrorism.
- The occurrence of political control does not involve the activity of assassinations.
- The occurrence of political control does not involve the activity of war.
- The occurrence of political control does not involve the activity of gaming.²⁷
- The occurrence of political control does not involve an activity that the Commission has determined to be contrary to the public interest.

The Contract's Event, therefore, does not involve an activity that was included by Congress in the list of activities in Step Two of the Special Rule, and therefore the contract fails the Step Two eligibility requirements. The analysis therefore terminates and does not proceed to Step Three, and Congress did not authorize the Commission to apply the Special Rule to prohibit the Contract.

Conclusion to Part 1

Congress granted the Commission in the Special Rule the authority to prohibit certain contracts. This grant of authority is subject to the rules that Congress created. Congress included three distinct steps to determine if a contract is prohibited under the Special Rule. The Commission must abide by these rules. Step Two is clear; the analysis only considers whether the Event Contract's Event involves a listed activity, and it does not consider the Event Contract, as a whole. The Kalshi Contract's Event is political control. Political control does not involve any of the activities that Congress included in Step Two. Accordingly, the Contract fails Step Two, and the Special Rule cannot prohibit the Contract.

²⁷ The Commission has never stated, or even implied, that the occurrence of elections involves gaming. In the Commission's Nadex order, the Commission stated that "*taking a position* in a Political Event Contract" is gaming because elections are a "a contest between electoral candidates." See *North American Derivatives Exchange, April 2, 2012 (cftc.gov)*, pg. 3. However, the Commission was careful to not suggest that elections themselves, the very bedrock and foundation of our democracy, are a game.



As required by the CEA in 7 U.S.C. 7a-2(c)(5)(B), the Commission should approve the Contract.



Part 2

The following two letters contain analyses on the Special Rule, as well as the implementing regulations at 17 C.F.R. 40.11. They were originally submitted to the Commission for consideration as part of the original 40.3 submission, and the Exchange includes them now in a public comment for the Commission's further consideration.

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September 21, 2022

Sebastian Pujol Schott
Acting Deputy Director, Product Review Branch
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
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Re: Non-Application of Event Contracts Provisions to KalshiEX LLC's Political Control Contracts

Dear Mr. Pujol Schott:

I write to you on behalf of KalshiEX LLC (“Kalshi”) with respect to its intention to self-certify certain political control contracts (the “Contracts”) to be listed for trading on its designated contract market (“DCM”), and to address any outstanding concerns the Commodity Futures Trading Commission (“CFTC” or “Commission”), including the Division of Market Oversight (“DMO”), might have. We greatly appreciate the Commission’s and DMO’s continued willingness to allow Kalshi to highlight the many reasons why the Contracts should be listed, including the demonstrated economic purposes they serve.

In the spirit of building upon that productive dialogue, and in advance of Kalshi’s self-certification of the Contracts, we wanted to elaborate on why Section 5c(c)(5)(C) of the Commodity Exchange Act (“CEA”) and CFTC Regulation 40.11 (together, the “Event Contracts Provisions”) do not provide a legal basis for the staff or the Commission to impede self-certification of the Contracts.

As further explained below, Section 5c(c)(5)(C)(i) of the CEA does not hinder self-certification of the Contracts because the activity on which they are based does not “involve” any of the enumerated event categories in the provision. Although the Commission previously determined

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that other political event contracts that were self-certified by a different exchange, the North American Derivatives Exchange (“Nadex”), were subject to the Event Contracts Provisions, that determination was based on a misinterpretation of the Event Contracts Provisions. Therefore, the Commission’s previous determination on Nadex’s proposed contracts should not be followed here with regards to the Contracts.¹ Under the Event Contracts Provisions, and contrary to the Commission’s order relating to Nadex’s political event contracts (“Nadex Order”), which determined that the *trading* of contracts based on the outcomes of elections constituted gaming activity, the Commission must consider whether the occurrence or contingency *on which the Contracts are based* – elections – involves one of the enumerated activities. And because elections do not fit within any of the enumerated event categories, the Event Contracts Provisions provide no basis to delay self-certification. CFTC Regulation 40.11 calls for the same result. Accordingly, even if, arguendo, CFTC Regulation 40.11 contains language that could be construed to support a different result, the Commission should read CFTC Regulation 40.11 to be consistent with Section 5c(c)(5)(C) and, accordingly, the Contracts should be self-certified without delay or encumbrance.

As explained in greater detail below, because the Event Contracts Provisions do not establish any legal or regulatory basis for impeding the Contracts, the Commission should take no action that would delay Kalshi from self-certifying them pursuant to CFTC Regulation 40.2.

I. SECTION 5C(C)(5)(C) OF THE CEA PROVIDES NO BASIS TO IMPEDE SELF-CERTIFICATION OF KALSHI’S POLITICAL CONTROL CONTRACTS.

Section 5c(c)(5)(C)(i) of the CEA establishes that, in connection with the listing of agreements, contracts, or transactions on “excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency[.]”

the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve[.] (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

Section 5c(c)(5)(C)(ii) further specifies that “[n]o agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.” Thus, the CEA, through this

¹ 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>.

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provision, establishes a clear framework under which the Commission can – but is not obligated to – review an event contract that is based upon an “occurrence, extent of an occurrence, or contingency” that involves one of the enumerated underlying activities in order to determine if those contracts would be contrary to the public interest. A Commission determination that the contract is contrary to the public interest would render its listing prohibited.

In short, through Section 5c(c)(5)(C), Congress granted the Commission the discretion to determine that a given event contract is contrary to the public interest, and thereby prohibited, only when the event underlying that contract involves one of the statute’s specifically enumerated activities. Congress did not grant the Commission the authority to prohibit a contract based upon an event that involves an unenumerated activity on the grounds that it would be contrary to the public interest.²

The plain language and structure of Section 5c(c)(5)(C)(i) make clear that the scope of the Commission’s discretionary review is narrowly focused on the nature of the contract’s underlying event, not of trading in the contract itself. Section 5c(c)(5)(C)(i) begins with the clause: “[i]n connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities *that are based upon the occurrence, extent of an occurrence, or contingency*[.]” (emphasis added). Thus, at the outset of the controlling provision, the statute establishes that the distinguishing feature of the contract is the nature of the occurrence or contingency. The final clause of Section 5c(c)(5)(C)(i), immediately prior to the provision’s enumeration of the covered activities, refers back to the first clause of the provision when it says: “the Commission may determine that *such* agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve” the enumerated activities. (emphasis added). When the clauses are read together, Section 5c(c)(5)(C)(i) grants the Commission only limited authority to review a contract that is “based upon [an] occurrence, extent of an occurrence, or contingency” that “involve[s]” one of the enumerated activities.

The plain language of the enumerated events themselves bolsters this interpretation. As Kalshi has pointed out in previous submissions,³ Section 5c(c)(5)(C)(i)’s first and sixth categories are defined respectively as an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added). The inclusion of the noun “activity” (and the reference in the sixth

² This lack of authority includes the sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), as that provision requires the Commission to conduct a rulemaking to determine that another activity is contrary to the public interest and then only if it is similar to one of the other specified underlying activities (crimes, terrorism, assassination, war, or gaming). See Commission Rulemaking Explained, available at: https://www.cftc.gov/LawRegulation/CommissionRule-makingExplained/index.htm#_ftn1.

³ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to DMO March 28, 2022.

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category to all five preceding “similar activit[ies]”) makes clear that Congress intended the underlying activity, not the contract itself, to be the subject of review and scrutiny and it must be assumed that decision was intentional.⁴

The sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), further highlights that Congress’s intention was for the Commission to analyze the activity underlying the contract rather than trading in the contract itself. This final enumerated activity provides the Commission a sort of catchall to determine whether the event involves “similar activity” to the preceding categories and thus might be inappropriate for listing. Since terrorism, assassination, war, and activity unlawful under state or federal law unquestionably refer to the occurrence or contingency underlying the contract, the sixth catch-all category must be read consistently with the rest of the enumerated list (apples must be compared to apples).⁵

Another reason that Section 5c(c)(5)(C) must be read as focusing on the underlying activity is that such focus is congruent with the nature of event contracts themselves. If Congress was concerned about trading in the contract itself, there is no indication why it would have limited the provision to event contracts rather than establishing a general rule that would have authorized the Commission to prohibit any derivatives contract that the trading in is, for example, unlawful under state law.

In the Nadex Order,⁶ the Commission did not interpret Section 5c(c)(5)(C) as focusing on the underlying activity. Instead, the Commission appears to have read the gaming provision (the fifth enumerated activity) to refer to trading in the contract itself. Accordingly, the Commission determined that the gaming provision applied to Nadex’s political event contracts because the contracts involved “a person staking something of value upon a contest of others.”⁷ The Commission likened this trading activity to activity prohibited by state anti-gambling laws. The Commission’s interpretation in this instance ran counter to the plain language and structure of the statute, as explained above.

⁴ The scant legislative history – a colloquy between Senators Diane Feinstein and Blanche Lincoln during the Senate’s consideration of Dodd-Frank’s regulation of event contracts – does not change the analysis. The colloquy did not address whether the underlying event, rather than trading in the contract itself, is the proper subject of analysis; instead, the Senators discussed the distinction in economic purpose between contracts that serve hedging utility and contracts that are designed predominantly for speculation. *See* 56 Cong. Rec. S5906-07 (July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at: <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. In any event, the language and structure of the statute are clear, so resorting to legislative history is unnecessary.

⁵ We explain below why, notwithstanding the Commission’s Nadex Order, the gaming provision must also refer to the underlying activity and not trading in the contract itself.

⁶ *See supra* note 1.

⁷ Nadex Order at 3 (internal quotation marks omitted).

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Other principles of statutory construction also undercut the application of the Event Contracts Provisions in the Nadex Order. Under the Commission’s interpretation, a person trading a political event contract is engaged in gaming – “staking something of value upon a contest of others.”⁸ By parallel reasoning, a person trading a terrorism contract is engaged in terrorism and a person trading a war contract is engaged in war. That is not a tenable interpretation of the statute. If Congress intended the Commission to focus on the underlying event for some of the enumerated categories, but to focus on trading in the contract itself for others, it would have said so. It certainly cannot be presumed or inferred from silence that Congress intended the Commission to apply disparate analytical approaches to the single list of enumerated activities. When the correct interpretation of Section 5c(c)(5)(C) is applied to the Contracts, the result is clear. Elections are not illegal under state or federal law, are not gaming, and are not similar to any of the enumerated activities – federal or state crimes, terrorism, assassination, war, and gaming – all of which are activities that Congress did not want to legitimize or encourage via event contracts without careful consideration by the Commission. The Commission should therefore not impede Kalshi from self-certifying the Contracts and lacks a legal basis to invoke Section 5c(c)(5)(C) to do so.

While we could stop here, we believe it is worth pointing out that the Nadex Order not only contravenes the language and structure of Section 5c(c)(5)(C), but also threatens to upend the CEA itself. Virtually every futures or swaps contract can be described as staking something of value on the outcome of some future event.⁹ Yet the CFTC’s exclusive jurisdiction over derivatives markets means that the CEA preempts any state law that would attempt to regulate derivatives markets.¹⁰ Therefore, regulated futures and swaps contracts *cannot be* illegal gambling under state law.

In fact, many states ban “gambling” not just on elections, but more generally on the outcomes of future events. These laws would prohibit the entire category of event contracts (at a minimum), which both Congress and the CFTC have expressly permitted to be listed on DCMs. Some of these states provide carve-outs for CFTC-regulated products, or otherwise for activities like commodities and securities trading. However, not all do. New Hampshire, for example, bans gambling and defines it as, “to risk something of value upon a future contingent event not under one’s control or influence.”¹¹ Alaska also bans gambling and defines it similarly as when:

⁸ *Id.*

⁹ This overly broad interpretation of the term “gaming” would threaten to render 5c(c)(5)(C)’s other enumerated provisions superfluous, given that, as explained above, virtually all event contracts could potentially qualify for that categorization. As the Supreme Court has repeatedly observed, there is a “canon against interpreting any statutory provision in a manner that would render another provision superfluous.” *Bilski v. Kappos*, 561 U.S. 593, 607-8 (2010).

¹⁰ *See Am. Agric. Movement v. Bd. of Trade*, 977 F.2d 1147, 1156-57 (7th Cir. 1992) (holding that “When application of state law would directly affect trading on or the operation of a futures market, it would stand ‘as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,’ and hence is preempted.” (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941))).

¹¹ NH Rev Stat § 647:2(II)(d), available at: <https://www.gencourt.state.nh.us/rsa/html/l/xii/647/647-2.htm/>.

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...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.¹²

Finally, at least one federal law that addresses gambling specifically carves out regulated derivatives products from their definitions of "bet or wager," highlighting that Congress views the two types of transactions as fundamentally distinct. The Unlawful Internet Gambling Enforcement Act of 2006's ("UIGEA") definition of "bet or wager" specifically "does not include [as relevant here:]"

- (ii) any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act;
- (iii) any over-the-counter derivative instrument;
- (iv) any other transaction that—
 - (I) is excluded or exempt from regulation under the Commodity Exchange Act; or
 - (II) is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.¹³

Notably, the Commission relied upon UIGEA's definition of "bet or wager" in its Nadex Order,¹⁴ but made no mention of the carve out for derivatives products.

All of these various provisions illustrate the flaw in evaluating whether *trading* a futures or swaps contract constitutes gaming or gambling activity, as the Commission did in the Nadex Order, or whether *trading* a futures or swaps contract is unlawful under federal or state law. Instead, to maintain the structural integrity of Section 5c(c)(5)(C) and the CEA itself, the Commission should evaluate whether the Contracts involve an underlying activity – elections – that fits into one of the enumerated categories of activities in Section 5c(c)(5)(C). Because elections do not

¹² AK Stat § 11.66.280(2).

¹³ 31 U.S.C. § 5362(1)(E) (2006).

¹⁴ *Supra* note 1 at 3.

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fit within any of the enumerated activities, the Commission should not impede self-certification of the Contracts.

II. CFTC REGULATION 40.11 CALLS FOR THE SAME RESULT.

A determination that Section 5c(c)(5)(C) does not present an obstacle to Kalshi's self-certification of the Contracts should be dispositive, because CFTC Regulation 40.11, which the CFTC adopted to implement Section 5c(c)(5)(C), should likewise be read to allow only for the Commission's consideration of the contract's underlying activity, rather than its consideration of trading in the contract itself. While the language of the rule is not identical to the statute, there is no reason to read the language of CFTC Regulation 40.11 to require an analysis of trading in the contract rather than the contract's underlying activity that constitutes the event.

The scope of CFTC Regulation 40.11 should not be read to go beyond the scope of the special rule in the statute. By using the words "relates to, or references" in addition to "involves," the regulation only reinforces that the relevant activity is the underlying event, not trading on the underlying event. It would not make sense for a futures contract or swap to "reference" trading in the contract; to the contrary, the word "reference" is a clear direction to focus on the underlying event that the contract "references." Thus, under the regulation, like the statute, the relevant activity for purposes of the Commission's event contract analysis is the activity on which the contract is based (or to which the contract refers) rather than the contract itself.¹⁵ Even if the different words in the regulation could conceivably be read to support a different analysis that would broaden the scope of contracts subject to the statute, courts have held that, even under a standard of review that is highly deferential, an agency interpretation will not stand if "it is contrary to clear congressional intent or frustrates the policy Congress sought to implement."¹⁶

¹⁵ Because the Contracts are not based on an enumerated activity, the Commission does not need to consider undertaking a public interest analysis. If the Commission were to conclude otherwise, however, the Commission could either permit the contracts to be listed (the statute authorizes prohibition only upon a Commission determination that the contract would be contrary to the public interest, a determination that the Commission "may" undertake) or conduct a public interest analysis. CFTC Regulation 40.11 should not be read to constitute a blanket prohibition, as that reading could not be squared with the statute. See Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitz-statement040721> ("if sports event contracts involving gaming are found to have an economic purpose, they should be permitted to be listed on a DCM and retail customers cannot be prohibited from trading those contracts"); Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521> ("Congress [through Section 5c(c)(5)(C) of the CEA] unambiguously provided a default rule that all event contracts, including the enumerated ones, are allowed").

¹⁶ *Garcia Carias v. Holder*, 697 F.3d 257, 271 (5th Cir. 2012); *CHW W. Bay v. Thompson*, 246 F.3d 1218, 1223 (9th Cir. 2001) ("deference is not owed to an agency decision if it construes a statute in a way that is contrary to congressional intent or frustrates congressional policy").

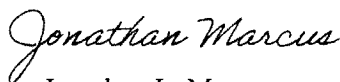
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III. CONCLUSION

For all of the reasons stated above, the Commission has no reason to stay Kalshi's self-certification of the Contracts. We welcome your feedback on this position and would appreciate the opportunity to follow-up on these specific considerations in a conference call or in-person meeting to the extent you have further questions.

Very truly yours,



Jonathan L. Marcus

Cc: Eliezer Mishory
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May 31, 2022

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Re: Political Event Contracts, Section 5c(c)(5)(C) of the CEA, and CFTC Rule 40.11

Dear Mr. Mishory:

This letter is in response to your request for legal advice regarding KalshiEx LLC's ("Kalshi") engagement with the Commodity Futures Trading Commission ("CFTC" or "Commission") about the listing of certain event contracts relating to the partisan makeup of Congress, specifically the political control of Congress. One of the factors that Kalshi considers in listing contracts is ensuring regulatory compliance and, as such, you requested advice on the following question:

Are Kalshi's proposed political control contracts subject to the Commodity Exchange Act's ("CEA's") special rule for event contracts described in Section 5c(c)(5)(C) of the CEA and the implementing regulations at 17 C.F.R. § 40.11?

By way of background, in 2012, Nadex listed similar contracts (although with different characteristics) which the Commission prohibited by order ("Nadex Order"),¹ finding that trading in the Nadex contracts violated the CEA. Specifically, the Nadex Order found that Section 5c(c)(5)(C) of the CEA applied to the Nadex contracts because the Nadex contracts constituted gaming.² The Nadex Order also determined that the Nadex contracts were contrary to the public interest because the Nadex contracts could have an adverse effect on the integrity of elections.³

Section 5c(c)(5)(C) and Rule 40.11, however, are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match

¹ 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 (Apr. 2, 2012) (<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/-documents/ffddocs/nadexorder040212.pdf>) (last visited May 30, 2022).

² Nadex Order at 2-3.

³ *Id.* at 4.

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any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation. In reaching this conclusion, I will first provide some background of principles of interpretation and the relevant text of Section 5c(c)(5)(C) and Rule 40.11. I will then apply those principles to the Kalshi political control contracts and describe how the Nadex Order’s conclusions to the contrary are incorrect.

I. BACKGROUND

A. Principles of Interpretation

Since the Nadex Order, the Supreme Court has significantly modified the method through which regulatory text should be interpreted and the circumstances in which an agency will receive deference for its interpretation of regulatory text. The tools for interpreting regulatory text are similar to those for evaluating statutory text. I first discuss these principles and then use them to evaluate Section 5c(c)(5)(C) and CFTC Rule 40.11 and their application to Kalshi’s political event contracts.

The Supreme Court revamped the process for evaluating regulatory text in the 2019 case of *Kisor v. Wilkie*.⁴ In *Kisor*, the court considered whether to overrule *Auer v. Robbins*⁵ and *Bowles v. Seminole Rock*,⁶ cases which found that an agency was entitled to deference of its interpretation of an agency rule so long as it was not “plainly erroneous or inconsistent with the regulation.”⁷ In *Kisor*, the Court did not overrule *Auer* and *Seminole Rock*, but significantly limited their application: “The deference doctrine we describe is potent in its place, but cabined in its scope.”⁸

In reviewing the meaning of Rule 40.11, according to *Kisor*, one must “exhaust the ‘traditional tools’ of statutory construction.”⁹ “Agency regulations can sometimes make the eyes glaze over. But hard interpretive conundrums, even relating to complex rules, can often be solved.”¹⁰ One must “resort[] to all the standard tools of interpretation,”¹¹ including a careful consideration of

⁴ 139 S. Ct. 2400 (2019).

⁵ 519 U.S. 452 (1996).

⁶ 325 U.S. 410 (1945).

⁷ *Seminole Rock*, 325 U.S. at 414.

⁸ *Kisor*, 139 S. Ct. at 2408.

⁹ *Id.* at 2415 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

¹⁰ *Kisor*, 139 S. Ct. at 2415.

¹¹ *Id.* at 2414.

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“the text, structure, history, and purpose of a regulation”¹² to determine whether a rule has “one reasonable construction of a regulation”¹³ or can “at least establish the outer bounds of reasonable interpretation.”¹⁴ In discussing this approach to regulatory construction, the Supreme Court relied heavily on the principles of statutory construction discussed in *Chevron* and its progeny.

B. The Statute And The Rule

With these key principles in mind, I turn to the statute and rule. This analysis begins, of course, with the statutory text of Section 5c(c)(5)(C) of the CEA, from which the CFTC promulgated Rule 40.11. That section of the CEA states:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon **the occurrence, extent of an occurrence, or contingency** (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest **if** the agreements, contracts, or transactions **involve—**

- (I) **activity** that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) **other similar activity** determined by the Commission, by rule or regulation, to be contrary to the public interest.¹⁵

In relevant part for purposes of this analysis, Rule 40.11(a) states:

A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following:

- (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that **involves, relates to,**

¹² *Id.* at 2415.

¹³ *Id.*

¹⁴ *Id.* at 2416. The *Kisor* court goes on to explain that an agency’s interpretation of an ambiguous regulation may still not receive deference. The Court must then determine if “the character and context of the agency interpretation entitles it to controlling weight.” *Id.*

¹⁵ 7 U.S.C. § 7a-2(c)(5)(C)(i)(I)-(VI) (emphases added). If the Commission determines that such an agreement, contract, or transaction is contrary to the public interest, such agreement, contract, or transaction may not “be listed or made available for clearing or trading on or through a registered entity.” *Id.* § 7a-2(c)(5)(C)(ii).

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or references terrorism, assassination, war, gaming, or an **activity** that is unlawful under any State or Federal law; or

(2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references **an activity that is similar to an activity** enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.¹⁶

II. APPLICATION TO KALSHI'S POLITICAL CONTROL CONTRACTS

To help frame the matter, the key question here requires understanding the limitations on the scope of Section 5c(c)(5)(C) and Rule 40.11. Is the scope (1) limited to contracts when the activity underlying the event contract involves one of the enumerated activities or do they (2) include the act of participating in the contract is itself?

Applying the principles of statutory and regulatory construction shows that Section 5c(c)(5)(C) and Rule 40.11 are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation.

A. Section 5c(c)(5)(C) and Rule 40.11 Apply Only To Event Contracts Where The Activity Underlying The Event Contract Is One Of The Enumerated Activities.

The plain text of Section 5c(c)(5)(C) demonstrates that Congress limited the statute's scope to instances where the underlying activity of an event contract is one of the enumerated events. If the activity underlying the event contract does not involve one of the enumerated activities, the listing is outside the scope of the Statute and Rule 40.11, regardless of how the act of *participating* in the event contract itself is classified. An interpretation of the statute that extends the applicable scope to also include contracts where the underlying activity is not one of the enumerated events is overbroad and incorrect.

First, Section 5c(c)(5)(C) limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously acknowledged that Section 5c(c)(5)(C)'s textual focus is on "activities," *i.e.*, the underlying conduct. In describing Section

¹⁶ 17 C.F.R. § 40.11(a) (emphases added).

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5c(c)(5)(C), the Commission stated that the rule applied to contracts that “involve one or more *activities* enumerated in the Dodd-Frank Act.”¹⁷ These “activities” are not the contracts themselves. They are the events that create the basis for the relevant contract.

To give but one straightforward example, in the statute events two through four are terrorism, assassination, and war. The inclusion of these activities clearly demonstrates that the scope of Section 5c(c)(5)(C) and Rule 40.11 includes contracts when the activity underlying the event contract involves one of the enumerated activities. The act of participating in a contract is not itself an act of terrorism, assassination, or war.¹⁸ The same analytical approach, by extension, should apply to each of the items on the list, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C) would be internally inconsistent, contrary to the traditional tools of construction.

Second, Section 5c(c)(5)(C) and Rule 40.11 allow the Commission to prohibit the listing of an event contract only “if the agreements, contracts, or transactions **involve**” any of the enumerated activities that are against the public interest. Event contracts that do not involve any of the enumerated activities may be listed for trading because the special rule would not prohibit the listing of those contracts by a DCM.

Third, Section 5c(c)(5)(C) places an additional, key limitation on the “agreements, contracts, or transactions” within the scope of the text. Those “agreements, contracts, or transactions” must be “in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency.” The reference to “occurrence” or “contingency” can only mean to the underlying event of the contract, not the contract itself. The contract cannot reasonably be described as an occurrence or a contingency. Indeed, the headings of the section—“Special rule for review and approval of event contracts and swap contracts” (Section 5c(c)(5)(C)) and “Event Contracts” (Section 5c(c)(5)(C)(i))—reinforce Congress’ focus on the “event” or occurrence, not the trading

¹⁷ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) (“Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more **activities** enumerated in the Dodd-Frank Act.”) (emphasis added) (“40.11 Proposed Rule”); *see id.* at 67,289 (“If [] the Commission determines that such product may involve an **activity** that is enumerated in 40.11 . . .”) (emphasis added).

¹⁸ To illustrate this point, consider hypothetical contracts on whether a foreign leader will be assassinated, how many Russian planes will be shot down by Ukrainian forces, or how many murders will occur in a given city over a certain time period. Section 5c(c)(5)(C) and Rule 40.11 would apply to these hypothetical contracts because the activities underlying the contracts in these hypothetical examples are the enumerated activities of “assassination,” “war,” and “an activity that is unlawful under Federal or State law.” The purchasing of the contract itself, however, is not “an activity” of “assassination,” “war,” or “an activity that is unlawful under Federal or State law.”

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of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningfully limit the Commission's reach regarding event contracts.

Because the text and structure is clear, there is no need to resort to legislative history. That is a bedrock principle of the traditional tools of statutory construction. Nevertheless, the sparse legislative history regarding Section 5c(c)(5)(C)¹⁹ provides no guidance as to whether Congress intended the Commission to limit the scope of Section 5c(c)(5)(C) to instances where the underlying activity of an event contract is one of the enumerated events.

This reading of Section 5c(c)(5)(C) is consistent with the terms used by the Commission in Rule 40.11. Rule 40.11 borrows heavily from the terms used in the statute, including multiple uses of "activity" in both subsections 40.11(a). The Regulation also uses the same term "involves" which appears in the Statute, but also adds the phrase "relates to, or references" when describing enumerated activities. Because "involves" is the only statutory authority provided by Congress, the Commission cannot expand upon the scope of that term. Thus, the only way to read "relates to, or references" consistent with the Commission's authority is that they are the specific meanings of "involves" that the Commission adopted.²⁰ The terms "relates to" and "references," in turn, clearly describe the underlying activity upon which the event contract is based. It would be nonsensical to interpret "relates to" and "references" as describing the act of participating in the event contract itself.

To be clear, Congress could certainly promulgate a law that covers the *participation* in an event contract. But Section 5c(c)(5)(C) is not that law. Instead, applying the traditional tools of construction, Congress enacted Section 5c(c)(5)(C) to prohibit a narrow group of contracts whose underlying activities are the enumerated activities and the CFTC has determined are contrary to

¹⁹ The only legislative history that has been cited by the Commission regarding Rule 40.11 involves a short colloquy between Senator Feinstein of California and Senator Lincoln of Arkansas on July 15, 2010. *See, e.g.*, 40.11 Final Rule, 76 Fed. Reg. at 44,786 & nn. 34-35; *see also* Nadex Order, Whereas Clauses 2 & 7. This 555-word back-and-forth between two Senators, which takes up less than two columns of one page of the Congressional Record (Volume 156, Issue 105, S5906-5907 (July 15, 2010)), is particularly weak evidence of the intent of Congress as a whole and the meaning of the provision. *See, e.g.*, *NLRB v. SW General, Inc.*, 137 S. Ct. 929, 943 (2017) ("[F]loor statements by individual legislators rank among the least illuminating forms of legislative history."). The text is by far the more probative evidence of Congress' meaning. The Nadex Order's extensive reliance on this sparse legislative history is simply inconsistent with the interpretive approach laid out in *Kisor* and provides an additional reason why Kalshi can self-certify the contracts notwithstanding the Nadex Order. In any event, none of the short legislative history specifically addresses the question about whether Section 5c(c)(5)(C) applies only to the underlying events or the trading of the contracts as well, so it has nothing to add to this analysis.

²⁰ Rule 40.11 cannot exceed the scope of Section 5c(c)(5)(C). Any interpretation of Rule 40.11 that views it as expanding the scope delineated in Section 5c(c)(5)(C) would run afoul of the Constitution's separation of powers and the Administrative Procedure Act.

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the public interest and those limitations apply to Rule 40.11. If the underlying activity of a contract is not an enumerated event, it is outside the scope of Section 5c(c)(5)(C) and Rule 40.11.

B. The Nadex Order Incorrectly Interprets And Applies Section 5c(c)(5)(C) And Rule 40.11 To Apply To Political Control Contracts Like Kalshi's.

As described above, Section 5c(c)(5)(C) and Rule 40.11 apply only to the listing of event contracts whose underlying activity involves one of the six enumerated activities. They do not apply to event contracts whose underlying activity does not involve one of the enumerated activities. This key distinction between the activity itself or a *contract on the activity* is of particular importance for the Kalshi contracts at issue here. The underlying activity of Kalshi's contracts is political control of the chambers of Congress. Political control of Congress is none of the activities identified in Section 5c(c)(5)(C) and, as such, Kalshi's political control contracts are not subject to the special rule.

The Nadex Order's contrary conclusion was incorrectly reasoned and misapplied in several aspects.²¹ First, contrary to the above explanation, the Nadex Order incorrectly expanded the scope of the statute and regulation to include the act of participating in the contract, and not just the underlying activity. Second, the Nadex Order incorrectly includes election contracts in the enumerated activities of illegal under state law and gaming.

The Nadex Order incorrectly expanded the scope of Section 5c(c)(5)(C) and Rule 40.11 to include the act of participating in the contract, and not just the underlying activity. The first enumerated activity of Section 5c(c)(5)(C) is "activity that is unlawful under any Federal or State law." The underlying activity of Kalshi's contracts is political control of the chambers of Congress. There is no Federal or State law that makes political control of Congress illegal. There is also no Federal or State law that prohibits elections or voting in elections which result in the political control of Congress. Accordingly, political control contracts would not fall under the special rule's enumerated act of "illegal activity."

To be sure, 27 states do prohibit, in one form or another, betting on elections. And the Nadex Order (incorrectly) stated that "state gambling definitions of 'wager' and 'bet' are analogous to the act of taking a position in the Political Event Contracts"²² as a justification for prohibiting those contracts' listing. In this regard, however, the Nadex Order overextended. Section 5c(c)(5)(C) is limited to the activity underlying the contract, not the participation in the contract itself.

²¹ As noted previously (*see supra* nn. 4-14), the Commission adopted the Nadex Order prior to the Supreme Court's decision in *Kisor v. Wilkie* and thus the Order did not use the framework now required by the Supreme Court for evaluating the scope and implications of Rule 40.11.

²² Nadex Order at 2.

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The Nadex Order also misapplies the enumerated activity of “gaming.” There are at least two fundamental differences between the relevant state gaming or gambling laws and event contracts. As Commissioner Brian Quintenz described with regards to the withdrawn ErisX sports event contract, trading an event contract with a binary outcome is not automatically considered a gamble.²³ Indeed, if Section 5c(c)(5)(C) had assumed that participating in any event contract involved making a wager or gamble, there would have been no need for Congress to individually enumerate “gaming” as a distinct category of event contracts upon which the Commission could make a public interest determination. The fact that Congress separated “gaming” from other event contracts is a clear indication that Congress did not intend for all event contracts to be considered gaming.

In fact, the statutory definition of “bet” or “wager” used by the Nadex Order itself, in the same statute, clearly indicates that not all CFTC regulated products are gaming. The statute cited by the Nadex Order²⁴ for defining “bet” or “wager” is 31 U.S.C. § 5362(1), a part of the Unlawful Internet Gambling Enforcement Act of 2006. That definition of “bet or wager,” however, includes two relevant exclusions. First, the term “bet or wager” does 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.”²⁵ The term also does not include “any other transaction that is excluded or exempt from regulation under the Commodity Exchange Act.”²⁶ The statute cited by the Nadex Order itself demonstrates that the Nadex Order’s expansive application of Section 5c(c)(5)(C) and Rule 40.11 is incorrect.

The Nadex Order’s broad interpretation of gaming under the statute and rule would result in prohibiting much of the legally registered activity that the CFTC has previously approved. Indeed, many states ban “gambling” not just on elections, but specifically on the outcomes of future events. For example, New Hampshire bans gambling and defines it as “to risk something of value upon a future contingent event not under one’s control or influence”²⁷ while North Carolina includes a

²³ See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>) (last visited May 30, 2022). The many other distinctions between an event contract and a gamble include the fact that betting is a game of pure chance without any economic utility while event contracts are non-chance driven outcomes with economic utility.

²⁴ Nadex Order at 3.

²⁵ 31 U.S.C. § 5362(1)(a)(E)(ii).

²⁶ *Id.* § 5362(1)(a)(E)(iv)(I).

²⁷ NH 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

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wager on an “unknown or contingent event” in its statutory definition of gambling.²⁸ New York defines gambling as staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.²⁹ Other states explicitly prohibit trading on the future delivery of securities and commodities without delivery and which are purely cash-settled, as is normal for products like stock index futures and eurodollar futures.³⁰ In all, 19 states contain provisions in their state codes that prohibit the listing of at least some subset of contracts that the CFTC has approved.³¹

Under the Nadex Order’s reasoning, because Rule 40.11 prohibits the listing of contracts that “involve” “gaming,” laws like these would prohibit *all* event contracts. For example, event contracts on the weather and various economic indicators would be considered “risking something of value upon a future contingent event not under one’s control or influence.” And yet, not only are these event contracts a staple of CFTC regulated DCMs, but the Commission’s Core Principles require that event contracts be specifically outside the control or influence of a market participant and not readily susceptible to manipulation. The Nadex Order’s application of Rule 40.11 would therefore preclude the CFTC from regulating any event contract because event contracts are considered gambling under (some) state laws.³² Because such an interpretation of “gaming” would lead to absurd results, the traditional tools of interpretation and the process required by the

value in the event of a certain outcome”); Or. 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 . . .”).

²⁸ N.C. Gen. Stat. § 16-1.

²⁹ NY Penal Law, Chapter 40, Part 3, Title M, Article 225.

³⁰ For example, the laws of South Carolina, Oklahoma, and Mississippi use the following language: “Any contract of sale for the future delivery of cotton, grain, stocks or other commodities . . . upon which contracts of sale for future delivery are executed and dealt in without any actual bonafide execution and the carrying out or discharge of such contracts upon the floor of such exchange, board of trade, or similar institution in accordance with the rules thereof, shall be null and void and unenforceable in any court of this state, and no action shall lie thereon at the suit of any party thereto.”

³¹ Moreover, the purpose of the CEA, CFMA and other laws was to create clear and consistent national guidelines; a contrary interpretation would lead to the undesirable result that if one state prohibited a specific kind of contract then the Commission could use the special rule to ban that contract in all states.

³² On this point, it seems that at the very least, Rule 40.11 would be an APA violation, or even unconstitutional, if the analysis in Nadex Order was taken to its logical conclusion because of its dramatic impacts on the regulatory scheme. *Cf. Whitman v. American Trucking Ass’ns, Inc.*, 531 U.S. 457, 468 (2001) (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.”).

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Supreme Court in *Kisor* demonstrate that the Nadex Order's view cannot be the correct way to interpret Rule 40.11.³³

Seen in this context, the state laws that prohibit gambling on elections do not and cannot refer to CFTC regulated event contracts. The laws of many states prohibit gambling on event contracts, case-settled commodity futures contracts, and elections as one. Yet, the CFTC clearly continues to regulate and approve of the event contracts and cash-settled commodity futures markets even though it may seem to conflict with those state laws.³⁴ Event contracts relating to elections should be no different. Indeed, just as other event contracts regulated by the CFTC, Kalshi's political control contract should also not be precluded by the gaming provisions of Rule 40.11.

Furthermore, the CFTC's actions and inactions since the Nadex Order indicate that even the Commission has not continued the Nadex Order's reasoning in this regard. Consider, for example, the Small Cannabis Equity Index Futures Contract listed by the Small Exchange. The Cannabis Index involves the stock prices of companies in the cannabis industry that produce and distribute cannabis for consumption—an activity that is unlawful under Federal law and many State laws. The contract is “dependent on the occurrence, nonoccurrence, or the extent of the occurrence” of an event with “potential financial, economic, or commercial consequence,”³⁵ namely the value of the Cannabis Index. The activities of these companies are production and distribution of cannabis for consumption, which are all activities that are “unlawful under Federal and [many] State laws,”

³³ See, e.g., *Tennessee Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2462 (2019) (“reading § 2 [of the Twenty-First Amendment] to prohibit the transportation or importation of alcoholic beverages in violation of *any* state law would lead to absurd results that the provision cannot have been meant to produce”) (emphasis in original). Indeed, the “Commission agrees that the term ‘gaming’ requires further clarification and that the term is not susceptible to easy definition.” *Provisions Common to Registered Entities: Final Rule*, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). In the 40.11 Final Rule, the Commission noted that it had previously sought comments regarding event contracts and gaming in 2008 and that the “Commission continues to consider these comments and may issue a future rulemaking concerning the appropriate regulatory treatment of ‘event contracts,’ including those involving ‘gaming.’” 40.11 Final Rule at 44,785. “In the meantime, the Commission has determined to prohibit contracts based upon the activities enumerated in Section 745 of the Dodd-Frank Act and to consider individual product submissions on a case-by-case basis under 40.2 or 40.3.” *Id.* That process is undermined if the Nadex's Order's approach to “gaming” stands.

³⁴ The CFMA explicitly preempts the application of state gambling statutes when it applies to legal commodity futures contracts and as such there is also a federal preemption argument here that the state gambling statutes should not be considered, regardless of the Nadex Order's misapplication of Rule 40.11. See 7 U.S.C. § 16(e)(2) (“This chapter shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops (other than antifraud provisions of general applicability) in the case of—(A) an electronic trading facility excluded under section 2(e) of this title; and (B) an agreement, contract, or transaction that is excluded from this chapter under section 2(c) or 2(f) of this title or sections 27 to 27f of this title, or exempted under section 6(c) of this title (regardless of whether any such agreement, contract, or transaction is otherwise subject to this chapter).”).

³⁵ See 7 U.S.C. § 1a(19) (definition of excluded commodity).

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and should otherwise fall under the purview of Section 5c(c)(5)(C) and Rule 40.11. Certainly, if Section 5c(c)(5)(C) was given the same broad reading that the Commission gave to it in the Nadex Order, the Cannabis Equity Index would certainly “involve” an enumerated activity and be subject to Section 5c(c)(5)(C) and Rule 40.11. Yet, the Cannabis Index contract was self-certified and the Commission did not invoke Section 5c(c)(5)(C) or Rule 40.11. Therefore, it is clear that the Commission has not maintained the Nadex Order’s overbroad and incorrect reading of the Statute and Rule 40.11.

Even if the proposed Kalshi contracts somehow came within the scope of Section 5c(c)(5)(C) and Rule 40.11, that does not preclude them from being listed. I understand that Kalshi has made submissions to the Commission demonstrating offering the contracts would be in the public interest. A full discussion of those points is outside the scope of this letter. I do note, however, that the Commission is not limited to using an economic purpose test for determining whether a contract is within the public interest. That test is found nowhere in the text of Section 5c(c)(5)(C) or Rule 40.11. One reference to the economic purpose test between two Senators in a brief discussion of what would become Section 5c(c)(5)(C) is insufficient to bind the Commission to that test.³⁶ The Commission recognized as much in the Nadex Order itself, stating “the Commission has the discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest.”³⁷

Furthermore, as a procedural matter, there is nothing in the CEA or Rule 40.11 requiring the Commission to act on Kalshi’s self-certification of the political control contracts discussed in this letter. Both Section 5c(c)(5)(C) and Rule 40.11 speak in terms that the Commission “may determine.”³⁸

At the end of the day, Kalshi has various arguments to justify the self-certification of the contracts described above.

³⁶ See supra note 19 (discussing limitations of floor statements as persuasive evidence of a statute’s meaning).

³⁷ Nadex Order at 4.

³⁸ 7 U.S.C. § 7a-2(c)(5)(C)(i) (“the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest . . .”) (emphasis added); 7 C.F.R. § 40.11(c) (“The Commission **may determine** . . . that a contract . . . be subject to the 90-day review.”) (emphasis added).

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Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml

Public Statements & Remarks

Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts

August 26, 2022

I respectfully dissent from the Commission's decision pursuant to CFTC Rule 40.11 to require a review and impose a stay of up to 90 days on KalshiEX LLC's (Kalshi) Congressional control political event contracts, because Rule 40.11 does not apply to the contracts and because the appropriate process is to review the contracts under Rule 40.3.

I would like to first thank staff in the Division of Market Oversight for their hard work and diligence on this matter. The CFTC is able to effectively oversee our markets due to the experience and expertise of our staff, and they are to be commended for their dedication and faithful service.

I. BACKGROUND

A. Kalshi voluntarily submitted political event contracts for Commission approval pursuant to CFTC Rule 40.3.

Kalshi, a CFTC-registered Designated Contract Market (DCM), voluntarily submitted^[1] the political event contracts for approval by the Commission pursuant to CFTC Rule 40.3^[2] on July 20, 2022, after engaging in approximately 36 meetings with the Commission and staff over nearly a year (since late 2021), and numerous meetings with members of Congress.

Kalshi states that the political event contracts are permitted under the Commodity Exchange Act (CEA) and CFTC rules because, among other things: 1) Section 5c(c)(5)(C) and Rule 40.11 do not apply to the contracts because the underlying event of political control of Congress is neither gaming nor illegal under Federal or State law; 2) the contracts can be used to hedge predictable financial, economic, and commercial consequences; 3) the contracts would not negatively affect election integrity or the perception of election integrity; and 4) similar contracts can already be accessed by U.S. persons on other markets that are not registered or otherwise regulated by the Commission.

II. DISCUSSION

A. CEA section 5c(c)(5)(C) and CFTC Rule 40.11 apply only to certain event contracts based upon specifically enumerated activities.

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Section 5c(c)(5)(C) provides that certain event contracts may be prohibited from being listed or made available for clearing or trading if the Commission determines such event contracts to be “contrary to the public interest” because they “involve” certain enumerated activities: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”[3]

The Commission exercised its discretion under Section 5c(c)(5)(C) (i.e., “may determine”) to promulgate its implementing Rule 40.11.[4] Rule 40.11(a) sets forth a prohibition on the trading and clearing of any event contract[5] that “involves, relates to, or references” (1) “terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law”[6]; or (2) “an activity that is similar to an activity enumerated in 40.11(a)(1) of this part, **and** that the Commission determines, **by rule or regulation**, to be contrary to the public interest” (emphasis added).[7] Rule 40.11(b) is reserved.[8]

Rule 40.11(c) provides that the Commission may require a 90-day review if the event contract “may involve, relate to, or reference an activity enumerated in 40.11(a)(1) or 40.11(a)(2).”[9] Rule 40.11(c) (1) requires that the listing or trading of the event contract be suspended (stayed) during the 90-day review period.[10] Rule 40.11(c)(2) requires that the Commission issue an order approving or disapproving the contract at the end of the 90-day review period (or such other extended time period as agreed to by the registered entity (for example, a DCM)).

In promulgating Rule 40.11(a)(1) pursuant to Section 5c(c)(5)(C), the Commission determined that an event contract that “involves, relates to, or references” terrorism, assassination, war, gaming, or illegal activity is prohibited because it is contrary to the public interest.[11] There is no further public interest test in Rule 40.11(a)(1); per the operation of the statute, the Commission must have *already* made its determination that the event contract is contrary to the public interest in order to prohibit its being listed for trading or accepted for clearing.[12] Therefore, the Commission has no discretion to infer an additional case-by-case public interest test[13] under Rule 40.11(a)(1) because the plain meaning of both the statutory text and the rule text is clear and unambiguous. An event contract is only prohibited under Rule 40.11(a)(1) if it is based upon the underlying activity of terrorism, assassination, war, or gaming, or an activity that is unlawful under any State or Federal law.[14]

Further, Rule 40.11(a)(2) prohibits an event contract that “involves, relates to, or references an activity that is similar to an activity enumerated in 40.11(a)(1),” *only if* the Commission has already promulgated a rule or regulation to determine that such activity is contrary to the public interest.[15] Indeed, the preamble to the final rulemaking for Rule 40.11 explicitly states, “[The Commission] has determined not to propose such regulations at this time.”[16] Therefore, Rule 40.11(a)(2) is not operative because the Commission has never satisfied the predicate condition of promulgating a rule or regulation in order to determine an activity that is similar to an enumerated activity is contrary to the public interest.[17] Further, the rule text is clear on its face that the public interest test in Rule 40.11(a)(2) can only be applied through a rulemaking, and can only be applied to the underlying activity that is similar to an enumerated activity, as provided by Section 5c(c)(5)(C)(VI).[18]

B. The political event contracts are not based on any enumerated activities under Rule 40.11(a)(1), and the contracts are not subject to Rule 40.11(a)(2) because it is not operative.

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Both Section 5c(c)(5)(C) and Rule 40.11 set forth language that refers to contracts that are based upon an event that involves an enumerated activity.[19] And in the preamble to the final rulemaking for Rule 40.11, the Commission describes the rule as applicable to “contracts *based upon* the [enumerated activities] . . .” (emphasis added).[20] The preamble shows that whether an event contract is prohibited by Rule 40.11 depends on the underlying activity that the contract is based upon—the underlying activity that the contract “involves, relates to, or references.”[21] With respect to the political event contracts here, the underlying activity is political control.

The Commission must apply the same Congressional intent to each of the enumerated activities, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C)(i) would be internally inconsistent and in conflict with “‘traditional tools’ of statutory construction.”[22]

Accordingly, because “political control” is neither terrorism, assassination, war, gaming, nor unlawful under any Federal or State law, Rule 40.11(a)(1) does not apply to the political event contracts. And, as discussed in II.A., Rule 40.11(a)(2) is not operative until the Commission promulgates a rule or regulation to determine that an activity that is “similar to” an enumerated activity is contrary to the public interest,[23] therefore, Rule 40.11(a)(2) does not apply to the political event contracts.

C. The Commission must apply principles of fair competition and fair treatment to similar contract markets.

We must apply our rules fairly. Congress has mandated that the CFTC promote responsible innovation and fair competition.[24] The Commission is already allowing an unregistered event contract market, PredictIt, to continue to operate its political control markets through the November 2022 election cycle and until Feb. 15, 2023.[25] But the Commission has not taken any action on Kalshi’s contracts, even though Kalshi submitted their request for voluntary approval over a month ago, and have been discussing it with the CFTC for almost a year.

In the interest of fair competition and fair treatment, Kalshi, a CFTC registered entity, should be allowed to operate their political control markets as well. Although the Commission’s notification letter acknowledges that this issue is “time-sensitive” and that the Commission “will endeavor” to make a decision on the political event contracts by October 28, 2022, the Commission does not actually have to stick to that date.

And even *if* the Commission does make a decision by October 28 (and the decision is to approve—not deny—the contracts), Kalshi would only be able to realistically operate its political control markets for a couple of days before the November midterm elections.

The outcome is the same: the Commission’s action to impose a stay will essentially run out the clock on Kalshi’s ability to list contracts for the November 2022 elections. I believe that it is only fair for either both exchanges to list the political control contracts, or neither of them should.

D. The 2012 Nadex order is not binding precedent on the Commission with respect to the Kalshi political event contracts.

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In addition, the Commission should evaluate the issues presented by the Kalshi political event contracts as a matter of first impression. The Commission's 2012 order prohibiting North American Derivatives Exchange's (Nadex) political event contracts was specific to Nadex's contracts and did not create a broad limitation or rule of general applicability.[26]

III. CONCLUSION

Rule 40.11(a)(1) does not apply to the political event contracts here because they are based upon the underlying activity of political control, which is not an enumerated activity, and there is no additional required public interest test. Rule 40.11(a)(2) is not operative because the Commission has not determined by rule or regulation that similar activity is contrary to the public interest.

Therefore, the Commission cannot exercise Rule 40.11(c) to require a review and impose a stay of Kalshi's contracts. However, the Commission can review the political event contracts pursuant to the process set forth under Rule 40.2 or 40.3, as applicable.

Further, when the Commission reviews a contract under Rule 40.2 or 40.3, it includes review for compliance with the CEA and Commission regulations—including section 5c(c)(5)(C) and Rule 40.11.[27] Indeed, the preamble to the final rulemaking for Rule 40.11 states that the Commission will “consider individual product submissions on a case-by-case basis under § 40.2 or § 40.3,” including the applicability of § 40.11(a).[28] In addition, the Commission can request comment from the public at any time and does not need to use Rule 40.11 to do so.

The Commission should engage with the public in a transparent manner. Kalshi has proactively and extensively discussed the political event contracts with the Commission and staff over the course of approximately 36 meetings for nearly a year. Not only that, but Kalshi has also had many meetings with members of Congress. In all that time, if the Commission had a concern that the political event contracts violate CEA section 5c(c)(5)(C) and CFTC Rule 40.11, or if the Commission did not ever intend to allow the contracts to be traded, then the Commission should have said so. We should say what we mean and mean what we say.

Businesses make material strategic and commercial decisions that have material impacts on their operations and performance, based on regulatory engagement with the Commission. Lost opportunities may never be regained. The “regulatory burn rate” is real, and we should be transparent so that businesses can get the information they need to move forward and redeploy capital to more productive use.

I look forward to receiving comments from the public on these important issues.

[1] Kalshi is not prevented from withdrawing the request for approval and self-certifying the contracts pursuant to CFTC Rule 40.2.

[2] 17 C.F.R. § 40.3(a).

[3] 7 U.S.C. § 7a–2(c)(5)(C)(i)(I)–(VI).

[4] Provisions Common to Registered Entities, 76 Fed. Reg. 44776, 44786 (July 27, 2011).

[5] Rule 40.11 defines an event contract as “[a]n agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the [CEA].” 17 C.F.R. § 40.11(a)(1).

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[6] 17 C.F.R. § 40.11(a)(1).

[7] 17 C.F.R. § 40.11(a)(2).

[8] 17 C.F.R. § 40.11(b).

[9] 17 C.F.R. § 40.11(c).

[10] 17 C.F.R. § 40.11(c)(1).

[11] See 76 Fed. Reg. at 44786 (“[T]he Commission would like to note that its prohibition of certain ‘gaming’ contracts is . . . to ‘protect the public interest from gaming and other event contracts.’”) and at 44786, FN 35 (“[T]he Commission ‘needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling through supposed event contracts.’”); see also 7 U.S.C. § 7a–2(c)(5)(C)(i) (“[T]he Commission may determine that such [event contracts] are contrary to the public interest if the [event contracts] involve [the enumerated activities].”).

[12] See 7 U.S.C. § 7a–2(c)(5)(C)(ii) (“**Prohibition.** No [event contract] determined by the Commission to be contrary to the public interest [because it involves an enumerated activity] may be listed or made available for clearing or trading”).

[13] The preamble to the final rulemaking for Rule 40.11 states that the Commission will “consider individual product submissions on a case-by-case basis under § 40.2 or § 40.3,” including the applicability of § 40.11(a). However, this does not mean that the Commission will apply a public interest test on a case-by-case basis, which is not provided for under Rule 40.11(a)(1), and may only be applied through a rulemaking under Rule 40.11(a)(2).

[14] See 76 Fed. Reg. at 44785 (“[T]he Commission has determined to prohibit contracts based upon the [enumerated activities].”). Cf. FN 15, *infra* (“prohibit products that are based upon activities. . . .”).

[15] See FN 7, *supra*.

[16] 76 Fed. Reg. at 44786 (“The Commission may, at some future time, adopt regulations that prohibit products that are *based upon activities* ‘similar to’ [the enumerated activities]. It has determined not to propose such regulations at this time.”) (emphasis added).

[17] *Id.*

[18] 17 C.F.R. § 40.11(a)(2).

[19] 7 U.S.C. § 7a–2(c)(5)(C)(i) (“In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are *based upon* the occurrence, extent of an occurrence, or contingency [*i.e.*, event] . . . if the agreements, contracts, or transactions involve [an enumerated *activity*]”) (emphasis added), 17 C.F.R. § 40.11(a)(1)-(2) (“An agreement, contract, transaction, or swap *based upon* an [event], that involves, relates to, or references [an enumerated *activity* or similar *activity*]”) (emphasis added).

[20] See FN 13, *supra*.

[21] As an example, terrorism, assassination, and war are three of the activities enumerated by Section 5c(c)(5)(C)(i) and Rule 40.11(c)(1). Trading an event contract based upon one of these activities is not in itself an act of terrorism, assassination, or war. It is clear that Congress intended the prohibition to apply to event contracts where the activity underlying the contract is one of the enumerated activities.

[22] *Kisor v. Wilkie*, 139 S. Ct. 2408, 2415 (2019) (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

[23] See FN 15, *supra*.

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[24] 7 U.S.C. § 5(b).

[25] CFTC Letter No. 22-08, Withdrawal of CFTC Letter No. 14-130 (Aug. 4, 2022). As of August 15, 2022, PredictIt lists contracts on whether the Democrat or Republican party will control the Senate after 2022, and whether the Democrat or Republican party will win the House in 2022.

[26] 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 (Apr. 2, 2012), *available at* <https://www.cftc.gov/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf> ([/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf](https://www.cftc.gov/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf)). *Cf.* 5 U.S.C. § 553.

[27] See FN 13, *supra*.

[28] *Id.*

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June 23, 2023

Xavier Sottile
Head of Markets
KalshiEX LLC
594 Broadway
New York, NY 10012

Re: Notification of Commodity Futures Trading Commission (“Commission”)
Commencement of 90-day Review of “Will <chamber of Congress> be controlled
by <party> for <term>?” Contracts

Dear Mr. Sottile:

This is to inform you that, pursuant to Commission regulation 40.11(c), the Commission has commenced a 90-day review of the KalshiEX LLC (“Kalshi”) self-certified submission dated June 12, 2023 (the “Submission”) of “Will <chamber of Congress> be controlled by <party> for <term>?” contracts (the “Congressional Control Contracts”). The Commission has determined that the Submission comprises contracts that may involve, relate to, or reference an activity enumerated in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C)(i) of the Commodity Exchange Act. Accordingly, the Commission requests, pursuant to Commission regulation 40.11(c)(1), that Kalshi suspend any listing and trading of the Congressional Control Contracts during the pendency of the Commission’s 90-day review period, which will commence as of the date of this notification letter.

Please note that, consistent with Commission regulation 40.11(c)(1), the Commission will post on its website a notification of its intent to carry out a 90-day review of the Submission. Please further note that the Commission has decided to open a 30-day public comment period within the 90-day review period to assist the Commission in its evaluation of the Submission. To do so, the Commission intends to supplement the notification posted on the Commission’s website with the publicly filed portion of the Submission and specific questions regarding the Congressional Control Contracts.

If you have any questions regarding this notification, please contact Chris Goodman (cgoodman@cftc.gov; (202) 418-5616).

Sincerely,

Christopher J. Kirkpatrick
Secretary of the Commission

Release Number 8728-23

CFTC Announces Review of Kalshi Congressional Control Contracts and Public Comment Period

June 23, 2023

Washington, D.C. — The Commodity Futures Trading Commission today announced that it has commenced a 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). Kalshi, a designated contract market, submitted the contracts to the CFTC following the close of business on June 12, 2023. The CFTC has 90 days subsequent to the date that it commences review, or if applicable, until the conclusion of such extended period agreed to or requested by Kalshi, to make a determination with respect to the contracts.

As described in Kalshi's submission, the contracts are cash-settled, binary contracts based on the question: "Will <chamber of Congress> be controlled by <party> for <term>?" The contracts settle based on the party affiliation of the Speaker of the U.S. House of Representatives or the President Pro Tempore of the U.S. Senate. The CFTC has determined the contracts may involve, relate to, or reference an activity enumerated in CFTC Regulation 40.11(a) and section 5c(c)(5)(C) of the Commodity Exchange Act and has therefore commenced a review pursuant to CFTC Regulation 40.11(c).

As required under CFTC Regulation 40.11(c)(1), the CFTC has requested that Kalshi refrain from listing or trading the contracts during the CFTC's review period.

The CFTC seeks public comment on specific questions related to Kalshi's self-certified congressional control contracts during a 30-day public comment period. The questions are available here (<https://www.cftc.gov/media/8801/DMOKalshiQuestions062323/download>). The public comment period ends on July 24, 2023.

Kalshi's publicly-filed submission, which provides detailed information about the contracts, is available here (<https://www.cftc.gov/IndustryOversight/IndustryFilings/TradingOrganizationProducts/50934>).

-CFTC-

Questions on the KalshiEX LLC “Will <chamber of Congress> be controlled by <party> for <term>?” Contracts for Public Comment

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?
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?
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?
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?
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?
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>.
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>.
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?

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?
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.
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?
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?
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?
14. Are the contracts contrary to the public interest? Why or why not?
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?
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?
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?
18. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements?
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?

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

June 26, 2023

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
Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

Introduction:

We are undergraduate researchers at Duke University focused on financial regulation whose areas of study include economics, mathematics, and computer science. In this letter, we hope to convince the Commission that they should not grant Kalshi approval to offer contracts related to partisan control of Congress. First and foremost, approving such contracts would contradict the Commission's prior treatment of similar contracts with respect to the North American Derivatives Exchange (Nadex) and PredictIt without suitable justification. Additionally, we believe that such contracts pose a net societal harm despite their alleged benefits. Kalshi and its supporters contend that such contracts would function as useful hedging instruments, yield more accurate election predictions through aggregating public opinion, and serve a price-basing role for real assets. On the other hand, critics of said contracts have argued their existence could expose retail traders to needless financial risk and, more importantly, create the risk of market manipulation that could weaken both election integrity and the perception of election integrity. In analyzing these potential costs and benefits, we hope to illustrate why rejecting Kalshi's proposal to offer such contracts, and more generally, why preventing any exchange from offering event contracts related to election results in the future, is consistent with the prior rulings of the Commission, in accordance with state and federal law, and clearly in the

public interest. In summary, while the alleged benefits of such contracts are spurious and marginal, the risks are both legitimate and significant.

Background:

Launched in 2021, Kalshi is a federally regulated exchange that offers binary “event contracts.”¹ These contracts allow users to purchase “yes” or “no” positions with regard to outcomes of particular events related to topics like the economy, climate, and public health.² Some of the exchange’s most popular recent contracts have concerned inflation data and the federal funds rate.³ In July 2022, Kalshi submitted a proposal to the Commission asking to list a set of contracts that would allow users to predict which political party would be in control of the Senate and House following the 2022 midterm elections.⁴ In the past, the Commission has been selective in permitting similar platforms to list political event contracts in acknowledgement of the potential risks inherent in allowing Americans to wager on election results.

In the early 1990s, the Commission provided Iowa Election Markets no-action relief to offer political event contracts under certain conditions.⁵ Iowa Election Markets had to remain strictly a not-for-profit, academic organization that sought to research “whether markets can aggregate information and predict outcomes more accurately than alternative technology such as

¹ Y-Combinator, “Kalshi: 1st Federally Regulated Exchange Where People Can Trade on Events,” <https://www.ycombinator.com/companies/kalshi>

² Alexander Osipovich, “Online-Trading Platform Will Let Investors Bet on Yes-or-No Questions,” *WSJ*, February 17, 2021, <https://www.wsj.com/articles/online-trading-platform-will-let-investors-bet-on-yes-or-no-questions-11613557800>.

³ *Ibid.*

⁴ Eliezer Mishory to the CFTC Secretary of the Commission, July 19, 2022, <https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdc001.pdf>

⁵ Andrea M. Corcoran to George R. Neumann, June 18, 1993, <https://www.cftc.gov/sites/default/files/files/foia/repfoia/foirf0503b004.pdf>.

public opinion polling.”⁶ Additionally, the Commission prohibited any individual user from wagering more than \$500 and did not render an opinion on whether Iowa Election Markets violated any state laws.⁷ In late 2011, Nadex, a binary options exchange, submitted a proposal to the Commission seeking to offer political event contracts for the 2012 elections analogous to those Kalshi seeks to list for the 2022 midterms.⁸ The Commission rejected Nadex’s proposal, citing Section 5c of the Commodity Exchange Act (CEA) and two Commission Regulation clauses.⁹ Specifically, the agency explained that numerous state statutes consider trading political event contracts to be a form of gambling and that the Nadex contracts failed the economic purpose test in that they could not be employed as a hedging tool due to the “unpredictability of specific economic consequences of an election” and provided “no price basing utility” for real assets.¹⁰

In 2014, the Commission offered no-action relief to a platform called PredictIt, a joint-venture between Victoria University in New Zealand and American for-profit political technology company Aristotle.¹¹ Like Iowa Election Markets, PredictIt also vowed that the platform would be used primarily for academic research purposes and that its operators would receive no compensation.¹² Unlike Iowa Election Markets, the Commission allowed PredictIt to

⁶ Andrea M. Corcoran to George R. Neumann, June 18, 1993, <https://www.cftc.gov/sites/default/files/files/foia/repfoia/foirf0503b004.pdf>.

⁷ Jeff Sommer, “Forecasting the Future of Election Prediction Markets,” *NYT*, November 4, 2022, <https://www.nytimes.com/2022/11/04/business/election-prediction-markets-midterms.html>.

⁸ Timothy G. McDermott to David Stawick, December 19, 2011, <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul121911nadex002.pdf>.

⁹ Ben Prottess, “Panel Rejects Proposal to Allow Election-Related Trading,” *NYT*, April 2, 2012, <https://archive.nytimes.com/dcalbook.nytimes.com/2012/04/02/panelrejects-proposal-to-allow-election-related-trading/>.

¹⁰ David Stawick, “Order Prohibiting the Listing or Trading of Political Event Contracts,” April 2, 2012, <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

¹¹ Sommer, *NYT*, <https://www.nytimes.com/2022/11/04/business/election-prediction-markets-midterms.html>.

¹² Vincent McGonagle to Neil Quigley, October 29, 2014, <https://www.cftc.gov/PressRoom/PressReleases/7047-14>.

offer a higher cap on maximum wagers, increase the number of investors allowed on the platform, and advertise in a limited capacity.¹³ The Commission reasoned that these modifications from the Iowa Election Markets precedent would allow PredictIt to better serve its academic function yet still prevent these contracts from harming the public interest.¹⁴ While Iowa Election Markets continues to operate under its no-action relief, the Commission revoked PredictIt's relief in August of 2022.¹⁵ The Commission has not commented specifically on how PredictIt violated the terms of their no-action letter; however, they reserve the right to revoke relief at their discretion.¹⁶

The Commission also recently took regulatory action against Polymarket, a crypto-based exchange that offers political event contracts.¹⁷ Polymarket offered "off-exchange" contracts, which means that they did not have designated contract market (DCM) status like Nadex or no-action relief like Iowa Election Markets and PredictIt. As a consequence, Polymarket was forced to pay a \$1.4 million fine.¹⁸ Polymarket, however, continues to offer event contracts related to the midterm elections to international users.¹⁹ InTrade, an Ireland-based trading exchange, tried to offer similar off-exchange contracts to American traders before the Commission sued them in 2012.²⁰ Even though for-profit exchanges have not been allowed to offer political event contracts

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Vincent McGonagle to Margaret Hyland, August 4, 2022, <https://www.cftc.gov/PressRoom/PressReleases/8567-22>.

¹⁶ Neal E. Kumar, Serge B. Agbre, and Alexandra K. Calabro, "CFTC Staff Pull Longstanding No-Action Relief for Event Market PredictIt," Wilkie, Farr, & Gallagher LLP, August 15, 2022, <https://www.willkie.com/-/media/files/publications/2022/cftcstaffpulllongstandingnoactionreliefforeventmar.pdf>

¹⁷ CFTC, "Release Number 8478-22: CFTC Orders Event-Based Binary Options Markets Operator to Pay \$1.4 Million Penalty," January 3, 2022, <https://www.cftc.gov/PressRoom/PressReleases/8478-22>.

¹⁸ Ibid.

¹⁹ Ryan Deffenbaugh, "Prediction markets are facing a key test," *Protocol*, October 17, 2022, <https://www.protocol.com/newsletters/protocol-fintech/kalshi-cftc-election-markets>.

²⁰ CFTC, "Release Number 6423-12: CFTC Charges Ireland-based "Prediction Market" Proprietors Intrade and TEN with Violating the CFTC's Off-Exchange Options Trading Ban and Filing False Forms with the CFTC," November 26, 2012, <https://www.cftc.gov/PressRoom/PressReleases/6423-12>.

to American traders, established markets for betting on American elections exist in Europe—particularly in the United Kingdom and Ireland.²¹

Thus far, Kalshi has abided by all applicable regulations. They have registered as a DCM through the CFTC, partnered with a registered affiliate derivatives clearinghouse organization (DCO), and sought and received proper approval for all the contracts they currently list.²² One point of note is that Kalshi’s DCO, LedgerX LLC, is a subsidiary of FTX US Derivatives.²³ In response to FTX’s primary business unit, FTX Trading Ltd., filing for bankruptcy, Kalshi reassured its customers in an open letter that their funds were safe.²⁴ LedgerX was only authorized to clear fully-collateralized futures, options on futures, and swaps, and Kalshi users are not permitted to trade on leverage; however, because there are still a great deal of unknowns regarding the FTX collapse, there is reason to be wary of Kalshi’s relationship with the firm.²⁵

Regardless of LedgerX’s status, the Commission should reject Kalshi’s proposal, because it is not materially different from Nadex’s proposal, and because allowing such contracts would threaten the perception of the United States’ election integrity. The arguments Kalshi advances with regard to these contracts’ hedging utility, predictive power, and price-basing function are not only weak but contradictory and dwarf in comparison to the imperative duty of public institutions to do what they can to strengthen election integrity and the perception of election integrity at a time when trust in our democratic processes is concerningly fragile.

²¹ Divya Chowdhury and Aaron Saldanha, “Betting markets expect U.S. election result by Wednesday,” *Reuters*, November 2, 2020, <https://www.reuters.com/article/usa-election-gambling-gmf/betting-markets-expect-u-s-election-result-by-wednesday-idUSL4N2H037M>.

²² CFTC, “Release Number 8302-20: CFTC Designates KalshiEX LLC as a Contract Market,” November 4, 2020, <https://www.cftc.gov/PressRoom/PressReleases/8302-20>.

²³ Kalshi, “Kalshi and LedgerX advance to next step of launching new event contracts exchange,” September 8, 2020, <https://kalshi.com/blog/kalshi-ledger-partnership>.

²⁴ Kalshi, “Kalshi Customer Funds are Safeguarded in Segregated Accounts,” November 11, 2022, <https://kalshi.com/blog/kalshi-customers-are-safeguarded>.

²⁵ LedgerX, “Overview,” <https://ledgerx.com/clearing>.

Analysis:

Hedging:

In examining the costs and benefits of allowing Kalshi users to trade binary options predicting the parties that would control the House and Senate following the midterms, we concluded that, while the benefits are tenuous and only accrue to a limited number of citizens, the potential risks are severe and could impact American society at large. According to the Commodity Exchange Act, the Commission is called to put proposed contracts to an economic purpose test to determine whether their existence would provide any hedging or price-basing utility.²⁶ Specifically, the Commission raises the question (6) of whether or not the economic consequences of a party controlling Congress are predictable enough to allow these contracts to serve a useful hedging function.²⁷ In rejecting Nadex's proposal in 2012, the Commission reasoned that there was too tenuous a connection between election results and specific economic consequences that could be hedged against.²⁸ In this sense, we see no good reason to believe that the Commission's argument here was flawed or that the relationship between election results and economic effects has changed.

For example, if a restaurant wanted to hedge against an expected change in the small business tax code that a particular party has indicated they would enact, Kalshi's contract would not offer as direct and robust a hedge as would, for instance, a bet against the price of beef increasing. In the latter case, the restaurant can definitively protect themselves against increases

²⁶ Commodity Exchange Act, 7 U.S.C. § 1, United States Code, <https://www.law.cornell.edu/uscode/text/7/chapter-1>.

²⁷ CFTC, "Questions on the KalshiEX, LLC "Will <party> be in control of the <chamber of Congress>?" Contracts for Public Comment," <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexpublicquestions220829.pdf>.

²⁸ Stawick, "Prohibiting Political Event Contracts," <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/jfdocs/nadexorder040212.pdf>.

in the price of beef by purchasing cattle options that they can redeem if prices increase. In the former case, there are countless scenarios where the party that the restaurant bets on loses yet the tax change is still enacted. Perhaps, the winning party compromises with the losing party, allowing them to enact the tax change in exchange for concessions on what they deem to be a more important piece of legislation. In this example, the restaurant would have not only lost the bet on Kalshi's election contract, but it would also have been forced to pay the higher taxes. Depending on the magnitude of their hedge, the results could be disastrous for a small business. A more concrete example relates to student loans. In the 2020 election cycle, Democrats made it clear that they hoped to forgive student loan debt; however, even after President Biden used executive action to forgive \$10,000 of federal student loans per person, the constitutionality of his move is currently being challenged in the courts.²⁹ As such, a student who bet on President Trump winning the 2020 in order to hedge against their student loan debt not being forgiven would have lost the wager and also would have been forced to pay back their student loans. Accordingly, these examples illustrate that political events contracts are a poor hedging instrument and suggest that the flawed portrayal of political event contracts as adequate hedging tools could put retail investors at risk of financial harm.

In another submitted comment letter, NYU law professor Max Raskin argues in defense of these contracts as a useful means of hedging.³⁰ He is correct in stating that individuals often hedge against downside risks without being absolutely certain of the hedge's success.³¹ However, the probability that an individual can account for all the nuances of the U.S.' political

²⁹ Katie Lobosco, "What student loan borrowers need to know after a federal court struck down Biden's forgiveness program," *CNN*, <https://www.cnn.com/2022/11/10/politics/bidenstudent-loan-forgiveness-struck-down>.

³⁰ Max Raskin to the CFTC Secretary of the Commission, September 22, 2022, <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>

³¹ *Ibid.*

processes to predict that a piece of legislation will pass and to foresee the specific effect it will have on them given a party winning control of one house of Congress is nowhere near close to one hundred percent. While Professor Raskin believes that “congressional leaders make genuine attempts to enact the agendas they lobby for,” we are slightly less optimistic about the transparency and predictability of America’s legislative processes and the willingness— let alone ability— of legislatures to enact their campaign promises.³² By calculating a weighted-average from eleven academic studies, FiveThirtyEight estimates that presidents fail to keep roughly one-third of their campaign promises.³³

Insurance:

Kalshi claims that its exchange can be used as a form of insurance, but Kalshi is indisputably inferior to existing insurance in its ability to protect against future losses.³⁴ In an interview with Yahoo Finance, Tarek Mansour, a co-founder of Kalshi, claims that election betting and similar trades function as a transparently exchanged form of insurance.³⁵ More specifically, according to their website, Kalshi has advantages over traditional insurance due to its umbrella coverage, next day payouts, granular control, and lack of claims adjusters.³⁶ Though it is true that Kalshi allows investors to bet on specific events that may not otherwise be covered under insurance, such as election outcomes, these events are not direct indicators of loss or gain, and are therefore unreliable. Car insurance, for instance, can help cover the cost of a car crash in the event that it occurs; this form of insurance is directly contingent upon the presumed loss

³² Raskin, <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=731>!

³³ Timothy Hill, “Trust Us: Politicians Keep Most of Their Promises,” *538*, April 21, 2016, <https://fivethirtyeight.com/features/trust-us-politicians-keep-most-of-their-promises/>.

³⁴ Yahoo Finance, *Yahoo Finance*, March 15, 2022.

³⁵ *Ibid.*

³⁶ “Hedge on Your Terms,” Kalshi, 2022, <https://kalshi.com/hedging>.

occurring. On the other hand, if a trucking business believes gas prices are tied to a particular congressional majority, they may try to protect themselves from the potential losses derived from gas price increases by betting on Democrats holding a congressional. While the policies politicians or political parties endorse may impact gas prices, no individual politician or party can unilaterally raise or lower gas prices. Rather than insuring one's business, one can only insure against a tangentially related factor, thus making this form of "insurance" far riskier than its traditional counterpart. Since Kalshi only hosts \$1 binary contracts, one can only truly bet on whether something will occur, but not on the extent of the occurrence. For example, one may bet that gas prices will increase, but they cannot bet on the amount by which they will increase, thus limiting Kalshi's ability to specifically insure against downside risks. Furthermore, while next day payouts may be advantageous, they may attract people who are in need of a payout quickly, thus making Kalshi more akin to gambling than an efficient insurance mechanism. In terms of granular control, which Kalshi describes as the ability to choose exactly how much money to bet and the option to cancel early to minimize losses, it is true that bettors may benefit from deciding how much to bet on a given event. However, this means bettors assume extra risk compared to insurance; while insurance rates are determined by underwriters using a number of variables, it is up to the individual to determine how much to invest in a given contract. Additionally, while bettors can cancel their orders before trades are made and close out their position by essentially buying contracts opposite to the direction of those that one wishes to cancel, it is not possible to cancel a trade. Therefore, Kalshi's cancellation ability is inferior to that of insurance policies, which can be canceled when one decides they do not want insurance anymore. Finally, the proposed benefit of not needing claims adjusters is not so much a benefit as it is a product of Kalshi not offering bets on getting into a car crash, for instance. Kalshi's insurance function is

more akin to speculation and gambling than it is to insurance against real-world risk. Overall, investors may have more flexibility through Kalshi than through traditional insurance, but they are not protected by insurance regulators or by the guarantee that they will be insured against the loss against which they are betting.

Price-Basing Utility:

In response to another one of the Commission’s questions (11), political event contracts fail to serve any real price-basing utility for the same reasons that they are an inadequate tool for hedging.³⁷ In the Commission’s Nadex decision, they argued that “there is no situation in which the Political Event Contracts’ prices could form the basis for the pricing of commercial transactions.”³⁸ We see no reason to overturn the Commission’s reasoning as the economic ramifications of an election are indirect and opaque – as discussed with regard to hedging – which implies that the price of election markets does not help determine the price of any physical or financial asset in a predictable manner. Some commenters have attempted to argue otherwise. The CIO of Sharp Square Capital, Filip Pidot, argues that decisions such as whether two companies should merge or not are affected by congressional majorities.³⁹ Here, Pidot makes a correct, yet weak, assertion that which party controls Congress will affect a corporate merger. A complex endeavor such as a corporate merger will obviously be impacted by which party controls Congress as they would presumably pass different laws and appoint different personnel

³⁷ CFTC, “Questions on KalshiEX,”

<https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkxpublicquestions220829.pdf>

³⁸ Stawick, “Prohibiting Political Event Contracts,”

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

³⁹ Flip Pidot to the CFTC, September 2, 2022,

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69645&SearchText=>

⁴⁰ Notably, Sharp Square Capital describes themselves as a “alternative investment management firm specializing in event futures on @kalshi.”

to regulatory agencies that oversee mergers. However, the more pertinent question is what impact congressional control would have on the price of mergers. If a merger concerned a solar panel company, it is easy in hindsight to say that the Democrats 2020 congressional majority would increase its price because of the green tax credits that were ultimately included in the Inflation Reduction Act (IRA).⁴¹ But, as shown through the example of student debt relief, not all campaign promises are kept. In this way, it is easy to say that a midterm election will affect the prices of companies, but it would be highly spurious to say that one can make meaningful inferences regarding the price of a company from the prices of election markets.

Gaming:

In their rejection of Nadex's proposal, the Commission explained that "a federal statute defines 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.'"⁴² The Commission specified that even though political event contracts on congressional majorities are only premised indirectly upon "the outcome of a contest between electoral candidates" they still defined the act of participating in Nadex's proposed markets as "betting" or "wagering."⁴³ In this way, Nadex's proposed markets would be considered gambling in several states where state statutes either define gambling in part as an act that involves "wagering" and "betting" or directly reference election wagering in their gambling definitions.⁴⁴ The only material difference between Nadex's proposal and Kalshi's is that Nadex

⁴¹ Francesca Paris, Alicia Parlapieno, Margot Sanger-Katz, and Eve Washington, "A Detailed Picture of What's in the Democrats' Climate and Health Bill," *NYT*, August 16, 2022, <https://www.nytimes.com/interactive/2022/08/13/upshot/whats-in-the-democrats-climate-health-bill.html>.

⁴² Stawick, "Prohibiting Political Event Contracts," <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadex.order0402.12.pdf>.

⁴³ *Ibid.*

⁴⁴ *Ibid.*

wanted to also list a contract relating to the Presidential election.⁴⁵ Thus, in response to the Commission's first question (1), we believe that Kalshi's proposed contracts do reference "gaming" as defined in Commission regulation 40.11 (a)(1) and 5c(c)(5)(C) of the Commodity Exchange Act.⁴⁶ Additionally, in response to the Commission's second (2) and third (3) questions, we believe that the Commission must consider whether taking a position on which party will win a congressional majority is illegal under state gambling laws.⁴⁷ Although Kalshi maintains that their platform is for trading and not gambling, political gambling is banned at the federal level.⁴⁸ In this way, we urge the Commission to consider what would distinguish trading on Kalshi's political event contracts from gambling.

Predictive Power:

There is a long history of political betting in the United States, legal, or, in many cases, illegal. Before the rise of scientific polling, the political betting market functioned well as a predictor of elections at both the state and the national level.⁴⁹ Election betting consisted of standardized contracts that employed fixed dollar payments if a particular candidate won office; typically, so-called betting commissioners offered these contracts, held the stakes of both parties, and took a five percent commission on winnings.⁵⁰ In the 1880s, betting markets moved from poolrooms to the Curb Exchange and Broadway hotels, and in the 1920s and 1930s, specialist

⁴⁵ Ibid.

⁴⁶ CFTC, "Questions on KalshiEX," <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexpublicquestions220829.pdf>

⁴⁷ Ibid.

⁴⁸ Rick Maese, "Political Betting Is Surging. The Forecast Is about to Get Complicated." *The Washington Post*, November 2, 2022, <https://www.washingtonpost.com/sports/2022/11/02/politicalbetting/>.

⁴⁹ Paul W Rhode and Koleman S Strumpf, "Historical Presidential Betting Markets," *Journal of Economic Perspectives* 18, no. 2 (2004): pp. 127-142, <https://doi.org/10.1257/0895330041371277>

⁵⁰ Ibid.

firms comprised of betting commissioners emerged.⁵¹ In the 1896, 1899, 1904, 1916, and 1924 elections, three newspapers, including the *New York Times*, provided almost-daily price quotations on different candidates' odds, and the average betting volume was over two hundred times the maximum amount wagered in any Iowa Election Market, with over \$165 million in 2002 dollars bet in the 1916 election.⁵² However, after 1940, and concurrently with the rise of scientific polling – which was a substitute for betting odds free from the moral objections against gambling – and laws addressing moral hazard, election tampering, information withholding, and strategic manipulation, there was a significant reduction in betting activity.⁵³ Thus, while there is not much legal precedence for election betting, there is cultural precedence, and the data does suggest fair markets may work well as election indicators.

One of the main reasons Kalshi and its supporters believe political event contracts are beneficial is that they may serve as more accurate indicators of political outcomes than polling. Kalshi claims its markets host “the most accurate predictions in the industry.”⁵⁴ It is unclear if Kalshi is referring to the political betting industry – which, given the Commission’s history of eliminating participating parties, is a very small industry, at least domestically – or to the election prediction industry in general; in either case, Kalshi does not provide any evidence to support this claim. Writing in support of Kalshi, Dr. Jason Furman, the Former Deputy Director of the National Economic Council, claims that political betting markets provide important information regarding political outcomes.⁵⁵ Specifically, he argues that the White House,

⁵¹ Ibid.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ “Forecasting,” Kalshi, 2022, <https://kalshi.com/forecasting>.

⁵⁵ Jason Furman to the CFTC Secretary of the Commission, September 18, 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?ID=69708&GUID=264324ae75eb-4c97-9d45-62baa1877335>.

economic researchers, and educators rely upon these markets in their work.⁵⁶ However, the assertion that political betting markets are accurate indicators of election outcomes relies upon the assumption that those engaged in the market are trading based on the outcomes they expect. In this way, Kalshi's argument that their political event contracts would serve as a hedging instrument contradicts their argument that their contracts would help predict election results. For instance, if someone thinks the Republicans will win the Senate, they may still bet on the Democrats winning to hedge against the perceived risk – in their opinion – that Democratic policies will increase their taxes, thus skewing the markets away from an accurate depiction of public opinion. Here, a trader using these political event contracts to hedge risk will bet not on the party they believe will win, but instead on the party they believe will expose them to some financial risk should they win. Even if only a fraction of Kalshi's users intend to use political event contracts to hedge, they would limit the ability of these contracts to provide accurate predictions. If Kalshi provided data concerning the breakdown of users and their primary goals with Kalshi, whether hedging or prediction outcomes, then it would be easier to analyze its efficacy as an election predictor. Accordingly, even though Kalshi's political event contracts are ineffective hedging instruments, the mere fact that Kalshi projects these contracts are effective hedging tools is good reason to believe that at least some traders will use them as such, thereby limiting the contracts' aggregated predictive power.

Market Manipulation:

Kalshi's political event contracts could also be vulnerable to market manipulation that would impact their efficacy as predictors. As Better Markets argues in their comment letter,

⁵⁶ Ibid.

parties privy to non-public information – such as campaign finance data and internal polling – may profit off of their knowledge.⁵⁷ Professor Rebecca Haw Allensworth notes in a 2009 Harvard Law Review article that, in 2004, an Ireland-based exchange called TradeSports offered an election market that experienced two “sustained attempts” of market manipulation.⁵⁸ In this regard, Better Markets argues that Kalshi has not offered – or at least disclosed to the public – any explanation for how they would combat such manipulation.⁵⁹ Allowing Kalshi to list these contracts without confirming that these markets would not be “readily subject to manipulation” would violate the Commission’s Core Principle Three requirement.⁶⁰ For example, trading syndicates could artificially lower the price of contracts and buy shares to sell for a profit once prices rise, or they could purchase shares at an elevated price to lead others to believe a given candidate is more likely to win.⁶¹

In the long run, Kalshi hopes to rival exchanges like the New York Stock Exchange and CME Group.⁶² While they currently have a downside limit for \$25,000 for individual contracts, Kalshi plans on increasing this limit.⁶³ As it stands now, this \$25,000 limit already exceeds the \$850 investment limit the Commission set for PredictIt in their 2014 no action letter.⁶⁴ Further increasing their limit would help Kalshi attract institutional investors – something executives

⁵⁷ Better Markets to the CFTC Secretary of the Commission, September 25, 2022, https://bettermarkets.org/wp-content/uploads/2022/09/Better_Markets_Comment_Letter_KalshiEX.pdf

⁵⁸ Rebecca Haw Allensworth, “Prediction Markets and Law: A Skeptical Account,” 122 HARV. L. REV. 1217 (2009).

⁵⁹ Better Markets to the CFTC, https://bettermarkets.org/wp-content/uploads/2022/09/Better_Markets_Comment_Letter_KalshiEX.pdf

⁶⁰ *Ibid.*

⁶¹ *Ibid.*

⁶² Ryan Deffenbaugh, “Election Markets Are Far from a Sure Bet,” *Protocol*, October 6, 2022.

⁶³ Jesse Pound, “This New Exchange Lets Investors Vote Yes or No on Major Events to Hedge Their Portfolios,” *CNBC*, December 29, 2021, <https://www.cnbc.com/2021/12/29/this-new-exchange-lets-investors-vote-yes-or-no-on-major-events-to-hedge-their-portfolios.html>.

⁶⁴ CFTC Director of the Division of Market Oversight Vincent McGonagle to Neil Quigley of the Victoria University of Wellington, October 29, 2014, <https://www.cftc.gov/PressRoom/PressReleases/7047-14>.

have also touted as a goal.⁶⁵ That being said, such increases would only make it easier for wealthy traders or syndicates to manipulate election markets. The vulnerability of these political event contract markets to manipulation not only detracts from the legitimacy of them as predictors of election outcomes, but it also opens elections themselves up to potential manipulation.

Election Integrity:

In the United States, voter turnout is approximately sixty percent in presidential elections and forty percent in midterm elections.⁶⁶ In a recent ABC/Ipsos poll, only twenty percent of the public reported feeling “very confident” about the election system,⁶⁷ and fifty-six percent of Americans reported having little or no confidence that American elections represent the will of the people.⁶⁸ Following the January 6th attack on the United States Capitol and the perpetuation of President Trump’s election lies, bolstering rather than weakening our elections should be of paramount importance. If Americans believe that Kalshi’s election markets are accurate predictors of election outcomes – as Kalshi contends – these markets could affect voter turnout. Dr. Leonardo Bursztyn, a University of Chicago economist, identified “a causal effect of anticipated election closeness on voter turnout in Swiss referenda” across cantons where polling estimates differed.⁶⁹ In his paper, Bursztyn demonstrates that cantons where polling indicated

⁶⁵ Segal, “MIT Grads Were Interns at Goldman and Citadel,” <https://www.institutionalinvestor.com/article/b1t43r4w6x4z3x/These-MIT-Grads-Were-Interns-at-Goldman-and-Citadel-Now-They-Want-to-Democratize-Hedging>.

⁶⁶ “Voter Turnout.” FairVote, October 17, 2022, <https://fairvote.org/resources/voter-turnout/>.

⁶⁷ Brittany Shepherd, “Americans’ Faith in Election Integrity Drops: POLL,” *ABC News*, January 6, 2022, <https://abcnews.go.com/Politics/americans-faith-election-integrity-drops-poll/story?id=82069876>.

⁶⁸ Jennifer Agiesta, “CNN Poll: A Growing Number of People Lack Confidence in American Elections,” *CNN*, February 11, 2022, <https://www.cnn.com/2022/02/10/politics/cnnpoll-democracy/index.html>.

⁶⁹ Leonardo Bursztyn, Davide Cantoni, Patricia Funk, and Noam Yuchtman, “Polls, the Press, the Political Participation: The Effects of Anticipated Election Closeness on Voter Turnout,” July 2018, https://faculty.haas.berkeley.edu/yuchtman/Noam_Yuchtman_files/close_polls.pdf.

close outcomes experienced greater voter turnout than cantons where polling indicated landslide outcomes, all else equal.⁷⁰ Although the research on this relationship is limited because economists have struggled to find suitable natural experiments, Bursztyn extrapolates that anticipated election closeness could have played a role in the 2016 U.S. Presidential election.⁷¹ Here, he explains that conservative leaning sources, which he argues Republicans are more likely to see, predicted much closer election outcomes than non-partisan and left leaning sources, which could have incentivized Republican voter turnout.⁷² In this sense, foreign adversaries could work to manipulate Kalshi's election markets by overwhelming them with a huge influx of trades to distort the public's expectation of election closeness and potentially negatively affect voter turnout. Even if one believes that foreign adversaries or any other mal-intentioned domestic groups will not attempt to manipulate Kalshi's elections markets and that perceived election closeness has no real causal impact on voter turnout, the existence of such risks could harm the perception of election integrity.

The Perception of Election Integrity:

While some might feel that protecting the perception of election integrity is a subordinate concern beneath protecting election integrity, the 2020 Presidential election and its subsequent controversy demonstrated that protecting the perception of election integrity is just as important as protecting election integrity with regard to defending our democracy. Further, although we have explained why we believe Kalshi's election markets would not provide accurate predictors of election outcomes as the company believes, the effect Kalshi's markets have on voter

⁷⁰ Ibid, 5.

⁷¹ Ibid, 22.

⁷² Ibid, 22.

behavior depends on how the public perceives their predictive accuracy. For example, if President Trump had been predicted to win the 2020 election based on the manipulation or inaccuracy of Kalshi's market, he and his supporters could have used this fact as evidence to support their fraudulent claims of election corruption.

Thus, in response to the Commission's twelfth question (12), we believe these contracts would harm the public interest through the impact they could have on the perception of election integrity. Trust in civil institutions represents the bedrock of democracy and sound public governance. The foundation of a healthy democracy has historically been rooted in trust, yet today, two-thirds of Americans have little to no confidence in the federal government.⁷³ Many ascribe this fading trust to a political culture and media landscape riddled with misinformation, and Kalshi's election markets would provide those who wish to sow division in this country yet another means to potentially manipulate the public perception surrounding election integrity. Accordingly, we urge the Commission to consider how election lies have poisoned our public discourse as a glaring demonstration of the impact that perceived flaws in election integrity can have on our country. Allowing Kalshi to list these contracts will hinder efforts to rebuild trust in our elections and increase the likelihood that election misinformation will have an impact on the public's acceptance of the 2024 presidential election results.

Conclusion:

To reiterate, we strongly believe the best approach for the Commission to take is to ban Kalshi from offering event contracts that would permit trading on whether Democrats or Republicans will take control over each chamber of Congress after the midterm elections. These

⁷³ Rosenberg, Stacy. "Trust and Distrust in America." Pew Research Center - U.S. Politics & Policy. Pew Research Center, July 27, 2021. <https://www.pewresearch.org/politics/2019/07/22/trust-and-distrust-in-america/>.

contracts are flawed hedging tools because of the unpredictable relationship between election results and subsequent economic consequences. With regard to these contracts' price-basing function, there is no good reason to question the Commission's verdict in 2014 that they serve no such function. Further analysis of the Nadex decision reveals that Kalshi's proposed contracts do in fact reference "gaming," and thus, may be considered gambling, in which case they would be illegal in several states.⁷⁴ Although there is some evidence supporting the predictive power of political markets, Kalshi's emphasis on hedging and their failure to explain how they plan to prevent market manipulation undermine their claim that their markets would have meaningful predictive power. The potential positive causal relationship between the anticipated closeness of elections and voter turnout increases the importance of addressing the market manipulation risks and demonstrates how manipulating political markets could influence election integrity. Even if actual market manipulation did not occur, the mere potential for such manipulation to occur weakens the perception of election integrity. Accordingly, the recency of the January 6th insurrection should serve as a stern reminder that if the public – or a part of the public – perceives elections to be corrupt, political violence can ensue. Rather than democratizing finance, as Kalshi hopes, these political event contracts may instead finance threats to democracy. The marginal benefit of allowing an election market that may produce better predictions cannot justify these outsized risks to the public interest, and specifically, to our democracy – at a time when bolstering trust in our civil institutions must be of the utmost importance. Thus, we urge the Commission to deny Kalshi's proposal to list contracts related to partisan control of Congress and to remain steadfast in their commitment to not allowing for-profit companies to create political trading markets.

⁷⁴ CFTC, "Questions on the KalshiEX," <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkxpublicquestions220829.pdf>

Sincerely,

Laura Boyle, Thomas Colicchio, and Morgan Joseph

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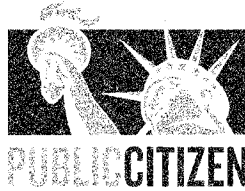
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July 20, 2023

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

RE: Public Citizen response to the request for comment on the proposed gaming contract of KalshiEX that would authorize gambling on election outcomes (Release No. 8728-23)

Dear Chairman Behnam and Commissioners:

Public Citizen is writing to express firm opposition to the contract proposal by KalshiEX, LLC (Kalshi) to allow the firm to run organized and large-scale gambling on election outcomes, in this particular case, betting on partisan control of Congress. Such a government-authorized contract would explicitly run afoul of Commission regulation 40.11(a)(1) and Section 5c(c)(5)(C) of the Commodity Exchange Act that prohibits contracts “contrary to the public interest,” such as those involving injurious gaming practices.

In fact, we are stunned that the Commodity Futures Trading Commission (CFTC) is even considering approval of such a gaming contract that will likely damage both the appearance and the practice of the integrity of American elections.

Public Citizen is a nonprofit consumer advocacy organization that champions the public interest in the halls of power. We defend democracy and fight to ensure that government works for the people – not big corporations. Founded in 1971, we now have 500,000 members and supporters throughout the country.

As a public interest organization dedicated to strengthening the American democracy – and the integrity of elections, in particular, as well as one focused on protecting the markets and financial systems to benefit regular consumers – Public Citizen encourages the CFTC not to provide government sanction for gambling on elections.

COMMENT: ELECTIONS SHOULD NOT BE JUST ABOUT MONEY

The integrity of elections is the cornerstone of a healthy democracy. When the integrity of elections is tainted in appearance or in actuality, democracy itself is threatened. The Kalshi

contract proposal poses precisely such a threat by seeking government sanction of sports betting on election outcomes.

While little can be done about individuals betting on election outcomes in their personal capacity – even though it is illegal at the federal level and in all states – if the CFTC provides its official endorsement of such wagering, the practice is very likely to spread across the nation. The states and the CFTC have appropriately banned gambling on election outcomes through most of American history. Political wagering was briefly allowed in West Virginia in 2020, for about one hour, before the state reversed course and shut it down.¹

The Commodity Futures Trading Commission has generally followed suit. Economists at Victoria University of Wellington in New Zealand requested approval of such gambling from the CFTC in 2014. A couple of years before, the Commission rejected a similar request from Nadex to offer political-event contracts, ruling that such contracts met a federal definition of gambling: “the staking or risking by any person of something of value upon the outcome of a contest of others.”² In 2013, the CFTC had effectively shut down Intrade, an Ireland-based exchange that had accepted millions of dollars in bets on U.S. elections.

But there was a small, noncommercial exception to this rule: the University of Iowa, with permission from the CFTC, had overseen the Iowa Electronic Markets—which accept trades from students and faculty on participating campuses—since 1993. Victoria University proposed expanding on the Iowa model. The CFTC replied that “an academic exercise demonstrating the information gathering and predictive capabilities of markets” would be allowed, so long as Victoria didn’t profit from it. The betting pool was named PredictIt. But the Commission reversed course and shut the pool down after it became evident that PredictIt started reaping huge profits rather than serving just as an academic experiment.³

Shortly after, the CFTC made another surprise announcement in opening up a comment period to consider this Kalshi proposal. Kalshi would allow traders to invest up to \$25,000 on a given political contract, well beyond what PredictIt was allowed to accept.

The Kalshi proposal should also not be allowed to stand. First of all, gambling on election outcomes is fraught with deceptive manipulation and, secondly, can cast a pall over the integrity of elections. In 2012, for example, a high-profile incident involving the prediction market Intrade showed how election wagering can be manipulative, called the “Romney Whale.” In the lead up to the final election contest between Barack Obama and Mitt Romney, the Intrade betting pool led many observers to believe Romney was favored to win. Upon closer investigation,

¹ Anthony Izaguirre, “Presidential betting gets axed quickly in West Virginia,” *Associated Press* (April 8, 2020), available at: <https://apnews.com/article/3748c12d07fefedc6fbdf6478842a782>.

² Danny Funt, “Betting on elections can tell us a lot. Why is it still mostly illegal?” *New Yorker* (Nov. 2, 2022), available at: <https://www.newyorker.com/news/the-political-scene/betting-on-elections-can-tell-us-a-lot-why-is-it-mostly-illegal>

³ *Id.*

it turned out that a single bettor placed large sums of money to falsely prop up Romney as the likely victor.⁴

Furthermore, wealthy special interests who have large sums of money riding on election outcomes are going to be motivated to affect those outcomes through whatever means are available. This could include pouring more money into outside electioneering groups, such as super PACs, or intimidating election officials and poll workers, or even denying unfavorable election results.

Worse yet, placing large sums of money on the outcome of elections will likely fuel the public perception that elections are all about money rather than an expression of the popular will. Public confidence in the integrity of elections is already at an all-time low. Most Americans lack confidence that the results of American elections reflect the will of the people, a sentiment that has grown steadily since January 2021. And nearly half of Americans polled say they think it is at least somewhat likely that in the next few years, some elected officials will successfully overturn the results of an election because their party did not win.⁵

Turning elections into a financial game for the wealthy will further add to suspicions as to whose interests elections represent. Not only would election results be influenced by wealthy special interests funding campaigns, but those same special interests would then have a very compelling reason to secure self-serving results. The consequences of gambling on elections are far-reaching and alarming. Given the abuses of social media in both the gambling and political spaces, allowing gambling on elections will incentivize more interference and misconduct as gamblers seek to shape political outcomes for financial profit. The public perception that money buys elections would be vastly magnified.

CONCLUSION: THE COMMODITY FUTURES TRADING COMMISSION SHOULD NOT SANCTION GAMBLING ON ELECTIONS

The Commission got it right the first time: gambling and elections are a bad mix that runs contrary to the public interest. There is good reason that federal, state and local governments have long banned betting on elections. The CFTC should continue standing for election integrity and not allow itself to be used as back-door entry for the gaming industry to profit from politics.

Election gaming serves no useful function other than to generate a profit for the few. In the meantime, election gaming can encourage manipulation of the electoral process and risks incentivizing a variety of means to affect election outcomes by those who stand to lose or gain large sums of money, from pouring additional funds into outside electioneering groups to intimidating election workers and perhaps even denying election results.

⁴ John Holden, "Why can't Americans bet legally on the US presidential election?" Legal Sports Report (Feb. 18, 2020), available at: <https://www.legalsportsreport.com/37949/2020-presidential-election-betting-us/>.

⁵ Jennifer Agiesta, "CNN poll: Americans' confidence in elections has faded since January 6," CNN Politics (July 21, 2022), available at: <https://www.cnn.com/2022/07/21/politics/cnn-poll-elections/index.html>.

Free and fair elections are an essential component of democratic governance. Transforming elections into what many could well perceive as a game for wealthy special interests undermines the democratic body politic.

Sincerely,

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Lisa Gilbert
Executive Vice President, Public Citizen
1600 20th Street, NW
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THE LAW OFFICES OF
JEREMY D. WEINSTEIN
A PROFESSIONAL CORPORATION

July 21, 2023

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581
<https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7394>

Re: CFTC Review of KalshiEx Proposed Congressional Control Contracts
Under CFTC Regulation 40.11

Dear Mr. Kirkpatrick:

I am responding to the CFTC's Questions on the KalshiEX LLC ("Kalshi") "Will <chamber of Congress> be controlled by <party> for <term>?" Contracts for Public Comment ("CFTC 2023 Questions").¹ I respond despite signs that the CFTC has already made up its mind.

The Kalshi contracts are clearly not prohibited under the Commodity Exchange Act ("CEA") and CFTC regulations. These prohibit *an instrument* that has any involvement with, relationship to, or *reference* a defined set of listed activities. The prohibition is not whether people can make an illegal bet on an outcome- for example who will win an election or whether the price of wheat will increase- but whether *the instrument "involves, relates to, or references"* activities listed by the CFTC in Rule 40.11 as against the public interest. These listed activities are "terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law" or "an activity that *is similar ... and* that the Commission determines, by rule or regulation, to be contrary to the public interest." "Elections" is not in this list, and elections are not "similar" to terrorism, assassination, war, gaming, or an activity that is unlawful under any state and federal law.

Part One

The CEA defines "event contracts" as "an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not

¹ CFTC, Release No. 8728-23, *CFTC Announces Review of Kalshi Congressional Control Contracts and Public Comment Period*, Jun. 23, 2023, avail. at <https://www.cftc.gov/PressRoom/PressReleases/8728-23>.

described [here]) that is (I) beyond the control of the parties to the relevant contract ...; and (II) associated with a financial, commercial, or economic consequence.”² In 2008, the CFTC explained, “event contracts may be based on eventualities and measures as varied as the world’s population in the year 2050, the results of political elections, or the outcome of particular entertainment events. ... Event contracts have been based on ... the accomplishment of certain scientific advances, ... the adoption of particular pieces of legislation, the outcome of corporate product sales, the declaration of war and the length of celebrity marriages.”³

In 2010, §745 of the Dodd-Frank Act added §5c(c)(5)(C) to the CEA:

Special Rule For Review And Approval Of Event Contracts And Swaps Contracts.— (i) Event Contracts.—In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i)), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve— (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest. (ii) Prohibition.—No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity. ...⁴

The law provides that the CFTC “may determine” that “such” event contracts are “contrary to the public interest” for one of six listed reasons, and if the CFTC does so, “such” event contracts are prohibited. A year later the CFTC promulgated Rule 40.11:⁵

Review of event contracts based upon certain excluded commodities. (a) Prohibition. A registered entity ***shall not list for trading or accept for clearing*** on or through the registered entity any of the following: (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act,⁶ that ***involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful*** under any State or Federal law; or (2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references an activity that is ***similar*** to an activity enumerated in § 40.11(a)(1)

² CEA §1a(19)(iv).

³ CFTC, *Concept Release ...*, 73 Fed. Reg. 25669 at 25669-70 (May 7, 2008).

⁴ §5c(c)(5)(C)(i)-(ii) (emphasis supplied).

⁵ CFTC, *Final Rule, Provisions Common to Registered Entities*, 76 Fed. Reg. 44776 (Jul. 27, 2011).

⁶ “an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not described in clause (i)) that is— (I) beyond the control of the parties to the relevant contract, agreement, or transaction; and (II) associated with a financial, commercial, or economic consequence.”

of this part, **and that the Commission determines**, by rule or regulation, to be contrary to the public interest.⁷

In Rule 40.11(a)(1), as expressly permitted by §745, the CFTC made the determination that event contracts that meet five of Congress’s six reasons **are** contrary to the public interest and therefore **are** prohibited. In Rule 40.11(a)(2) the CFTC included Congress’s statutory mechanism for making a further “similar” determination for any specific contract that is “**similar**” to the first five reasons **and** against the public interest.

For example, on December 15, 2020, the CFTC received a self-certification by the Eris futures exchange for listing three financially settled contracts called “RSBIX NFL Futures Contracts.”⁸ The CFTC told Eris that it had determined that these futures contracts “may involve, relate to, or reference . . . gaming” under Rule 40.11, instructed Eris to suspend listing the proposed futures contracts for a 90-day review period,⁹ and posted questions for public comment.¹⁰ I and others commented.¹¹ Eris’s futures contracts involved, related to, **and** referenced sports gambling, as was clear in their names¹² – the “moneyline,”¹³ “point spread,”¹⁴ and “over/under”¹⁵ for individual games - terms of sports gambling and the three main types of illegal sports bets.¹⁶ The standard of Rule 40.11(a)(1) is “gaming,” not “illegal gaming.” An “activity that is unlawful under any Federal or State law” under §5c(c)(5)(C)(i)(I) is a separate and distinct prohibition than “gaming” under §5c(c)(5)(C)(i)(V).

Therefore, even if gambling on football was legal in every state, the ErisX contracts were prohibited under the statute and Rule 40.11 because they referenced “gaming” and football is a “game.” On March 22, 2021, just one day before the end of

⁷ 17 C.F.R. §40.11 (emphasis supplied).

⁸ Eris, CFTC Regulation 40.2(a) Certification (Dec. 14, 2020) (“Eris Certification”), avail. at <https://www.cftc.gov/sites/default/files/filings/ptc/20/12/ptc121520erisdcm005.pdf>.

⁹ Letter from Christopher J. Kirkpatrick, Secretary of the Commission, CFTC, to Mr. Thomas Chippas, Chief Executive Officer, Eris (Dec. 23, 2020), avail. at <https://www.cftc.gov/sites/default/files/filings/documents/2020/orgdcmerrsignedletter201223.pdf>.

¹⁰ CFTC, Release No. 8345-20, *CFTC Announces Review of RSBIX NFL Futures Contracts Proposed by Eris Exchange, LLC* (Dec. 23, 2020), avail. at <https://www.cftc.gov/PressRoom/PressReleases/8345-20>.

¹¹ Comments for Industry Filing 20-004, avail. at avail. at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=5203>; my comment at avail. at <https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=31489>. See discussion at Zachary Zaggar, *Sportsbooks Could Use Derivatives Market, But Is It Betting?*, Law360, Feb. 17, 2021, avail. at <https://www.law360.com/articles/1355199/sportsbooks-could-use-derivatives-market-but-is-it-betting->.

¹² Eris Certification, pp. 4-6.

¹³ E.g., Sports Interaction Insights, *Moneyline Betting Explained*: “A moneyline bet is one of the easiest kinds of bets you can make at a sportsbook.”, avail. at <https://news.sportsinteraction.com/guide/moneyline-betting-explained>.

¹⁴ E.g., Bookies.com, *Point Spread Betting Explained*, avail. at <https://bookies.com/guides/what-is-point-spread-betting>.

¹⁵ E.g., Bookies.com, *Understanding Over/Under Betting For Sports Bettors* (“In NFL betting, the Over/Under is the most popular way to wager on totals, with lines set for every game on Sunday and in prime time for Monday Night Football and Thursday Night Football.”) avail. at <https://bookies.com/guides/how-to-do-over-under-betting>.

¹⁶ See Appendix A, “Sports Wagering Primer” in Strumpf, Dept. of Economics, Univ. of N.C., Chapel Hill, *Illegal Sports Bookmakers* (Feb. 2003) avail. at <http://users.wfu.edu/strumpks/papers/Bookie4b.pdf>.

the 90-day review period, Eris withdrew its self-certification.¹⁷ It soon became apparent that the CFTC would have issued an order denying the NFL Contracts.

Public statements by two CFTC Commissioners over the following weeks, as well as the Freedom of Information Act, highlighted a deficient CFTC rulemaking process,¹⁸ which with additional deficiencies continues to be applied by the CFTC to the Kalshi contracts. Then-Commissioner Quintenz, who went on to work for Kalshi,¹⁹ publicly stated, “the statute is unconstitutional, the regulation is invalid, and even without those issues, there were flaws in the Order that made it arbitrary and capricious.”²⁰ Then-Commissioner Dan Berkovitz’s made a public statement that treated the CFTC’s public interest determination in Rule 40.11 as if it had never happened,²¹ even though he was the CFTC’s General Counsel when Rule 40.11 was promulgated.²²

By §745 of the Dodd-Frank Act, as implemented in part by Rule 40.11(a), Congress made a policy determination to restrict certain event contracts. The standard of Rule 40.11 and §745 is not whether the trader of the instrument is involved in the illegal activity; it is whether *the instrument* has any involvement with, relationship to, or reference of listed activities. Therefore, the CFTC should not have approved the Eris contracts. An earlier CFTC Order prohibiting a Nadex election contract for involving gaming within the meaning of §5c(c)(5)(C)(V)²³ was incorrect. The prohibition is not whether people can make an illegal bet on an outcome- for example who will win an election or whether the price of wheat will increase- since people can make illegal bets on anything, including the direction of any price of any futures contract, but whether *the instrument “involves, relates to, or references”* activities listed by the CFTC as against the public interest in Rule 40.11. These are “terrorism, assassination, war, gaming, or an activity

¹⁷ Alexander Osipovich and Dave Michaels, *NFL Futures Plan Withdrawn as Regulator Prepared to Reject It*, Wall Street Journal, Mar. 23, 2021, avail. at https://www.wsj.com/articles/nfl-futures-plan-withdrawn-by-exchange-as-regulator-prepared-to-spike-it-11616521600?st=4woyq3k67shbwg6&reflink=article_email_share&mg=prod/com-wsj.

¹⁸ Jeremy Weinstein, *Football Gambling Futures Contract: Can the CFTC Measure up to the Keystone Cops?*, 41 Futures and Derivatives Law Report (Aug. 2021), avail. at <https://bit.ly/3qJrBZ4>.

¹⁹ *Former CFTC Commissioner Brian Quintenz Joins Our Board* (Nov. 16, 2021), avail. at <https://kalshi.com/blog/former-cftc-commissioner-brian-quintenz-joins-our-board>.

²⁰ 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) B.3, avail. at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>.

²¹ Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts: Sports Event Contracts: No Dice Unless There is an Economic Purpose and the Exchange is Open to the Public (Apr. 7, 2021), avail. at <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>.

²² CFTC, *Commissioner Dan M. Berkovitz*, avail. at <https://web.archive.org/web/20190321055134/avail> at <https://www.cftc.gov/About/Commissioners/CommissionerDanMBerkovitz/index.htm>.

²³ CFTC, *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* (Apr. 2, 2012) at p. 2, avail. at <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>. See CFTC, Release No. 6224-12, *CFTC Issues Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts* (Apr. 2, 2012), avail. at <https://www.cftc.gov/PressRoom/PressReleases/6224-12> (“the contracts involve gaming and are contrary to the public interest, and cannot be listed or made available for clearing or trading”).

that is unlawful under any State or Federal law” or “an activity that is *similar ... and* that the Commission determines, by rule or regulation [i.e., not on a one-off basis],²⁴ to be contrary to the public interest.” The Eris contracts referenced gaming. In contrast, the Kalshi instruments *do not reference* terrorism, assassination, war, gaming, or an activity that is unlawful under any state or federal law, or any similar activity that the Commission has determined by rule or regulation to be contrary to the public interest. Rather, they reference elections, which are legal under all state and federal laws, and present risks that people could use the contracts to hedge.

Last year in response to a Kalshi self-certification, the CFTC posted and asked its Questions on the Kalshi “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment (“CFTC 2022 Questions”).²⁵ Many responded to the CFTC 2022 Questions, including me.²⁶ Yet, the CFTC provided no indication of what the CFTC did with all that public input. In fact, a self-appointed market “watchdog” complained to the CFTC’s inspector general when one Commissioner sought to shed some light on it.²⁷

After the CFTC’s vaporware Kalshi elections contract review, the CFTC withdrew previously granted no action relief to a venue that trades election event contracts.²⁸ The reason the CFTC stated was “The [venue] has not operated its market in compliance with the terms of Letter 14-130.” The CFTC provided no indication of evidence of the manipulation risks of which it asked in the CFTC 2022 Questions or the CFTC 2023 Questions. That withdrawal is currently in litigation.²⁹

If the CFTC does not want election event futures contracts, it can propose rules

²⁴ The texts of CEA §5c(c)(5)(C) and Rule 40.11 differ. The statute authorizes the CFTC to make a determination that types of activity could be against the public interest, whereas in the text of Rule 40.11 the CFTC made such a determination. See answer to Question 1 below.

²⁵ CFTC, Release Number 8578-22, *CFTC Announces Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11*, Aug. 26, 2022, avail. at <https://www.cftc.gov/PressRoom/PressReleases/8578-22>.

²⁶ Avail. at <https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=33678>.

²⁷ Better Markets, *Better Markets Files Complaint With CFTC IG To Investigate CFTC Commissioner Pham’s Apparent Disclosure Of Highly Confidential Agency Information Involving Kalshi’s Application*, December 9, 2022, avail. at <https://bettermarkets.org/newsroom/better-markets-files-complaint-with-cftc-ig-to-investigate-cftc-commissioner-phams-apparent-disclosure-of-highly-confidential-agency-information-involving-kalshis-application/>. Better Markets has also demanded that said Commissioner recuse herself from this process. Better Markets, *The CFTC Should Not Be Used As A Sneaky Backdoor To Unleash Gambling On U.S. Elections, Undermining Public Trust, Democracy, And The Commodity Markets*, June 26, 2023, avail. at <https://bettermarkets.org/newsroom/the-cftc-should-not-be-used-as-a-sneaky-backdoor-to-unleash-gambling-on-u-s-elections-undermining-public-trust-democracy-and-the-commodity-markets/>.

²⁸ CFTC Letter No. 22-08, Withdrawal of CFTC Letter No. 14-130 (Aug. 4, 2022), avail. at <https://www.cftc.gov/csl/22-08/download>. CFTC Staff Letter 14-130 (Oct. 29, 2014); CFTC, *CFTC Staff Provides No-Action Relief for Victoria University of Wellington, New Zealand, to Operate a Not-For-Profit Market for Event Contracts and to Offer Event Contracts to U.S. Persons*, avail. at <https://www.cftc.gov/PressRoom/PressReleases/7047-14>.

²⁹ *Clarke et al. v. CFTC*, 5th Cir., case no. 22-51124. See, e.g., Katryna Perera, *5th Circ. Judge Decries CFTC ‘Bully’ In Election Betting Suit*, Law360, February 8, 2023; *Election Betting Co. Can Continue For Now*, 5th Circ. Says, Law360, Jan. 27, 2023; Katryna Perera, *Election-Betting Firm Sues CFTC Over Order To Shut Down*, Law360, Sept. 12, 2022.

that prohibit them in a public rulemaking process in accordance with the Administrative Procedures Act. It can provide the regulations of event contracts that it teased 15 years ago.³⁰ Right now, the CFTC does not have a rule that prohibits the Kalshi contracts; certainly they are not prohibited by §5c(c)(5)(C) or Rule 40.11.

Part Two

Several of the CFTC’s numbered questions are set forth below with my responses.

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?

No, they do not. These contracts are not about games or subjects of gambling, such as a football game or whether a roulette wheel will stop on red. People can make legal or illegal bets on any outcome- for example who will win an election or by how much the price of wheat or interest rates will increase. Therefore, to say these contracts involve gaming would be to say that all futures contracts involve gaming. Please see discussion in Part One above.

The CFTC 2023 Questions and CFTC 2022 Questions differ for this question. In 2022, the CFTC asked about “regulation 40.11(a)(2) or section 5c(c)(5)(C)”. The texts of §5c(c)(5)(C) and Rule 40.11 differ. The statute authorizes the CFTC to make a determination that types of similar activity could be against the public interest, whereas in Rule 40.11 the CFTC made such a determination. Nowhere does §5c(c)(5)(C)(i) say that the CFTC must make its public interest determination on a contract-by-contract basis. In fact, §5c(c)(5)(B),³¹ referring to approval as the default state unless prohibited, and the prohibition of §5c(c)(5)(C)(ii) against listing any contract “determined by the [CFTC] to be contrary to the public interest” under § 5c(c)(5)(C)(i), each refer to futures contracts in the singular, while §5c(c)(5)(C)(i), which authorizes the CFTC to make public interest determinations, refers to contracts in the plural. This change to Question 1 perhaps indicates that the CFTC believes “gaming” has the same meaning in the statute and the rule.

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?

None, since the contracts do not involve, relate to, or reference “(I) activity that is

³⁰ CFTC, *Concept Release on the Appropriate Regulatory Treatment of Event Contracts*, 73 Fed. Reg. 25669 (May 7, 2008); comment file at <https://www.cftc.gov/LawRegulation/PublicComments/08-004.html>.

³¹ “The Commission shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this chapter (including regulations).”

unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” Please see discussion in Part One above.

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?

No. The prohibition is not whether people can make a legal or illegal bet on an outcome - for example who will win an election or on the closing price of a futures contract in wheat or interest rates next Tuesday - but whether *the instrument “involves, relates to, or references”* “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” Please see discussion in Part One above.

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. Elections are legal under all state and federal laws, just as buying and selling wheat futures or interest rate futures on a DCM is legal under all state and federal laws.

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. “Wagering” is illegal in most states, and it is not the subject of the wager that is illegal. People can break the law by illegally “wagering” on football games, which raindrop will reach the bottom of a train window first, an election outcome, or next Tuesday’s closing price of the March 2024 wheat futures contract. Rule 40.11 prohibits contracts that help people in the business of wagering, not contracts that reference something on which people might wager.

The availability of hedging instruments, including those traded in public futures markets, is an essential tool for businesses to mitigate commercial risks.³² Reducing commercial risks through hedging³³ enhances the ability of any business to succeed. That is what the ErisX futures contracts would have done for organized crime. The ErisX contracts would have given illegal bookies futures contracts to hedge their commercial

³² Thomas A. Hieronymus, *The Economics of Futures Trading* (Commodity Research Bureau, 1971); CFTC, *Final Rule, Position Limits for Derivatives*, 86 Fed. Reg. 3236 at *passim* (Jan. 14, 2021).

³³ “Hedging occurs when positions acquired are economically appropriate to the reduction of risks in the conduct and management of a commercial enterprise. See, e.g., 17 CFR 1.3(z) (definition of bona fide hedging).” CFTC, *Concept Release ...*, 73 Fed. Reg. 25669 at 25672 n. 16.

risks by allowing the futures markets to be used for layoff betting.³⁴ Giving illegal bookies a futures contract to hedge their commercial risks likewise would enhance their ability to succeed. Sports gambling and illegal sports bookmaking are foundational tools for organized crime.³⁵ The ability to hedge commercial risk helps businesses succeed, and the ability to use these futures contracts to hedge commercial risk would have helped these illegal businesses succeed. That success would have inflicted upon the public more of all of the harms that accompany illegal gambling, including money laundering, loan sharking,³⁶ extortion, game-fixing, corruption, infiltration of legitimate businesses,³⁷ and broken families. Likewise, §5c(c)(5)(C)(i)(I) prohibits instruments that would permit any other criminals to hedge their risk through a contract that references crime, or provide an incentive for the commission of crime by, for example, an event contract on burglary statistics in a residential neighborhood. By prohibiting contracts that involve, relate to or reference one particular type of crime, “assassination,” §5c(c)(5)(C)(i)(III) seeks to avoid creating any economic incentive for an assassination.

No such use may be made of the Kalshi contracts and they are accordingly not prohibited by §5c(c)(5)(C)(i)(I).

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)...

Maybe. It does not matter, since the Nadex Order prohibiting an election contract

³⁴ Morris Ploscowe, *New Approaches to Gambling, Prostitution and Organized Crime*, 38 Notre Dame L. Rev. 654, 655-56 (1963) (“Lay-off Betting. Every bookmaker from time to time gets more action on a particular horse or a particular sporting event that he can handle. The losses, in case the bettor wins, may be too great for the individual bookmaker. Like any businessman, therefore, the bookmaker tries to reinsure himself against large losses through the mechanics of lay-off betting. The risks of too great losses are spread through several layers of the bookmaking hierarchy. The top echelons of the hierarchy may take an additional step to insure themselves against too large losses. They may at the last minute bet substantial sums on the horse on which they have large bets (this is so-called comeback money). In this way, if a horse wins, they will have considerable moneys from the track with which to pay off bettors.”).

³⁵ “For the last century and a half, gambling has been the cornerstone of organized crime, providing both power and capital” Prof. Gary Potter, *Criminal Organizations: Vice, Racketeering and Politics in an American City*, p. 72 (1994). See also Kevin B. Kinnee, *Practical Gambling Investigation Techniques*, ch. 1 (Elsevier 1992).

³⁶ FBI, *Illegal Sports Betting*, avail. at <https://www.fbi.gov/scams-and-safety/common-scams-and-crimes/illegal-sports-betting>: “Illegal sports betting has real consequences for people who place and receive wagers—and for the safety of the American public. Organized crime groups often run illegal gambling operations. These groups often use the money made from illegal gambling to fund other criminal activities, like the trafficking of humans, drugs, and weapons. These operations may also be involved in tax evasion and money laundering. One of the FBI’s priorities is to investigate organized crime groups that operate illegal sports betting operations and disrupt and dismantle their activities. Besides possibly funding organized crime activities, people who place wagers with illegal sports betting operations may be at risk of extortion and violence, which bookmakers may use to collect debts.”

³⁷ Kevin B. Kinnee, *Practical Gambling Investigation Techniques*, p. 6 (Elsevier 1992). Mr. Kinnee’s diagram illustration is dramatized in the “Bust Out” episode 23 of HBO’s *The Sopranos* (2000).

as involving gaming within the meaning of §5c(c)(5)(C)(V)³⁸ was incorrect. The prohibition is not whether people can make an illegal bet on an outcome. Please see discussion in Part One above.

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) ...

This question is inappropriate. The CFTC can run a redline and know the differences. The only reason to seek public input on those differences is to receive public input on the meaning and implication of those differences, and the CFTC has hidden those from the public. By its CFTC 2022 Questions, the CFTC solicited, and received, public input, and yet provided no public output. In the ErisX contracts, the CFTC solicited public input, yet provided no output. The CFTC engaged in processes by which it led the public to believe, by taking the public's time for input, that it would provide guidance that future sponsors of futures contracts could learn from and rely upon. Instead, the CFTC did not provide anything to the public. The CFTC now asks the public on the meaning of how the 2023 contracts differ from the 2022 contracts, when the public can have no idea what they mean for outcomes, because the public was not told.

That the CFTC is required to solicit public input does not excuse disrespect to the public that comes from disregarding that input.

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 could serve a hedging function. In connection with the approval of a new futures contract, as a matter of law and common sense, it must be sufficient that the contract could be used for hedging, because without the contracts being available for hedging, all hedging is theoretical and there is no way a proposer could present evidence of how often a contract is used for hedging. I provide evidence of that theoretical hedging function in my answer to Question 9.

³⁸ CFTC, *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* (Apr. 2, 2012) at p. 2, avail. at <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>. See CFTC, Release No. 6224-12, *CFTC Issues Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts*, Apr. 2, 2012 ("the CFTC determined that the contracts involve gaming and are contrary to the public interest, and cannot be listed or made available for clearing or trading"), avail. at <https://www.cftc.gov/PressRoom/PressReleases/6224-12>.

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?

Yes. Here are three examples:

One example is business line risk, risk is to a specific existing line of business that may be targeted by one of the political parties. Currently, proxy advisers may become subject to different economic risks based on which party controls Congress. One political party has introduced legislation to amend the Securities Exchange Act to require proxy adviser registration and compliance, opposed by the other political party.³⁹ Compliance would be expensive, and a real economic risks for proxy advisers and their stockholders for which no other hedging instruments are available.

Another example is targeted corporation risk, which is risk to a particular company that has incurred the ire of a political party. Companies in cross-hairs have the unique risks of the economic and reputational damage from boycotts, new legislation, and hearings that can be held by a party in control with the goal of harming them. This presents these companies and their stockholders with very real economic risks that these futures contracts can hedge, and for which no other hedging instruments are available.

Here are three current, real-world examples of targeted corporation risk:

A political boycott⁴⁰ of a beer company⁴¹ is being inflamed by Republican lawmakers. A Republican Senator demanded “investigation” of a beer company’s transgender-friendly marketing campaign,⁴² and that beer company should worry this could translate into hearings were the Republicans to control the Senate. This targeted corporation has so far suffered billions of dollars in revenue, and its stockholders have suffered billions of dollars in market capitalization loss.

Another is Republican retribution against a large entertainment company for speaking against legislation proposed in a state where it is the largest private employer. A Republican Congressman introduced legislation with the stated goal of bankrupting⁴³

³⁹ *House GOP Threatens Crackdown On Proxy Advisers*, Law360, Jul. 13, 2023, avail. at <https://www.law360.com/projectfinance/articles/1699304/house-gop-threatens-crackdown-on-proxy-advisers>

⁴⁰ “A political boycott uses economic coercion to force its victims to speak or act politically in a way that furthers the goals, not necessarily of the speaker, but of the boycotter.” Note, *The Political Boycott: An Unprivileged Form of Expression*, 1983 Duke L.J. 1076, 1077.

⁴¹ avail. at https://en.wikipedia.org/wiki/2023_Bud_Light_boycott.

⁴² *Cruz opens a probe into Anheuser-Busch over Dylan Mulvaney partnership*, The Hill, May 18, 2023, avail. at <https://thehill.com/homenews/senate/401114-cruz-opens-a-probe-into-anheuser-busch-over-dylan-mulvaney-partnership/>.

⁴³ Troy E. Nehls, *Rep. Troy E. Nehls Reintroduces Airlines Independent of Restrictions (AIR) Act*, May 05, 2023, “No corporation should get preferential treatment from the government—especially when it is grooming children. **Go woke, go broke.**” (emphasis supplied) avail. at

this company as punishment. If Republicans control both houses of Congress, this particular economic risk could become a reality for this targeted corporation were there also a Republican President.

Another is a threat a Republican Senator made to 51 large US law firms to hold hearings to investigate the legal advice the law firms provide clients on employment practices,⁴⁴ perhaps to see if that legal advice aligned with the Senator's views. Such hearings would present direct costs to the law firms and indirect costs by interfering with client relations. Such hearings could be held if the Republicans control the Senate, and there are no other instruments available to hedge this risk.

Another example is much broader, long-term risks for which the Kalshi contracts are not optimal hedging instruments right now, but could become such once a political party articulates specific legislation to advance its policies. For example, there are economic risks presented to American Jewry and Jewish-owned businesses by antisemitism. Today, 1 in 4 hiring managers say they are less likely to move forward with Jewish applicants.⁴⁵ Antisemitism presents economic risks to Jewish people and their businesses. Those risks become more directly hedgeable by these contracts if one party proposes legislation implementing antisemitic policies that the other party opposes.

Republican lawmakers have long engaged in dog whistle antisemitism, for example attacking Jewish financier George Soros,⁴⁶ and increasingly include overt

<https://web.archive.org/web/20230510040957/avail>. at <https://nehls.house.gov/posts/rep-troy-e-nehls-reintroduces-airlines-independent-of-restrictions-air-act>; MSNBC, *GOP lawmakers are now attacking Disney at the federal level*, May 11, 2023, avail. at <https://www.msnbc.com/the-reidout/reidout-blog/disney-desantis-boebert-no-fly-zone-rcna84030>.

⁴⁴ Tom Cotton, *Cotton Warns Top Law Firms About Race-Based Hiring Practices*, Jul. 17, 2023, "To the extent that your firm continues to advise clients regarding DEI programs or operate one of your own, both you and those clients should take care to preserve relevant documents in anticipation of investigations and litigation.", avail. at <https://www.cotton.senate.gov/news/press-releases/cotton-warns-top-law-firms-about-race-based-hiring-practices>

⁴⁵ "Key findings include: 26% of hiring managers say they are less likely to move forward with Jewish applicants; top reason for negative bias is belief Jews have too much power and control; 26% make assumptions about whether a candidate is Jewish based on their appearance; 23% say they want fewer Jews in their industry; 17% say leadership has told them to not hire Jews; 33% say antisemitism is common in their workplace; 29% say antisemitism is acceptable in their company." Reasons hiring managers stated they would be less likely to move forward with Jewish applicants included: Jews have too much power and control (38%); Jews claim to be the 'chosen people' (38%); Jews have too much wealth (35%); Jews are greedy (22%); Jews killed Jesus (18%); Jews are an inferior race (18%); Jews are oppressors (18%) and Jews are less capable (17%). Updated: Jan. 19, 2023, avail. at <https://www.resumebuilder.com/1-in-4-hiring-managers-say-they-are-less-likely-to-move-forward-with-jewish-applicants/>.

⁴⁶ A core tenet of modern antisemitism is that Jews control the world through shadowy conspiracies. See Holocaust Museum, *Protocols of the Elders of Zion*, avail. at <https://encyclopedia.ushmm.org/content/en/article/protocols-of-the-elders-of-zion>. A core tenet of both traditional and modern antisemitism is that Jews care most about money. American Jewish Committee, *5 of Kanye West's Antisemitic Remarks, Explained*, Dec. 2, 2022, avail. at <https://www.ajc.org/news/5-of-kanye-wests-antisemitic-remarks-explained>. See Umberto Eco, *The Prague Cemetery* (2010) for an explanation of antisemitism's transition from traditional to modern.

antisemitism in the Republican brand.⁴⁷ The Republican House of Representatives candidate in the 2018 general election in my district was an open Holocaust denier.⁴⁸ Republican President Trump’s Executive Order 13967 parroted Nazi attacks against Jewish “degenerate art,” even attacking US works of a refugee from the Nazis.⁴⁹ A Republican Congresswoman accused a wealthy Jewish family of starting California wildfires using light beams from outer space,⁵⁰ and the Republican leadership effectively

⁴⁷ E.g., Haaretz, *Antisemitism Is Now a Key Part of the Republican Agenda for America: Once fringe and denounced, extremism and antisemitism are now not only at home in the Republican Party, but built into the GOP’s political strategy for the midterms and beyond. As antisemitism in America rises, this is a startling normalization of hate*, Nov. 8, 2022, avail. at <https://www.haaretz.com/us-news/2022-11-08/ty-article-opinion/premium/antisemitism-now-a-key-part-of-the-republican-agenda-for-america/00000184-56ed-dc83-a7fd-feff297c0000>; Los Angeles Times, *Denouncing antisemitism shouldn’t be hard; for some Republicans, it seems to be*, Dec. 2, 2022, avail. at <https://www.latimes.com/politics/newsletter/2022-12-02/antisemitism-trump-and-the-gop-essential-politics>; *Arizona Republicans to host white nationalist antisemite Nick Fuentes at conference*, AZCentral, Jul. 11, 2023, avail. at <https://www.azcentral.com/story/opinion/op-ed/ej-montini/2023/07/11/arizona-republican-event-features-white-nationalist-nick-fuentes/70400626007/>; Media Matters, *100-plus examples of Republican politicians embracing antisemitic media since 2021*, Dec. 12, 2022, avail. at <https://www.mediamatters.org/diversity-discrimination/100-plus-examples-republican-politicians-embracing-antisemitic-media-2021>; *Dr. Oz Stood in Front of One of Hitler’s Cars at a Fundraiser*, Oct. 7, 2022, avail. at <https://jezebel.com/dr-oz-stood-in-front-of-one-of-hitlers-cars-at-a-fundr-1849630627>.

⁴⁸ “A Republican candidate for Congress in California is openly running as a Holocaust denier, calling it a ‘complete fabrication’ in an interview with The New York Times published Friday.” The Hill, *California GOP congressional candidate runs as open Holocaust denier*, Jul. 6, 2018, avail. at <https://thehill.com/homenews/campaign/395913-california-gop-congressional-candidate-runs-as-open-holocaust-denier/>.

⁴⁹ *Promoting Beautiful Federal Civic Architecture*, 85 Fed. Reg. 83739 (Dec. 23, 2020). “In the District of Columbia, classical architecture shall be the preferred and default architecture for Federal public buildings,” §2(a), and the President shall be notified and given a detailed explanation if the GSA “proposes to approve a design for a new applicable Federal public building that diverges from the preferred architecture set forth in [§]2(a) ..., including Brutalist ... architecture or any design derived from or related to these types of architecture,” and told “whether such design is as beautiful and reflective of ... vigor”. §6(b). “‘Brutalist’ means the style of architecture that grew out of the early 20th-century modernist movement ...” §3(b). EO 13967 attacked by name two buildings designed by a Jewish-born refugee from the Nazis, Bauhaus architect Marcel Breuer (HHS HQ, avail. at <https://www.hhs.gov/about/hhs-headquarters/index.html>) and Robert C. Weaver Federal Building avail. at <https://www.gsa.gov/historic-buildings/robert-c-weaver-federal-building-washington-dc>), 85 Fed. Reg. at 83740, para. 1. “Among Hitler’s grand plans upon coming to power ... was to purify German culture, to promote the Apollonian ‘classical’ and eradicate the uncontrollably Dionysian ‘primitive,’ a category that included ... avant-garde modernism, Bolshevism, and Jewish culture. ... Harassment of Bauhaus artists began even earlier.” NY Times, *First, They Came for the Art*, Mar. 13, 2014, avail. at <https://www.nytimes.com/2014/03/14/arts/design/degenerate-art-at-neue-galerie-recalls-nazi-censorship.html>; see also Bloomberg CityLab, *How the Bauhaus Kept the Nazis at Bay, Until It Couldn’t*, Mar. 11, 2019, avail. at <https://www.bloomberg.com/news/articles/2019-03-11/100-years-later-how-the-bauhaus-resisted-nazi-germany?sref=9qd489pp>; BBC News, *Bauhaus in pictures: The architects exiled by Nazis*, 16 Jan. 2019, avail. at <https://www.bbc.com/news/in-pictures-46863364>. President Biden rescinded EO 13967. *Executive Order on the Revocation of Certain Presidential Actions*, avail. at <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/02/24/executive-order-on-the-revocation-of-certain-presidential-actions/>.

⁵⁰ Zack Beauchamp, *Marjorie Taylor Greene’s space laser and the age-old problem of blaming the Jews: Why conspiracy theorists always end up pointing the finger at Jews — and why that’s a problem for the GOP*, Jan 30, 2021, Vox, avail. at <https://www.vox.com/22256258/marjorie-taylor-greene-jewish-space>.

backed her.⁵¹ Republican Speaker of the House Kevin McCarthy accused three Jewish people, including Soros, of trying to “buy” elections.⁵² The current front runner for the 2024 nomination for Republican presidential candidate publicly dined with open and notorious antisemites, and this was accepted by many Republicans in Congress.⁵³ The Republican conference of the House Judiciary committee supported a virulent antisemite on its Twitter feed, despite real consequences to American Jews.⁵⁴ Supporters of the

laser-anti-semitism-conspiracy-theories. “Blood libel” is the medieval false accusation that Jews kidnap and murder Christian children to use their blood to make Passover Matzah, avail. at https://en.wikipedia.org/wiki/Blood_libel; Sara Lipton, *Seven Centuries of Slander*, New York Review of Books, Sept. 23, 2022, avail. at <https://www.nybooks.com/articles/2021/09/23/blood-libel-seven-centuries-slander/>. “QAnon, conspiracy theory ... adherents believed [in] a cabal of satanic cannibalistic pedophiles within Hollywood, the Democratic Party, and the so-called ‘deep state’” Encyclopedia Britannica, *QAnon conspiracy theory*, avail. at <https://www.britannica.com/topic/QAnon>. QAnon is based in and expands upon blood libel and other antisemitic conspiracy theories. Wikipedia, *QAnon*, avail. at <https://en.wikipedia.org/wiki/QAnon#Antisemitism>. QAnon conspiracy theory is accepted, if not endorsed, by some Republican politicians. Axios, *11 GOP congressional nominees support QAnon conspiracy*, Jul. 12, 2020, avail. at <https://www.axios.com/2020/07/12/qanon-nominees-congress-gop>; *Wisconsin GOP invites QAnon, Jan. 6 conspiracy theorist to speak at state convention*, Wisconsin Examiner, May 5, 2023, avail. at <https://wisconsinexaminer.com/brief/wisconsin-gop-invites-qanon-jan-6-conspiracy-theorist-to-speak-at-state-convention/>; Wikipedia, *QAnon*, avail. at https://en.wikipedia.org/wiki/QAnon#Republican_politicians_and_organizations. The QAnon phenomena seems ripe for transition from “it’s the Democrats” to “it’s the Jews.”

⁵¹ New York Times, *Top House Republican Condemns Marjorie Taylor Greene’s Comments, but Stands by Her*, Feb. 3, 2021, avail. at <https://www.nytimes.com/2021/02/03/us/politics/kevin-mccarthy-marjorie-taylor-greene.html>.

⁵² Kevin McCarthy said on Twitter: “we cannot allow Soros, Steyer, and Bloomberg to BUY this election! Get out and vote Republican November 6th. #MAGA.” avail. at <https://twitter.com/JuddLegum/status/1055170806949523458>.

⁵³ Roll Call, *House GOP overlooks internal antisemitism, points at Democrats*, Dec. 1, 2022, avail. at <https://rollcall.com/2022/12/01/house-gop-overlooks-internal-antisemitism-points-at-democrats/>. Kevin McCarthy “went on to defend Trump, claiming the former president was ignorant of Fuentes’ well-known racist and antisemitic views when he had him over for dinner. ... Like other Republicans, McCarthy has stopped short of directly saying Trump has supported antisemitism with his actions.” Trump was not unaware of Kanye’s antisemitism, as Politico reported two months previously. Politico, *Trump and Kanye West speak amid rapper’s antisemitic rants, acquisition of Parler: A dinner between the two is in the future*, Oct. 17, 2022, avail. at <https://www.politico.com/news/2022/10/17/trump-and-kanye-speak-amid-rappers-anti-semitic-rants-aquisition-of-parlor-00062158>. PBS Newshour, *We asked 57 Republican lawmakers if they condemn Trump’s dinner with Fuentes and Ye. Here’s what they said*, Nov 29, 2022, avail. at <https://www.pbs.org/newshour/politics/we-asked-57-republican-lawmakers-if-they-condemn-trumps-dinner-with-fuentes-and-ye-heres-what-they-said>; Vanity Fair, *Surprise: A Number of Republicans Don’t Want to Condemn Donald Trump’s Dinner With a Couple of Antisemites: They too know where their bread is buttered*, Vanity Fair, Nov. 28, 2022, avail. at <https://www.vanityfair.com/news/2022/11/surprise-a-number-of-republicans-dont-want-to-condemn-donald-trumps-dinner-with-a-couple-of-antisemites>. But see Axios, *McConnell: Anyone meeting with antisemites “highly unlikely” to be president*, Updated Nov 29, 2022, avail. at <https://www.axios.com/2022/11/29/mitch-mcconnell-antisemites-2024-election>; NBC News, *RNC passes resolution condemning anti-Semitism following Trump dinner with Ye*, Jan. 27, 2023, avail. at <https://www.nbcnews.com/meet-the-press/meetthepressblog/rnc-passes-resolution-condemning-anti-semitism-trump-dinner-ye-rcna67922>.

⁵⁴ On Oct. 6, 2022, the House Judiciary Committee Republican caucus tweeted support of Kanye West, on the day Fox News aired West’s antisemitic remarks. The Republican caucus kept the tweet in place despite knowing Kanye was inspiring antisemitic intimidation in Jewish areas of the US, NBC News, *Rise in antisemitism is feared after banner saying ‘Kanye is right’ is hung over Los Angeles freeway*, Oct 24, 2022,

current second-place runner for the Republican 2024 Presidential candidate picketed Disney World with Nazi flags.⁵⁵ One can expect this to get worse, because since 2015 it has only gotten worse. Although Republicans do not have a monopoly on antisemitism,⁵⁶ too many embrace it. If Republican party antisemitism advances to legislative proposals that present American Jewry and their businesses economic risks of lost job opportunities and the need to move out of the US and sell assets at distressed prices, these contracts could hedge those risks. There are no other derivative products or commodity prices that can hedge these risks.

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, there are economic consequences of congressional control predictable enough for a contract based on such outcomes to serve a hedging function. See examples in my answer to Question 9. As an additional example, Republican-controlled House or Senate could make good on Republican threats to cause the US to default on its debt,⁵⁷

avail. at <https://www.nbcnews.com/news/us-news/banner-kanye-right-los-angeles-freeway-antisemitic-group-rcna53653>, and elsewhere in the US. ABC News, *Antisemitic message referencing Kanye West displayed outside Florida v. Georgia football game*, Oct. 31, 2022, avail. at <https://abcnews.go.com/US/antisemitic-message-referencing-kanye-west-displayed-florida-georgia/story?id=92387005>. After displaying the tweet for two months, the Republican caucus finally took it down when West pronounced his “love” of Nazis and Hitler, Variety, *Kanye West Praises Hitler in Horrific Antisemitic Tirade*, Dec. 1, 2022, avail. at <https://variety.com/2022/music/news/kanye-west-praises-hitler-antisemitic-tirade-1235447083/>, antagonizing non-Jewish constituents, such as WWII veterans and their survivors. NBC News, *House Judiciary Republicans delete ‘Kanye. Elon. Trump.’ tweet as rapper praises Hitler: Republicans on the House Judiciary Committee had tweeted in apparent support of Ye on Oct. 6. The tweet was removed Thursday, Dec. 1, 2022*, avail. at <https://www.nbcnews.com/politics/congress/house-judiciary-republicans-delete-kanye-elon-trump-tweet-rapper-prais-rcna59654>; Le Monde, *Kanye West praises Hitler and embarrasses the Republican Party*, Dec. 3, 2022, avail. at https://www.lemonde.fr/en/international/article/2022/12/03/kanye-west-praises-hitler-and-embarrasses-the-republican-party_6006495_4.html. The Republican message to American Jews is stark and unambiguous.

⁵⁵ *Nazis Wave Swastikas & DeSantis 2024 Flags, Yell ‘White Power’ Outside Walt Disney World Entrance*, June 10, 2023, Walt Disney World News Today, avail. at <https://wdwnt.com/2023/06/nazis-rally-at-entrance-to-walt-disney-world/>; *Protesters carrying Nazi flags and DeSantis imagery gathered outside Disney World in Orlando, Florida*, Business Insider, Jun. 11, 2023, avail. at <https://www.businessinsider.com/protesters-nazi-flags-desantis-posters-outside-disney-world-2023-6>

⁵⁶ E.g., CNN, *Jewish groups denounce [Democrat] RFK Jr.’s false remarks that Covid-19 was ‘ethnically targeted’ to spare Jews and Chinese people*, Jul. 15, 2023 (“‘Covid-19 is targeted to attack Caucasians and Black people. The people who are most immune are Ashkenazi Jews and Chinese,’ Kennedy said, adding that ‘we don’t know whether it’s deliberately targeted that or not.’”), avail. at <https://www.cnn.com/2023/07/15/politics/rfk-jr-covid-jewish-groups/index.html>; *White House calls anti-Semitic Covid conspiracy theory voiced by RFK Jr. ‘vile’*, Politico, Jul. 17, 2023, avail. at <https://www.politico.com/news/2023/07/17/white-house-rfk-conspiracy-comment-00106681>.

⁵⁷ Washington Post, *Republicans warn Biden: The next debt limit increase won’t be so easy*, Dec. 13, 2021, avail. at https://www.washingtonpost.com/politics/republicans-debt-ceiling-biden/2021/12/13/b40b6c2a-59d5-11ec-9a18-a506cf3aa31d_story.html.

which would present substantially adverse economic consequences,⁵⁸ although for this risk there are hedging instruments currently available.

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?

The examples of corporate hedging utility in my answer to Question 9 involve risks that are substantially in excess of the 5,000 contract limit.

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?

The question assumes facts not in evidence. As I noted in my answer to Question 9, for Anheuser-Busch and the Walt Disney Company, the economic risks that are hedgeable by the Kalshi contracts are in fact binary.

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

The inquiry is not if they are contrary to the public interest, but if they involve relate to, or reference "(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) *other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest." If they do not reference (I), (II), (III), (IV) or (V), which they do not, there is no public interest inquiry. Please see discussion in Part One above.

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?

No to both. There is no way to "fix" an election the way one can "fix" a baseball game by bribing a few players. It is hard to imagine a political candidate accepting a payoff to lose an election, and even harder to imagine proving it. It is extraordinarily unlikely that a person would seek election of a national slate of candidates with policies contrary to that person's economic or political interests, simply to win a fully collateralized futures contract binary outcome. It would be far more economically efficient to leverage a position in a contract with relatively low initial margin, such as

⁵⁸ CBS News, *U.S. debt default could wipe out 6 million jobs and \$15 trillion in wealth, Moody's says*, Sept. 22, 2021, avail. at <https://www.cbsnews.com/news/debt-ceiling-default-6-million-jobs-15-trillion-wealth/>.

crude oil, that will be impacted by the policies of the winning party.

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?

One can imagine people buying futures contracts to bid up the perceived chances of a political party, but it is far cheaper and effective to do what is done now, which is to pay companies that present themselves to the public as polling companies to write bogus polls, with a view to manipulating perceptions of which candidate is winning. This was done to create the false narrative of the “red wave” of 2022 that did not come to pass.⁵⁹ Seeking power through elections and false polls is a far more rational and prevalent reason for false polling than would be moving futures contracts.

Perhaps partisans could bid up a futures contract to create a false poll of strength. The effects would be attenuated at the individual candidate level. In either event, this is solved through market depth and public understanding of the predictive power of the contract as reflecting only the views of those participating in that market. The Kalshi contract might skew to overweight the views of those participating in that market, who can afford to collateralize 5,000 contracts. Eventually academic papers will be available instructing how to model to adjust for that skew.

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?

These contracts do not provide any opportunities to sidestep campaign finance and anti-bribery laws that are not already available from all other futures contracts.⁶⁰

Donors receive far more value for their money – **and do so legally** – by donating to candidates to obtain access and special favors than they could ever achieve through some fantastic illegal election futures market manipulation. Hedge fund managers got far more bang for their **legal** million dollars from Senator Sinema, who single-handedly prevented the closing of the carried interest tax loophole,⁶¹ than they ever could have hoped to make on futures contracts by spending hundreds of millions illegally seeking to influence hundreds of elections nationwide, especially if those races were to be won by

⁵⁹ New York Times, *The ‘Red Wave’ Washout: How Skewed Polls Fed a False Election Narrative*, Dec. 31, 2022, avail. at <https://www.nytimes.com/2022/12/31/us/politics/polling-election-2022-red-wave.html>.

⁶⁰ See, e.g., Wikipedia, *Hillary Clinton cattle futures controversy*, avail. at https://en.wikipedia.org/wiki/Hillary_Clinton_cattle_futures_controversy; Taylor & Ingersoll, *Hillary Clinton’s Commodities Broker Was Disciplined for a Variety of Violations*, Wall Street Journal; Gottschalk, *If Hillary Clinton Could Make Money in Commodities, Why Can’t You? Well, Let’s Count the Reasons*, Wall Street Journal (Mar. 28, 1994).

⁶¹ Fortune, *Kyrsten Sinema’s donations from investors surged to nearly \$1 million in the year before she killed a huge new tax on private equity and hedge funds*, Aug. 13, 2022, avail. at <https://fortune.com/2022/08/13/sinema-wall-street-money-killing-tax-investors/>.

candidates against the carried interest loophole. On a national level, political parties raise money and seek to win elections; they would not gamble the money on futures contracts, they would buy services and advertisements.

If in the future DCMs propose contracts on individual races, which are not the Kalshi contracts, the CFTC can evaluate those contracts at that time.

18. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements?⁶²

No. There are major companies that control large portions of wheat, oil, gas, or other commodity supply or demand. It is appropriate to watch for commodity market manipulation by companies improperly furthering their economic interest. In contrast, no one can “manipulate” which party controls a chamber of Congress. Considering evidence-free conspiracy theories to the contrary is not appropriate. Federal rulemaking must be reasoned.⁶³ There is no “inside information,” and any positing that there is traffics in fantasy conspiracy theory. Polling data would implicate 870 or more candidate for the House, and 66 or 67 for the Senate, and could hardly be “internal.” Please see answers to Questions 15-17 above as well.

Since these contracts are financial instruments in the US’s financial system, those inclined to traffic in antisemitism could use them as evidence in their false narrative of Jewish financier control of the country and over elections.⁶⁴ But the result will not involve the contracts being used to manipulate fundraising or voting, the result will be more antisemitism.

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?

Reports such as crop reports, Energy Information Administration reports, and Commitment of Traders reports from the federal government represent the publication of information that people are required by regulation to report to the government. This information could be price forming for futures contracts. The government does not sponsor political polls the way it sponsors reporting the information that people are required to

⁶² The CFTC 2022 Questions also included at the end of this questions: “For example, could candidate campaign committees or political action committees manipulate the contracts by trading on internal, non-public polling data?”

⁶³ A Guide to the Rulemaking Process Prepared by the Office of the Federal Register, avail. at https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.

⁶⁴ See answer to Question 9 above.

report to it. Rather, the information concerning the leading candidate is reported when the government holds an election, people vote, and the government reports to the public the results of the election.

Unlike in the movie *Trading Places* (1983), where an orange crop report was stolen as part of a scheme to manipulate the NYMEX Frozen Concentrated Orange Juice futures contract, there is no equivalent government report for political polls, nor should there be. That is not the role of the government. Were the government to poll and to seek to regulate political polling, the inevitable result would be the party in power using this to stay in power. Policing polling is certainly not the role of the CFTC. Any such purported policing would feed a false narrative that Congressional elections may be manipulated, not address any concerns, and should have no impacts on the CFTC's determination on whether the contracts have hedging utility or involve, relate to, or reference, one of the six prohibited activities.

It is highly inappropriate for the CFTC to even hint that the government should regulate political polls; taken together with Questions 20 and 22, it seems to indicate that the CFTC is hinting that it is considering regulating polling, or harbors some belief that approving these contracts somehow would justify the CFTC in regulating polling, or that its inability to regulate polling should be a reason to not approve these contracts. The CFTC should clarify what it means by Question 19.

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?

No. It is not possible to manipulate elections the way bad actors can manipulate commodity prices. The CFTC should not regulate political polls, or require private companies to monitor and report on them, on the grounds that such polls, if false, could be used to manipulate futures prices. As was the case for the bogus polls used to generate the false narrative of the 2022 “red wave” that did not come to pass, the goal of a false poll is to win an election, not to manipulate a futures price. Perhaps someone inclined to create a false narrative of a coming win might invest in both bogus polls and trying to bid up a futures contract; this risk does not justify the CFTC seeking to directly or indirectly regulate polling, because for the latter the problem is solved by market depth. The inability of the CFTC to regulate polling should not be a reason to deny the futures contract.

The CFTC approved film box office receipt futures contracts,⁶⁵ finding them “not

⁶⁵ CFTC, Release Number 5834-10, *CFTC Approves Box Office Receipt Contracts Submitted by Media Derivatives*, <https://www.cftc.gov/PressRoom/PressReleases/5834-10>, See dissenting statement of Commissioner Sommers, <https://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/mdexdissentingsommers061410.pdf>, noting that the CFTC even at that time (2010) needed to proceed with the events contracts rulemaking that it had floated in 2008. This remains the case. See Anderson, *Back to the Future[s]: A Critical Look at the Film Futures Ban*, 29 *Cardozo Arts & Ent. L.J.* 179 (2011), avail. at <https://www.cardozoelj.com/wp-content/uploads/Journal%20Issues/Volume%2029/Issue%201/Anderson.pdf>.

readily susceptible to manipulation,”⁶⁶ even though not only studios, but third parties, can advertise movies (an analogue to buying and promoting false polls) to affect box office receipts or deploy “insider status” to predict them. The CFTC even said that “false ... rumors or misreporting does not constitute a legal basis to conclude that a proposed futures or options contract would violate” the CEA.⁶⁷ Film box office receipt futures had at best a tiny fraction of the potential hedging utility of the Kalshi contracts.

See also answers to Questions 19-23.

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?*

No. The Federal Election Commission enforces against campaign finance violations. There are gasoline futures contracts, and it is the Federal Trade Commission that is responsible for surveilling and enforcing against gas market manipulation.⁶⁸ There are electricity and natural gas futures contracts, and it is the Federal Energy Regulatory Commission that is responsible for surveilling and enforcing against energy market manipulation.⁶⁹ The CFTC does not have to be responsible for surveilling and enforcing against manipulation or illegal conduct in the underlying for it to take action should the regulator with jurisdiction do so and provide the information to the CFTC.⁷⁰ There are futures on assets and prices that are subject to manipulation beyond the CFTC’s jurisdiction to regulate and investigate, and on which the CFTC can piggyback for its enforcement should manipulation be discovered by the law enforcement agency with jurisdiction. For example, the CFTC relied on the investigations of the UK Financial Conduct Authority when assessing fines against Lloyds Bank for LIBOR manipulation.⁷¹ See also answers to Questions 19-23.

23. *Could trading in the markets for the contracts obligate the*

⁶⁶ CFTC, *Statement of the Commission*, Jun. 14, 2010, pp. 6-9, avail. at <https://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf>.
⁶⁷ CFTC, *Statement of the Commission*, Jun. 14, 2010, p. 8. Ironically, the CFTC included this Statement as Exhibit 3 in CFTC, Brief for Amicus Curiae ... in Support of Rehearing, *Laydon v. Cooperative Rabobank, et al.*, 2d Cir. Case 20-3626, doc. 383, Nov. 29, 2022; see Law360, *CFTC Urges 2nd Circ. Redo Of Yen Libor-Rigging Suit*, Nov. 30, 2022, avail. at <https://www.law360.com/articles/1553368/cftc-urges-2nd-circ-redo-of-yen-libor-rigging-suit->.
⁶⁸ 16 C.F.R. §317 Prohibition of Energy Market Manipulation Rule; FTC, Guide to Complying with Petroleum Market Manipulation Regulations, avail. at <https://www.ftc.gov/sites/default/files/documents/rules/prohibition-energy-market-manipulation-rule/091113mmrguide.pdf>.
⁶⁹ FERC Order 670, 18 C.F.R. §1c.2 Energy market manipulation; FERC Enforcement Resources, avail at <https://ferc.gov/enforcement-resources>.
⁷⁰ E.g., Dodd-Frank Act §720.
⁷¹ Law360, *Lloyds To Pay \$370M In US, UK Libor-Rigging Deal*, Jul. 28, 2014, avail. at <https://www.law360.com/articles/561429/lloyds-to-pay-370m-in-us-uk-libor-rigging-deal>; CFTC, Release Number 6966-14, July 28, 2014, *CFTC Charges Lloyds Banking Group and Lloyds Bank with Manipulation, Attempted Manipulation, and False Reporting of LIBOR*, avail. at <https://www.cftc.gov/PressRoom/PressReleases/6966-14>.

Commission to investigate or otherwise become involved in the electoral process or political fundraising? If so, is this an appropriate role for the Commission?

No. See answers to Questions 19-22. The CFTC has not been granted authority by Congress to investigate elections or political fundraising. The CFTC does not expand its investigatory jurisdiction into an area by simply approving a contract in an underlying. The ICE futures contracts on Rotterdam coal, Brent crude oil, California Carbon allowances, London Cocoa, UK government bonds, US government bonds, UK equities, Austrian financial energy, and freight between Mediterranean ports, do not obligate the CFTC to investigate those markets that are under the primary jurisdiction of foreign governments, other federal agencies, or U.S. states, and the CFTC probably lacks the jurisdiction to do so.⁷² The CFTC cannot expand its investigatory jurisdiction whenever it likes simply by approving futures contracts that involve underlyings that it would like to investigate.

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

The only relevant factors that the CFTC should consider are set forth in the statute. Therefore the only relevant factors for CFTC inquiry are whether elections for control of Congress are one of, or an activity that is similar to, one of “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; [or] (V) gaming” They are not. Title 17 gives the CFTC no “contrary to the public interest” denial authority outside of Rule 40.11.

Conclusion

I and many other members of the public have provided very detailed responses to three CFTC requests on event contracts. I hope the CFTC has not prejudged this matter, and I hope that the CFTC will provide useful information to the public in return.

Yours truly,



Jeremy D. Weinstein

⁷² E.g., *Laydon v. Coöperatieve Rabobank U.A., et al.*, No. 20-3626 (2d Cir. Oct. 18, 2022); *West Virginia v. Environmental Protection Agency*, 597 U.S. ____ (2022).

September 24, 2022

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: Questions on the KalshiEX, LLC “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment

Honorable Chairman and Commissioners of the Commodity Futures Trading Commission (CFTC):

As the Commission and staff of the CFTC well know, speculators play a vital role in U.S. capital markets in general and futures markets in particular. Both markets assume risks that are an integral part of our well-functioning financial system, which continues to be the envy of the world. In futures markets, commercial entities transfer part of their risk to the speculator, who in turn assume that risk for the opportunity to earn a profit.

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.

This distinction builds on work done by both as academics and practitioners. Almost fifty years ago, the Chicago Board of Trade published a booklet for speculators entitled “Speculating in Futures.” A copy will be sent under separate cover. It clearly underlines the differences between hedgers and speculators, their interaction as market participants and the speculators’ key role to help facilitate efficient risk transfer.

As we enter a new era with innovation in new products and “deconstruction” of existing ones, those of us who care deeply about our futures markets hope this distinction between “gambling” and

“speculation” will help guide future decisions that the Commission may encounter. As always, long time market participants and practitioners stand ready to be an unbiased resource to the Commission and its staff.

Respectfully,

Richard L. Sandor

Chairman & CEO

Environmental Financial Products

Aaron Director Lecturer in Law & Economics

University of Chicago Law School

September 25, 2022

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: Questions on the KalshiEX, LLC “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment

Honorable Chairman and Commissioners of the Commodity Futures Trading Commission:

From 2017 to 2021, I had the privilege to serve as a Commissioner of the CFTC under the leaderships of former Chairs J. Christopher Giancarlo and Dr. Heath Tarbert, and then-Acting Chair Rostin Behnam. Before my time at the agency, I ran my own investment firm, worked for a bank-focused hedge fund during the financial crisis, and served as a staffer in the House of Representatives. Since leaving public office, I have been an advisor for Andreessen-Horowitz Capital Management, Crypto.com, and sit on Kalshi’s Board of Directors.

I remember fondly a saying at the agency, “Every day is a good day at the CFTC.” Indeed it was. That was the case, however, not because the Commission avoided making hard decisions or taking the easy route on difficult issues. In fact, it was true *because* we dealt with those things and did so in an honest, transparent, and accessible manner with decisions and statements well supported by legal analysis, data, and commenters’ perspectives. In fact, during my time as a Commissioner, the agency deliberated and decided upon many philosophically challenging, controversial, and statutorily confusing matters. In the execution of my role, I found the best way to address such issues was adhering to a strong regulatory philosophy combined with a very deliberate reading of the statute and weighing the appropriateness of any existing or proposed regulations to the issue’s risks and opportunities. I commend the current Chair and Commissioners for taking a similar posture towards their duties.

I also believe, as has been expressed through our Constitution and through the precedent of multiple Supreme Court decisions, that the government has limited authority, and independent agencies cannot assume broader authorities than the statutes - passed by Congress and signed into law by the President - convey to them. Such an outcome would put into question the checks and balances of the separation of powers as well as the ability of the population to have a direct effect on the government’s decisions. Speaking of power, independent agencies have a significant amount of it. Commissioners serve for staggered terms, agencies’ regulations are

heavily insulated from congressional review, and the chairs are difficult to remove, if not debatably irremovable, from office. As such, a deliberate and concerted focus on what discrete authorities the law conveys and whether the agency is acting in accordance with those powers in a manner that is justified, consistent, and repeatable is what the American public and our derivatives markets deserve.

Throughout my time at the Commission, and consistently through its distinguished history, the CFTC has been at the forefront of market-led innovation.¹ It is precisely because of this history the United States enjoys the deepest, most liquid, and broadest derivatives markets in the world. Along those lines, during my time as a commissioner, the agency dealt with event contracts on a number of occasions: through discussions with Aristotle on the scope of PredictIt's activity, through considering and approving Kalshi's license to operate a Designated Contract Market, to Kalshi's repeated efforts to move innovative event contracts through Commission reviews, and ultimately to the Commission's consideration of ErisX's proposed RSBIX NFL Football contracts, on which I authored a statement.² Kalshi's proposed contracts on the political control of the House and the Senate is another iteration of the Commission's considerations in this space, namely another frontier in prediction market innovation as well as another opportunity for the Commission to adhere to its statute and recognize its limited authority and ultimate purpose.

I commend you for undertaking this difficult task and for your time, effort, and thoughtfulness in fully analyzing the information provided through this comment process and in reviewing these contracts themselves.

Background

In 2012, North American Derivatives Exchange, a Designated Contract Market (DCM) self-certified contracts relating to election outcomes. The Commission imposed a 90-day stay and public review of the contracts pursuant to regulation 40.11. After review, it found that the contracts involved gaming, conflicted with certain state laws, brought into question election integrity, and were contrary to the public interest. The Commission voted to prevent the contracts from being listed ("*Nadex*").³

¹ See, for instance, J. Christopher Giancarlo, Letter to the U.S. Senate Committee on Agriculture, Nutrition, and Forestry, September 15, 2022, available at: <https://static1.squarespace.com/static/609d6c0e49158533ad1ae6b9/t/63226625af0a195856b46ec7/1663198758065/Giancarlo+ltr+Senate+Ag+Ctee+re+DCCPA+9.14.22.pdf>

² See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021), "Any Given Sunday in the Futures Market," available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

³ 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/if-docs/nadexorder040212.pdf>.

Kalshi received designation as a contract market in November 2020 and exclusively lists event contracts, which depend on the outcomes of events on economic indicators like inflation and GDP growth, natural occurrences such as hurricanes and the spread of Covid-19, and outcomes of legislation like will the Build Back Better bill pass into law.. Kalshi’s current proposal came after significant engagement over the last year with the Commission, the Division of Market Oversight, and legislators.

Introduction

Kalshi’s proposed contracts comport with the law, would provide meaningful economic and social benefits, and should be approved. Further, because it is critical for the agency to make determinations based on the law and not speculation, fear, or comfort, the Commission can not and should not disapprove these contracts. Such reasoning is important not only for the members of the marketplace and registrants, but for the Commission’s reputation and standing itself. This decision will have significant implications for the future of the marketplace. Kalshi’s proposal presents the Commission with an opportunity to right the wrongs of *Nadex*, and make a decision compliant with the law and consistent with broad segments of futures market activity.

The contract does not trigger the special rule

Section 5c(c)(5)(C)(i) of the Commodity Exchange Act (CEA) establishes the “Special rule for review and approval of event contracts and swaps contracts.”⁴ It reads:

(i) Event contracts

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

- (I)** activity that is unlawful under any Federal or State law;
- (II)** terrorism;
- (III)** assassination;
- (IV)** war;
- (V)** gaming; or

⁴ 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI).

(VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.⁵

The special rule includes three important steps for a contract to be relevant. First, the contract in question must be “based upon the occurrence, extent of an occurrence, or contingency”; in other words, an event contract. Second, the contract’s event must *involve* at least one of the enumerated activities. Then, if the Commission finds that the contract does involve one of the enumerated activities, it may determine the contract as a whole to be contrary to the public interest.

Nadex concluded that *participating* in the political event contracts in question was equivalent to ‘wagering’ or ‘betting’, and thus gaming, to trigger the special rule. Beyond its blatantly incorrect reading of the statute, this is a shockingly poor and vague classification of activity that would scope in common and vital participation in the futures market.

How should the line between morally dubious gaming activity and important and valuable speculative activity be drawn? 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.

Unbelievably, the Commission never concretely defined or even philosophically stated the difference between “gaming” as represented in 5c(c)(5)(C)(i) and the speculation that exists every day in derivatives marketplaces and is a critical component of their purpose. But yet, it has chosen to, and may choose to again here, apply a term it hasn’t defined to an activity that is actually more similar to traditional and valuable speculative market participation. Multiple esteemed and long-time futures market participants and former CFTC officials have commented

⁵ *Id.*

similarly in this filing.^{6 7 8 9 10 11 12 13} The Commission would owe them a strong explanation if its conclusion on this point has not changed.

There are plenty of events that have a discernable and legitimate economic impact and whose probabilistic outcomes can be estimated through an analysis of relevant factors. They are not gambling activities nor are they games of chance. That is just as true for election outcomes as it is for the prices, production, and demand of things like oil, corn, or gold. Hedge funds put infrared cameras on natural gas processing facilities to know the minutes they are operating or shut down so they have an edge on estimating production figures. Some investment firms have micro climate weather experts so as to more accurately predict localized rainfall and drought conditions to get a better estimate on crop yields. Those same firms' market positions then also provide a strong economic benefit. If the firms are confident enough in their predictions, they will move the equilibrium price and provide a market signal to any business involved (from production to processing to distribution) of the economic value that can be hedged based on an event's perceived outcome. Estimating election outcomes and expressing that view through a market mechanism is just as valuable to society as estimating oil, corn, or gold fundamentals and expressing those views through existing futures contracts. As a case in point, the demand for such predictive election information has exploded in recent years and has been the basis of entire publications like *FiveThirtyEight* or *The New York Times*' "needle".

From a statutory perspective, the relevant portion of the CEA prohibits registered boards of trade from listing event contracts whose *underlying activities* reference one of the enumerated activities. The CEA did not give the Commission authority to conclude that participating in the contract could constitute one of the enumerated activities. The statute is very clear on this matter:

(i) The statute limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on event contracts whose event involves (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously

⁶ Public comment on Kalshi's proposal by **Dr. Richard Sandor**.

⁷ Public comment on Kalshi's proposal by **Christopher Hehmeyer**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717>

⁸ Public comment on Kalshi's proposal by **Mark Wetjen**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

⁹ Public comment on Kalshi's proposal by **Josh Sterling**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69737>

¹⁰ Public comment on Kalshi's proposal by **Daniel Gorfine**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70755&SearchText>

¹¹ Public comment on Kalshi's proposal by **Paul Fribourg**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69727&SearchText>

¹² Public comment on Kalshi's proposal by **David Pollard**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70743>

¹³ Memoranda by **Jonathan Marcus** and **Daniel Davis** are also included in Kalshi's submission.

acknowledged that the special rule’s textual focus is on “activities,” i.e., the underlying conduct. In describing it, the Commission stated that the rule applied to contracts that “involve one or more activities enumerated in the Dodd-Frank Act.”¹⁴ These “activities” are not the contracts themselves. They are the events that create the basis for the relevant contract.

(ii) If Congress assumed, as the Commission implies through *Nadex*, that the act of participating in a event contract could itself constitute gaming, there would have been no need for Congress to individually enumerate “gaming” as a distinct category of event contracts upon which the Commission could make a public interest determination, since they would already fall under the “unlawful activity” prong.

(iii) If state gambling definitions of ‘wager’ and ‘bet’ are analogous to the act of taking a position in the Political Event Contracts, as *Nadex* argues,¹⁵ then those same state definitions would be analogous to taking a position on any event contract, including ones whose underlying activity is an economic indicator or the weather. The Commission cannot hold that participating in these proposed contracts involve gaming without also implicating participation in all other event contracts. Such an outcome would also clearly be in tension with the purpose of the statute, which is to carve out a select few event contracts with an underlying activity that is specifically referenced or subsequently identified by the Commission through a rulemaking.

(iv) This interpretation would require the Commission to interpret “involve” differently across the enumerated activities, since participating in any event contract itself clearly cannot ever constitute an act of assassination, war, or terrorism.

(v) The statute actually prevents events with no financial impacts to be considered as excluded commodities. In order for the Special Rule in 5c(c)(5)(C)(i) to apply to Kalshi’s contracts, those contracts already have to be on events that are considered excluded commodities. The statutory definition of an excluded commodity includes “...an occurrence, extent of an occurrence, or contingency...that is 1) beyond the control of the relevant parties to the contract...and 2) associated with a financial, commercial, or economic consequence.”¹⁶ Because Kalshi’s contract is on excluded commodity, subject to the Commission’s jurisdiction and being vetted through the Special Rule, then, by the very definition of an excluded commodity in the statute, the event contains an economic risk that can be hedged. If the event did not then that event would constitute gaming, not an excluded commodity, and not subject to the Commission’s purview.

¹⁴ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) (“Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more activities enumerated in the Dodd-Frank Act.”) (“40.11 Proposed Rule”); see 17 C.F.R. § 40.11(a) at 67,289 (“If [] the Commission determines that such product may involve an activity that is enumerated in 40.11”)

¹⁵ *Nadex* at 2-3.

¹⁶ 7 U.S.C. § 1a(19)(iv)

Questions: Other venues' offerings

In the second question posed to the public for comment, the Commission asked whether it should consider “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” when making its gaming determination. It is difficult to understand the rationale for including this question (but that sentiment is not unique to this question either, as this is one of several examples of arbitrary standards proposed through the Commission’s questions to the public). Strikingly, this specific question was not asked of the public when it was considering the legality of ErisX’s proposed NFL Futures contracts, which are a staple of such venues.¹⁷ Additionally, this standard is not found in law or in Commission history and precedent. Moreover, partisan control of Congress is not a bet available on any legal American sportsbook. That it is sometimes available on illegal ones cannot be held against Kalshi’s proposal. Taking a possible motive of this question to its potentially backward conclusion, it would be challenged regulatory logic to allow bucket shops, illegal venues, casinos, or offshore markets to preclude a CFTC registered exchange from offering a contract by virtue of listing that contract themselves. Similarly, we are fortunate the agency has never proposed this standard in the past, as it would have likely precluded the exchange listing of many new derivatives products. The most recent example of such is the agency’s greenlight for CBOE’s and CME’s Bitcoin futures contracts, which traded in some form or fashion in many unregulated venues before listing on CFTC registered DCMs.

Question: State laws

The Commission has asked whether Kalshi’s proposal involves state law provisions that prohibit ‘wagering’ on the outcomes of elections, in addition to the federal prohibition on interstate gambling (questions three and four). As discussed at length above, the statute refers to the underlying activity of the contract, not the contract itself. The contract only involves obviously legal activity: the partisan affiliation of the Speaker of the House and President *pro tempore*.

However, even if the Commission did consider the contract as a whole instead of just the contract’s underlying event against state laws, the contract nonetheless does not involve illegal activity. Because of preemption, a contract offered by a registered board of trade otherwise compliant with the law and regulations could never constitute unlawful state activity. There is no scenario where a Kalshi member would be illegally trading the proposed contract on the exchange from a state law perspective.

¹⁷ Questions on the Eris Exchange, LLC (“ErisX”) RSBIX NFL Futures Contracts for Public Comment. Available at: <https://www.cftc.gov/sites/default/files/filings/documents/2020/orgdcmerisquestionsre201223.pdf>

In addition, the definition of gaming cited by *Nadex* in federal law had a carveout specifically for regulated derivative products like Kalshi's proposal, as do many state laws regarding gaming. Similarly, the Commodity Futures Modernization Act of 2000 explicitly overrules state gaming and bucket shop provisions. State laws should not be relevant whatsoever in this instance and should not be considered in this process.¹⁸

Questions: Hedging and price basing standards

In its questions for the public, the Commission asks what standard should be used to determine whether Kalshi's contracts serve a hedging function (question six) and whether or not a registrant must provide demonstrated need of hedging and whether the Commission should consider the proportion of hedgers in the market (question eight).

Prior to its deletion in 2000 by the CFMA, CEA Section 5(g) provided that the Commission could not designate a board of trade as a contract market unless the board of trade affirmatively and pro-actively demonstrated that transactions in their contracts "will not be contrary to the public interest."¹⁹ The Commission interpreted the words "public interest" to include an economic purpose test, which required that exchanges affirmatively demonstrate to the Commission that a proposed contract could be used for hedging or price basing.^{20 21} In 2000, the CFMA repealed Section 5(g) of the CEA in its entirety.

In 2010, Congress passed the Dodd Frank Act, which added the new special rule in CEA section 5c(c)(5)(C) for the Commission to disapprove the enumerated event contracts. This section left untouched the CFMA's revised structure for contract certification. It did not add back any requirement for an exchange to affirmatively demonstrate that a contract has price hedging utility or any other burden to show that a contract was not contrary to the public interest.

In *Nadex*, the Commission re-imposed the economic purpose test on *Nadex*'s political contracts, based on what is presumed to be a short dialogue between Senators Feinstein and Lincoln in the Congressional record. Turning to the legislative history, or specifically a dialogue between only two of the 535 members of the House and Senate, on this matter is a reach. The law which both chambers passed and the President signed is clear, and Congress specifically removed the economic purpose test from the law. Rather than re-enact the economic purpose test, Congress specifically chose instead to create the special rule to target contracts whose events dealt with events that could be contrary to the public interest. The Commission should not—and

¹⁸ 7 U.S.C § 16a-2.

¹⁹ H.R. Rep. No. 975, 93 Cong., 2d Sess. 29 (1974).

²⁰ Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 FR 25669, 25672 (May 7, 2008).

²¹ A Joint Report of the SEC and the CFTC on Harmonization of Regulation. October 16, 2009, page 23 available at <https://www.sec.gov/news/p/ress/2009/cftcjointreport101609.pdf>.

cannot—interpret the absence of this provision to mean Congress would still prefer the Commission had that narrow tool. While the economic purpose test might be a good test, it is not appropriate for the Commission to require here and at this time without a change to the law or, at the very least, a notice-and-comment rule on the books.

In question 9, the Commission asks if the economic consequences of Congressional control are predictable enough for a contract based on that control to serve a hedging function. It further asks for examples of commercial activity that can be *directly* hedged via the proposed contracts. Again, the Commission is implementing too narrow of a standard for hedging utility of event contracts or of futures contracts writ large. Changes in *general risk* can provide a strong hedging need as opposed to the changes in risk of a specific outcome. If one party were to take over 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.²² For example, following the election of Republicans into Congress in 2016, many publications speculated that trade policy would become more restrictive; but, it was not known if this would come in the form of new but restrictive trade deals, re-negotiating existing trade agreements, new tariffs (and if so, on what goods and at what level), international lawsuits, and more. The general risk, however, of future restrictive trade policy to those industries, firms, and individuals heavily exposed to foreign trade existed concretely and directly because of who would win the election. This risk is exactly what Kalshi’s contracts allow traders to hedge.

In question eleven, the Commission makes the same mistake when it asks if the contract could “form the basis of pricing a commercial transaction in a physical commodity, financial asset, or service”. Not only is this language from the discarded economic purpose test, this question also excludes a price-forming impact on other futures contracts, such as other event contracts themselves. If it is in the public interest to list an event contract on potential tax rates two years from now, that contract’s price would have an embedded probability of which parties control Congress at that time. Eliciting that probability through a market-based event contract directly on the political control of each chamber would serve a valuable price discovery function for a tax-rate contract as well as other policy-related contracts. It is unfortunate the Commission discarded this valuable price-basing use case from the question’s list.

The economic purpose test represented through this question is too narrow for other reasons. In the *Nadex* decision, the Commission acknowledged this by suggesting it could consider other factors in its decision regarding public interest. These other factors, which should be considered

²²Public comment on Kalshi’s proposal by **Angelo Lisboa**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662&SearchText=angelo>

here as well, are actually reasons to support the contract, not oppose it. A market-based probability of election outcomes would provide an extremely valuable public service, and act as a competitor to polls and paid pundits. This is sorely needed in American politics and it is exactly why one of the comment letters supporting Nadex's proposal was authored by a host of economists led by the late Nobel Laureate Kenneth Arrow.²³ Many of Kalshi's comment letters testify to the contract's public and academic value.^{24 25} Former Chair of the Council of Economic Advisors, Jason Furman, even testified that such markets were used in the White House when analyzing policy and its outcomes.²⁶

Kalshi's contracts depend on an economically important commodity and have obvious and widespread hedging and price-basing utilities, as well as other benefits

The economic impact of politics is plain and undeniable. Though it is not required to, Kalshi provided dozens of pages to the Commission and its staff detailing the contract's hedging and price basing utilities that cited much of the deep research on the link between elections, commercial risk, and the prices of financial assets. Investment banks frequently provide such hedging recommendations to their clients, and academic research repeatedly confirms that markets price election risk, with repricing occurring as polls change. Although the outcomes of Congressional control are never truly known, the market is already engaging in significant hedging and pricing behavior and testifies as much.

Other public comments, such as those by members of industry (like that of Angelo Lisboa, a Managing Director at JPMorgan Chase; or Jorge Paulo Lemann, a board member of AB InBev, Kraft Heinz, and Gillette)²⁷²⁸, politically sensitive businesses (Greenwork)²⁹, and academics and former government officials (former CEA Chair and current Harvard Professor Jason Furman, Aaron Director Lecturer in Law & Economics at The University of Chicago Law School Dr. Richard Sandor, former CFTC Commissioner and Acting Chairman Mark Wetjen, and former

²³ Public comment on Nadex's political event contracts. Available here:
<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>

²⁴ Public comment on Kalshi's proposal by **Alex Tabarrok**. Available here:
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69697&SearchText=alex>

²⁵ Public comment on Kalshi's proposal by **Michael Gibbs**.
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69704&SearchText=>

²⁶ Public comment on Kalshi's proposal by **Jason Furman**. Available here:
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708&SearchText=>

²⁷ Public comment on Kalshi's proposal by **Angelo Lisboa**. Available here:
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662&SearchText=angelo>

²⁸ Public comment on Kalshi's proposal by **Jorge Paulo Lemann**. Available here:
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684&SearchText=jorge>

²⁹ Public comment on Kalshi's proposal by **Sam Steyer**. Available here:
<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69677&SearchText=greenwork>

SEC Commissioner and Stanford Professor Emeritus Joseph Grundfest, as well as others)^{30 31 32 33} repeatedly discuss extant market risk stemming from changes in partisan control of Congressional chambers and the ways that Kalshi's contract would create risk mitigation opportunities and foster important price discovery.

In Conclusion

The Commission is heavily, and appropriately, constrained by the narrow language of the statute as well as an implemented regulation with debatable validity.³⁴ None of the statutory language nor the Commission's regulations address many of the questions the Commission poses here in evaluating these contracts. A government agency can also not deny a proposal by relying on authorities or frameworks it wishes it had or any internal or external promises to redo any existing regulations to create a different and clearer framework in the future. The Commission has the statute at hand and the regulations it has passed to deal with the proposals currently before it.

A credible regulator also cannot continue to rely on varying and disprovable conjectures to impose value judgments on an ad hoc basis. From potential cherry picked state laws (which are inconsistent, broad, and would be preempted by any Commission action), to an improvised, imprecise, and non-Administrative Procedure Act-based definition of "gaming" (which, if applied widely, would cut out large swaths of valuable futures market activity), to imposing a narrow and changing economic purpose standard found nowhere in the statute nor ever clearly defined by Commission regulations (which would give the Commission unlimited authority over major questions and put the onus on Exchanges instead of the agency), no such excuses have any legal merit.

While it may seem difficult to overturn prior precedent, I believe the analysis is actually very straight forward. Given the enormous extant evidence provided—well in excess of legal requirement—the Commission needs to fully engage with Kalshi's proposed contracts and approve them. If it does not believe that the market would find these to be useful hedging and price basing tools, despite market participants', esteemed academics', and former government officials' repeated testimony, it should provide its reasoning in detail pursuant to its existing authorities and regulations rather than dismiss the contract out of hand. Businesses, especially

³⁰ Public comment on Kalshi's proposal by **Jason Furman**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708&SearchText=>

³¹ Public comment on Kalshi's proposal by **Dr. Richard Sandor**

³² Public comment on Kalshi's proposal by **Mark Wetjen**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

³³ Public comment on Kalshi's proposal by **Joseph Grundfest**. Available here: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69695&SearchText=grundfest>

³⁴ See Statement of Commission Brian D. Quintenz on ErisX RSBIx NFL Contracts and Certain Event Contracts (Mar. 25, 2021), "Any Given Sunday in the Futures Market," available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

ones that have long-term engagement with regulators, deserve to have a consistent and repeatable framework by which they can operate their firms in accordance with the law and regulations.

I thank you for your consideration of these comments and for doing the hard work of the Commission.

Sincerely,



Brian D. Quintenz

This comment is on behalf of Temper, one of America’s leading health and nutrition startups. Specifically, Temper sells a novel cannabinoid mint for diet management. Election contracts would allow Temper to reduce its risk exposure to federal elections, and would thus be a welcome addition to the event contracts space.

As a company that sells a product that involves cannabinoids, federal policy is a key determinant of our success. The lack of clarity at a federal level for hemp and cannabinoids has made securing financing, customers, corporate partnerships and advertising more difficult than it otherwise would be. Large financiers—such as pension funds and sovereign wealth funds—are reluctant to invest money in a company that could face crackdowns in the face of a hostile new government. Without regulatory clarity, taking the next step to becoming an even larger company is difficult. However, it is abundantly clear the differences between the two parties on cannabis policy. The Democratic Party is far more sympathetic to complete legalization, and hostile to enforcement efforts. In contrast, the Republican Party is much more critical. The odds of complete legalization and regulatory clarity substantially fall if the Republican Party gained control of at least one house of Congress. Notably, the harms manifest to a company like ours even before any policy action is taken, as financiers and corporate partners may be skittish in *anticipation* of potential action. As a result, the outcomes of Congressional control are more than sufficiently predictable for us to use the product for its hedging purposes.

In addition, as we plan to take the next steps in our business, the probabilities generated by the contract’s prices could be powerful inputs. Who is in power come January 2023 might affect our expansion plans, our growth strategy, and beyond. Having a market-driven data point that updates rapidly and is not subject to ideological bias could be helpful in facilitating the best decision-making process possible.

For thousands of companies, including our own, Congressional control is no game. It is a real threat to our business’s bottom line the same way a public health emergency or a natural disaster or an economic downturn might be a threat to other businesses. We should be able to access the same tools to manage those risks, as we can manage those others. Dismissing this valuable product on the grounds that it could be used for gaming, or cannot be used for hedging, would fly in the face of the experience of our company and many others. We would suggest kindly that the Commission allow the contract to move forward.



September 24, 2022

By Electronic Submission

Mr. Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
Three Lafayette Center
1155 21 Street NW
Washington, DC 20581

Re: Comments on KalshiEx, LLC's Proposed Congressional Control Contracts

Commissioners:

We sincerely appreciate the opportunity to comment on the submission by KalshiEx, LLC of its proposed Congressional control contracts for Commission review and approval. The question of election event contracts raises important issues of both law and public policy, and we commend the Commission for recognizing their importance and seeking public input.

We submit this comment on behalf of an anonymous client with a deep interest in the lawfulness of election event contracts.

We believe the Commission has a sound basis in law and policy for approving Kalshi's proposed contracts. As to the law, we believe that election event contracts like Kalshi's do not "involve gaming" under Section 5c(c)(5)(C) of the Commodity Exchange Act (CEA) or Rule 40.11 of the Commission's regulations, and so are not proscribed by those provisions. In addition, we believe that Rule 40.11, properly understood in light of the CEA and the Administrative Procedure Act (APA), affords the Commission discretion to approve election event contracts even if those contracts do "involve gaming." Finally, as to policy, we believe election event contracts promote the public good by, among other things, enhancing the accuracy of political predictions, promoting new forms of democratic participation, and serving as an economic hedge for both firms and individuals. We thus encourage the Commission to approve Kalshi's proposed contracts.

I. Section 5c(c)(5)(C) and Rule 40.11 Do Not Apply to Election Event Contracts.

Under the CEA, the Commission must approve contracts submitted to it unless the Commission affirmatively finds that they violate the CEA or the Commission's regulations. 7 U.S.C. § 7a-2(c)(5)(B); 17 C.F.R. § 40.3(b). The Commission has expressed concern that election event contracts may conflict with Section 5c(c)(5)(C) of the Act and Rule 40.11, which

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together prohibit event contracts based on gaming, four other enumerated activities, or “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” But an election is not gaming, nor any of the other four prohibited activities, nor a “similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” Thus, Kalshi’s contracts are lawful and should be approved.

The Commission previously found an election event contract to be gaming because the contract itself was a form of gaming. *N. Am. Derivatives Exch., Inc. (Nadex)*, slip op. at 3 (CFTC Apr. 2, 2012). Respectfully, we believe the Commission erred in that Order and should not adhere to that position here. Section 5c(c)(5)(C) and Rule 40.11 prohibit event contracts where the event on which the event contract is based is an act of gaming. They do not prohibit event contracts simply because entering into the contract might itself be construed as a form of gaming. Indeed, as explained below, *all* event contracts involve making predictions (and related wagers) about future “occurrences” that are outside of the relevant parties’ control. Were this facial similarity with “gaming” all that were required to fall within Section 5c(c)(5)(C)’s reach, every event contract would be implicated—a plainly untenable result. Moreover, even if considered under the *Nadex* Order’s framing, an election event contract is still not gaming. “Gaming” has a well-established and precise meaning: betting on games of chance. An election is not a game of chance—or even a game at all—so staking money on an election is not gaming. Finally, at the very least, Section 5c(c)(5)(C) and Rule 40.11 do not clearly prohibit election event contracts and several traditional canons of construction weigh against construing them to do so here.

A. Standard of Review.

The meaning of the Commodity Exchange Act and the Commission’s regulations is a question of law to be answered using “the traditional tools of construction.” *Kisor v. Wilkie*, 139 S. Ct. 2400, 2415 (2019) (cleaned up). In particular, the Commission must apply these provisions according to their “ordinary meaning.” *Wis. Cent. Ltd. v. United States*, 138 S. Ct. 2067, 2070 (2018) (citation omitted). The term “gaming” in Rule 40.11(a) comes from Section 5c(c)(5)(C)(i)(V) of the CEA without alteration. Thus, even if genuine ambiguity remains after applying the traditional tools of construction, the Commission still must apply the term’s ordinary meaning. *See Kisor*, 139 S. Ct. at 2417 n.5 (an agency does not receive “deference” when it “interprets a rule that parrots the statutory text”).

B. An Election Event Contract Is Based on an Election—Not Gaming or Any Other Prohibited Activity.

Under the CEA, an event—that is, an “occurrence, extent of an occurrence, or contingency” outside of the relevant parties’ control—can be an excluded commodity that



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forms the basis of a contract. 7 U.S.C. § 1a(19)(iv). Under Section 5c(c)(5)(C)(i) of the Act, the Commission may determine that an event contract is contrary to the public interest if the contract “involve[s]” an event falling within one of six categories: “activity that is unlawful under any Federal or State law,” “terrorism,” “assassination,” “war,” “gaming,” and “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” *Id.* § 7a-2(c)(5)(C)(i). Contracts that the Commission finds to be against the public interest are prohibited. *Id.* § 7a-2(c)(5)(C)(ii). Rule 40.11 provides that any contract “based upon an excluded commodity ... that involves, relates to, or references” the first five categories is prohibited. 17 C.F.R. § 40.11(a)(1).

These provisions are best read to exclude election event contracts. Elections are not games and so cannot be seen as gaming. Nor can the election event contract itself supply the requisite “gaming,” as that would upend the statutory scheme by converting every event contract into “gaming.” After all, every event contract is based on an uncertain future occurrence. Such an interpretation of “gaming” would thus, in turn, read out of the statute the other terms in Section 7a-2(c)(5)(C)(i)—“war,” “assassination,” etc—because each would be “gaming” under that view. Such an interpretation is not plausible, as detailed further below.

1. *The Statutory and Regulatory Text Shows That Election Contracts Are Based on Elections Rather Than Gaming or Other Prohibited Activities.*

An election for public office is not any of the activities enumerated in Section 5c(c)(5)(C)(i). It is (obviously) not an unlawful activity, terrorism, assassination, or war. But neither is it gaming. “Gaming” is the playing of “games of chance for money.” *Game, New Oxford American Dictionary* (3d ed. 2010). Unlike dice, roulette, and other games of chance, elections are not primarily decided by pure luck; they are decided by the voters’ deliberate choices as to who should hold the public office in question. And even more fundamentally, elections are not “games” in the first place. They are not “engaged in for diversion or amusement,” *Game, Merriam-Webster’s Collegiate Dictionary* (11th ed. 2020), but to determine who will occupy political offices across the country. Finally, an election also does not fall within the final category of a “similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest,” 7 U.S.C. § 7a-2(c)(5)(C)(i)(VI), as elections are not similar to unlawful activities, terrorism, assassination, war, or gaming. Section 5c(c)(5)(C) and Rule 40.11 are thus best read as not outlawing election event contracts.

The Commission’s *Nadex* order took a different approach, asking instead whether “the contract, considered as a whole,” constitutes gaming. Slip op. at 2. Respectfully, we believe that this analysis misconstrues the word “involve” in the Act. Section 5c(c)(5)(C) gives the



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Commission the power to ban contracts that “involve” gaming—not contracts that might be seen as *themselves* constituting gaming when “considered as a whole.” Specifically, the CEA and the Commission’s other regulations consistently use the term “involve” to identify the commodity (event) on which the contract is based.¹ For purposes of the Act, an event contract thus “involves” gaming when the contract is based on a gaming event.

Rule 40.11 confirms as much. The Rule is titled: “Review of event contracts *based upon* certain excluded commodities.” 17 C.F.R. § 40.11 (emphasis added). And its text prohibits any “[a]greement, contract, transaction, or swap *based upon* an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that involves, relates to, or references ... gaming.” *Id.* (emphasis added). The Rule is thus clear that the contract must be “based upon” the particular excluded commodity rather than itself being part of that commodity. In other words, the contract must be based upon gaming rather than the contract itself constituting gaming.

Thus, an event contract that turns on whether a winner will be announced at the next Mega Millions Lottery drawing “involves” gaming within the meaning of the Act, because such a contract is based on a gaming event—a lottery is a game of chance played for money. In contrast, an event contract that turns on the performance of a particular harvest, sector of the energy industry, or election for public office does not “involve” gaming within the meaning of the Act, because that sort of contract is *not* based on a game of chance. Contrary to *Nadex’s* reasoning, it is not dispositive—indeed, it cannot be dispositive—that entering into an event contract might be akin to gaming in some sense (*i.e.*, staking money or other resources on the occurrence of a future event that is outside of the relevant parties’ control). *See* slip op. at 2 & nn. 1 & 2. After all, every event contract shares this characteristic. Such an interpretation of Section 5c(c)(5)(C) would thus preclude entering into *any* event contract under the CEA and Rule 40.11—an outcome that is self-evidently untenable, as explained at

¹ *See, e.g.*, 7 U.S.C. § 6c(b) (“No person shall offer to enter into ... any transaction involving any commodity”); *id.* § 15b(e) (“Each cotton futures contract ... shall be in writing plainly stating ... the terms of such contract , including the quantity of the cotton involved”); *id.* § 16(e)(1)(B) (“Nothing in this chapter shall supersede or preempt ... the application of any Federal or State statute ... to any transaction in or involving any commodity”); *id.* 23(b)(1) (“The Commission may set different terms and conditions for transactions involving different commodities.”); 17 C.F.R. § 1.17(c)(5)(iii)(C)(1)(iii) (“In the case of over-the-counter swap transactions involving commodities, 20 percent of the market value of the amount of the underlying commodities.”); *id.* § 5.9(d) (“A major currency pair security deposit percentage is only applicable when both sides of a retail over-the-counter foreign exchange transaction involve major currencies.”); *id.* § 31.8(a)(2)(ii) (“Permissible cover for a long leverage contract is limited to: ... one type of bulk gold coins for leverage contracts involving another type of bulk gold coins”).



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greater length below.

2. *The Statutory and Regulatory Context Confirms That Election Contracts Are Based on Elections Rather Than Gaming or Other Prohibited Activities.*

Context confirms that Section 5c(c)(5)(C)(i) and Rule 40.11 are best understood to not reach election event contracts. By their terms, these provisions apply only to contracts that are based on an excluded commodity that is an event outside the contracting parties' control.² Likewise, the other listed activities are events outside the parties' control. An event contract cannot *itself* constitute an act of terrorism, assassination, or war, whereas such acts *can* be the excluded commodities that underly an event contract. It would be very strange if gaming were the only term in Section 5c(c)(5)(C)(i) that referred to the nature of the entire contract rather than to the underlying excluded commodity.

Construing “gaming” to include both the underlying occurrence and the contracts on that occurrence would, moreover, make the other subsections of Section 5c(c)(5)(C) surplus. After all, event contracts on whether New York City will be bombed in October (“terrorism”), whether Kim Jong Un will be killed (“assassination”), or whether Ukraine will defeat Russia (“war”) are all equally bets on the outcomes of future events. Each of these could simply be prohibited as a “gaming” contract under the reasoning in the Commission’s *Nadex* Order. Indeed, the broad *Nadex* construction would even risk supplanting the catchall provision for “any other similar activity” the Commission identifies “by rule or regulation,” 7 U.S.C. § 7a-2(c)(5)(C)(i)(VI), since *any* event contract could be prohibited as “gaming” under that view. That is not plausible.

Finally, although we do not believe the Commission should rely on Section 5c(c)(5)(C)’s legislative history to interpret Section 5c(c)(5)(C),³ it too supports the view that election event

² Section 5c(c)(5)(C)(i) refers to commodities described in “section 1a(2)(i) of this title,” a provision which does not exist, rather than Section 1a(19)(iv), which defines when an occurrence or contingency is an excluded commodity. That is a scrivener’s error, as Rule 40.11 recognizes. See 17 C.F.R. 40.11(a)(1) (referring to commodities “defined in Section 1a(19)(iv)”). And that definitional provision defines “excluded commodity” to include, in relevant part, “an occurrence ... beyond the control of the parties to the relevant contract, agreement, or transaction; and associated with a financial, commercial, or economic consequence.” 7 U.S.C. § 1a(19)(iv)(I)–(II).

³ As the Supreme Court has explained, “legislative history is not the law”; statutory interpretation must instead be based on “statutory text” and “structure.” *Azar v. Allina Health Servs.*, 139 S. Ct. 1804, 1814 (2019) (cleaned up).



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contracts are not gaming. When asked about the scope of the Commission’s power to ban gaming contracts, Senator Lincoln replied that it would cover event contracts based on “sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament.” 156 Cong. Rec. S5907 (daily ed. July 15, 2010). All these examples are contracts where the underlying commodity is the outcome of a game, which an election is not.

C. An Election Event Contract Is Not Itself Gaming.

But even if the *Nadex* Order were correct to consider the contract as well as the underlying commodity, we respectfully submit that the Order was still mistaken to apply that reasoning to election event contracts. Event contracts based on the outcome of an election might be *wagers*, but not all wagers are *gaming*. “Gaming” refers to placing stakes on the outcome of a game of chance. And as noted above, an election is not a game of chance, a game of skill, or even a game at all.

The ordinary meaning of the word “gaming” is betting on games of chance. See *Gaming*, *Oxford English Dictionary* (3d ed. 2013) (“To take part in an indoor game, of a kind on which stakes or wagers may be placed; *esp.* to play games of chance for such stakes or wagers”); *Game*, *New Oxford American Dictionary*, *supra* (“play games of chance for money”); *Game*, *Webster’s Third New International Dictionary* (1961) (“to play for a stake (as with cards, dice, or billiards)”); *Gaming*, *The Cambridge Advanced Learner’s Dictionary* (4th ed. 2013) (“the risking of money in games of chance, especially at a casino”). Hence courts have long recognized that “betting is not gaming unless the wager be laid upon a game.” *In re Opinion of the Justs.*, 63 A. 505, 507 (N.H. 1906). Had Congress wanted to sweep more broadly, it could have used the more common term “gambling,” which encompasses bets on both games of chance and “the outcome of particular events” more generally. *Gambling*, *Oxford English Dictionary*, *supra*. Indeed, the statutes relied upon in the *Nadex* Order to support a purported “link” between “gaming” and “betting on elections” mostly use the broader term “gambling,” not “gaming.” See slip op. at 2 & n. 1.

For contracts to constitute “gaming,” there must thus be underlying games of chance. Elections are not games, let alone games of chance. Election event contracts are thus best understood to not constitute gaming.

D. Section 5c(c)(5)(C) and Rule 40.11 Do Not Clearly Prohibit Election Event Contracts.

We further believe that four traditional tools of construction weigh against the Commission applying Section 5c(c)(5)(C) and Rule 40.11 to election event contracts: the federalism canon, the major questions doctrine, the presumption of validity, and the rule of



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lenity. For the reasons detailed above, we do not believe these provisions are best read to include election event contracts. But at a minimum, they do not clearly include election event contracts. The Commission acknowledged as much when promulgating Rule 40.11, noting that “the term ‘gaming’ requires further clarification” and may not extend beyond “participation in traditional ‘gaming’ activities.” Final Rulemaking, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). Accordingly, the Commission should not interpret these provisions to prohibit election event contracts.

1. *The Federalism Canon and the Major Questions Doctrine*

The Federalism canon provides that Congress must “enact exceedingly clear language if it wishes to significantly alter the balance between federal and state power.” *Ala. Ass’n of Realtors v. HHS*, 141 S. Ct. 2485, 2489 (2021) (citation omitted). Likewise, under the major questions doctrine, the Supreme Court has explained that Congress must “speak clearly if it wishes to assign to an agency decisions of vast economic and political significance.” *West Virginia v. EPA*, 142 S. Ct. 2587, 2605 (2022) (citation omitted). We believe that both principles are implicated here.

The regulation of gambling has long been “the particular domain of state law.” *Ala. Ass’n*, 141 S. Ct. at 2489. As a government of enumerated powers, the federal government does not possess a “general police power,” which is instead “retained by the States.” *United States v. Lopez*, 514 U.S. 549, 567 (1995). Legislation “to protect the public morals” lies at the core of the police power. *Chi., B. & Q. Ry. Co. v. Illinois*, 200 U.S. 561, 592 (1906). And gambling laws are quintessential public morals legislation. *See Murphy*, 138 S. Ct. at 1469. Hence, the lawfulness of gambling has long been a question of state law. *See id.* at 1468–71. The “general federal approach” has been to prohibit certain interstate activities related to gambling, but “only if that conduct is illegal under state or local law.” *Id.* at 1483; *see* 18 U.S.C. §§ 1084, 1952, 1953, 1955; 31 U.S.C. § 5363.

The regulation of gambling is also a matter of vast political and economic significance. Gambling is both a “controversial issue” and an “immensely popular” pastime, *Murphy*, 138 S. Ct. at 1469, 1483, which involves a great deal of money. In 2020, for instance, customers of a single British betting company collectively staked £434 million (about \$566 million) on the outcome of the U.S. presidential election. T. Adinarayan & D. Chowdhury, *Bettors Stampede Back in Favor of Biden as Results Stream in*, *Nat’l Post* (Nov. 4, 2020), <https://tinyurl.com/4w54t2dk>. If the Commission interprets “gaming” broadly, the size of the economic activity implicated will naturally be even greater. *See Ala. Realtors*, 141 S. Ct. at 2489 (evaluating the “majorness” of a question by the larger consequences of the agency’s assertion of authority, not merely the consequences of the specific outcome it is defending).



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Given these considerations, the Commission should not read Section 5c(c)(5)(C) to require that it ban event contracts which do not involve traditional gaming activities, *i.e.*, games of chance. If Congress had wished to confer that authority on the Commission, it would have said so explicitly.

2. *The Presumption of Validity*

Under the presumption of validity, an “interpretation that validates outweighs one that invalidates.” Scalia & Garner, *supra*, at 66. Accordingly, the Commission should not adopt an interpretation of Rule 40.11 that would place it in conflict with Section 5c(c)(5)(C) or the APA if another interpretation is fairly possible. *Cf. Jennings v. Rodriguez*, 138 S. Ct. 830, 836 (2018) (applying the same principle for a statute vis-à-vis the Constitution). Because reading Rule 40.11 to cover election event contracts would place it in conflict with those statutes, we respectfully submit that the Commission should not read it to apply beyond contracts involving games of chance.

Section 5c(c)(5)(C) empowers the Commission to prohibit contracts involving gaming only by “determin[ing]” that such contracts are “contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i), (ii). And the APA requires the Commission to give a reasoned explanation for its determination. 5 U.S.C. § 706(2)(A); *Motor Vehicle Mfrs. Ass’n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 48 (1983). In issuing Rule 40.11, the Commission noted that the term “gaming” may not extend beyond “participation in traditional ‘gaming’ activities” and that it would “continue[] to consider” whether there are “bases for distinguishing” such activities from “trading in contracts linked to the occurrence (or non-occurrence) of events.” Final Rulemaking, 76 Fed. Reg. at 44,785. The Commission thus never determined that election event contracts or other event contracts that are not traditional gaming activities are contrary to the public interest. Still less did it give a reasoned explanation for such a determination. If Rule 40.11 covers these event contracts, then it conflicts with Section 5c(c)(5)(C) and is arbitrary and capricious under the APA. The rule should thus instead be read to apply only to contracts involving games of chance.

3. *Rule of Lenity*

Where “a reasonable doubt persists” about the scope of a penal provision, the provision must be construed not to impose liability. *Moskal v. United States*, 498 U.S. 103, 108 (1990). A penal provision is one whose violation may be punished with a civil or criminal penalty. *See Wooden v. United States*, 142 S. Ct. 1063, 1086 & n.5 (2022) (Gorsuch, J., concurring in the judgment) (collecting authorities); Scalia & Garner, *supra*, at 297. Section 5c(c)(5)(C) and Rule 40.11 implicate both kinds of penalty. The Commission may civilly punish a registered entity that violates Rule 40.11 with suspension or revocation of its registration. 7 U.S.C.



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§ 7b. And any person who willfully violates Rule 40.11(a) is guilty of a felony. *Id.* § 13(a)(5). Nor does it matter that the Commission does not seek to punish Kalshi in this proceeding. “The rule of lenity ... is a rule of statutory construction whose purpose is to help give authoritative meaning to statutory language.” *United States v. Thompson/Ctr. Arms Co.*, 504 U.S. 505, 518 n.10 (1992). As such, it always applies to a penal provision, even when the provision is being applied in a nonpenal context. *Id.* Once the rule of lenity is applied, Section 5c(c)(5)(C) and Rule 40.11 are best understood to not cover election event contracts, given the Commission’s own stated doubt concerning whether contracts involving “gaming” include wagers on events that are not games of chance or even games.

II. Section 5c(c)(5)(C) and the APA Require an Individualized Public-Interest Determination in This Proceeding.

If the Commission nevertheless determines that Rule 40.11 applies to election event contracts, then we believe it should interpret that Rule as giving it discretion to nonetheless approve them—an approval it should grant for the reasons detailed in Part III below. Section 5c(c)(5)(C) and the APA are best understood as requiring case-by-case determinations by the Commission for contracts falling in the enumerated categories. That means the Commission must make a public-interest determination and give a reasoned explanation for such a determination here. This is especially true in light of the fact that the Commission has not yet determined whether gaming generally or Kalshi’s contracts in particular are contrary to the public interest nor given a reasoned explanation for any such determination.

A. Section 5c(c)(5)(C) Requires an Individualized Public-Interest Determination.

Under Section 5c(c)(5)(C), the Commission must decide whether contracts involving gaming are contrary to the public interest on a case-by-case basis. The statute is best understood to not permit a categorical determination that such contracts are always contrary to the public interest.

Start with the relevant text of Section 5c(c)(5)(C)(i):

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency ... by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve ... gaming.



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7 U.S.C. § 7a-2(c)(5)(C)(i). The Commission may make a public-interest determination only “[i]n connection with the listing of agreements, contracts, transactions, or swaps ... by a” registered entity. *Id.* That is, the determination must be *in response to* a registered entity listing a contract involving gaming. Moreover, the determination applies to “*such* agreements, contracts, or transactions ... if *the* agreements, contracts, or transactions involve” gaming. *Id.* (emphases added). When used as an adjective, “such” refers to particular things already mentioned. See *Such*, *Oxford English Dictionary*, *supra* (“The previously described or specified; the (person or thing) before mentioned.”); *Such*, *Black’s Law Dictionary* (11th ed. 2019) (“That or those; having just been mentioned”). The use of the definite article also indicates that the clause speaks of particular contracts, not contracts involving gaming generally. And the verb “determine” offers further support: It carries an adjudicative connotation, suggesting a case-by-case decision. See *Determine*, *Black’s Law Dictionary*, *supra* (“The act of deciding something officially; esp., a final decision by a court or administrative agency”); *Determine*, *Oxford English Dictionary*, *supra* (“To settle or decide (a dispute, question, matter in debate), as a judge or arbiter.”).

Zooming out, the sentence structure of Section 5c(c)(5)(C) would be awkward and redundant if it was meant to refer to contracts involving gaming generally. Had that been Congress’s intent, it could simply have said, “The Commission may determine that agreements, contracts, or transactions that are based on certain excluded commodities ... are contrary to the public interest if they involve gaming.”

Moreover, another clause of Section 5c(c)(5)(C), which addresses the clearing of swaps, uses the same sentence structure to unambiguously require an individualized determination:

In connection with the listing of a swap for clearing by a derivatives clearing organization, the Commission shall determine, upon request or on its own motion, the initial eligibility, or the continuing qualification, of a derivatives clearing organization to clear such a swap under those criteria, conditions, or rules that the Commission, in its discretion, determines.

7 U.S.C. § 7a-2(c)(5)(C)(iii)(I) (emphases added). A single derivatives clearing organization’s “initial eligibility” and “continuing qualification” can only be individualized determinations. And the Commission’s implementing regulation recognizes as much. See 17 C.F.R. § 39.5 (outlining process for reviewing swaps on an individualized basis).

In addition, Section 5c(c)(5)(C)(iv)’s deadline makes sense only if it refers to an individualized determination. “The Commission shall take final action under clauses (i) and (ii) in not later than 90 days from the commencement of its review unless *the party* seeking to offer *the contract or swap* agrees to an extension of this time limitation.” 7 U.S.C. § 7a-



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2(c)(5)(C)(iv) (emphases added). This language is best understood as acknowledging that a determination under Section 5c(c)(5)(C)(i) concerns a specific contract brought by a specific party. Thus, “final action” under that provision cannot be the issuance of a rule of general applicability. On top of that, a 90-day deadline is likely too short in the context of notice-and-comment rulemaking. For instance, two hundred sixty-seven days elapsed between the Notice of Proposed Rulemaking (NPRM) and the Final Rulemaking for Rule 40.11.

Finally, Rule 40.11 assumes that the Commission will determine the public interest on a case-by-case basis. While Rule 40.11(a)(1) may seem like a categorical prohibition when read in isolation, Rule 40.11(c) provides that the Commission can prohibit a contract involving gaming only after public notice and a 90-day review period. That would be quite unnecessary if the Commission only needed to decide whether a contract involved gaming, which would be cut and dry in many cases. *See infra* Part III.A (discussing Rule 40.11(c) further).

But even if the statute could be read to empower the Commission to categorically prohibit every contract that “involves” gaming, we submit it would exceed the statute’s scope to prohibit every contract that merely “relates to” or “references” gaming. 17 C.F.R. 40.11(a)(1). Section 5c(c)(5)(C) allows the Commission to prohibit only contracts that “involve” gaming. 7 U.S.C. § 7a-2(c)(5)(C)(i). Rule 40.11 is best understood as staying within that statutory constraint and as not expanding the Commission’s power beyond contracts “involving” gaming, as detailed in Part I above.

B. The Commission Has Not Yet Made an Applicable Public-Interest Determination.

Even if Section 5c(c)(5)(C) did not require an individualized public-interest determination, we respectfully submit that the Commission should make one here. The Commission can ban contracts involving gaming only if it first determines that such contracts are “contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i), (ii). But the Commission has not yet made a public-interest determination that applies to Kalshi’s contracts.

Nor did the Commission determine that gaming contracts are always contrary to the public interest when it issued Rule 40.11. The text of Rule 40.11(a)(1) does not mention the public interest. Neither did the NPRM, which said only that Section 5c(c)(5)(C) “authorizes the Commission to prohibit” contracts involving gaming and that the Commission is acting “[p]ursuant to this authority.” 75 Fed. Reg. 67,282, 67,288–89 (Nov. 2, 2010). The Commission did mention the public interest in the Final Rulemaking, where it said that it “would like to note that its prohibition of certain ‘gaming’ contracts is consistent with Congress’s intent to ‘prevent gambling through the futures markets’ and to ‘protect the public



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interest from gaming and other events contracts.” 76 Fed. Reg. at 44,786 (quoting legislative history). But this is not a *determination by the Commission* that gaming contracts violate the public interest. It is an *observation* that *Congress* has found gaming contracts to be contrary to the public interest and that the Commission is simply complying with that finding. Although we appreciate the Commission’s desire to respect the will of Congress, Congress left it to “the Commission” to “determine” whether gaming contracts “are contrary to the public interest.” 7 U.S.C. § 7a-2(c)(5)(C)(i). But finally and besides, even if this discussion did amount to a public-interest finding, as discussed above, it was limited to “traditional ‘gaming’ activity,” which does not include election event contracts. Final Rulemaking, 76 Fed. Reg. at 44,785; *supra* Part I.D.2.

Appropriately, the Commission did make an individualized public-interest determination in its *Nadex* Order. Slip op. at 4. But that finding by its terms was limited to “the Political Event Contracts,” *id.*, the defined term the Commission used for the specific contracts *Nadex* had proposed in that proceeding, *id.* at 1. Naturally, the Commission’s finding was also based on the specific facts and arguments presented in that proceeding, which are not identical to the ones presented here. Accordingly, if the Commission determines that Kalshi’s contracts involve gaming—which, as discussed above, would be contrary to the ordinary meaning of both “involve” and “gaming”—we believe it should also make an individualized public-interest finding to conform to the requirements of Section 5c(e)(5)(C).

C. The Commission Has Not Yet Explained Any Applicable Public-Interest Finding.

For similar reasons, we believe the Commission should make a public-interest determination here to conform to the APA. The APA requires agencies to give reasoned explanations for their decisions. 5 U.S.C. § 706(2)(A). The Commission has not yet given a reasoned explanation on whether Kalshi’s contracts or gaming contracts generally are contrary to the public interest. To the contrary, the Commission acknowledged that it would “continue[] to consider” whether contracts involving events that are not “traditional ‘gaming’ activities” should be banned at all. Final Rulemaking, 76 Fed. Reg. at 44,785.

In addition, the APA requires the Commission “to appreciate the full scope of [its] discretion” when making decisions. *See DHS v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1911 (2020). When issuing Rule 40.11, the Commission appeared to believe that Congress had already determined that gaming contracts are contrary to the public interest. *Supra* Part II.B. We believe the Commission should acknowledge its discretion (and obligation) to make its own public-interest determination and exercise it.



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Moreover, even setting aside the text of Section 5c(c)(5)(C), we do not believe the legislative history of that provision justifies a determination that gaming contracts are contrary to the public interest. The Final Rulemaking discerned Congress's intent from a single colloquy by two Senators. Final Rulemaking, 76 Fed. Reg. at 44,786 & nn. 34–35 (citing 156 Cong. Rec. S5906–07 (daily ed. July 15, 2010) (statements of Sens. Lincoln and Feinstein)). But Congress does not speak authoritatively through legislative history, only through duly enacted statutes. *Allina Health Servs.*, 139 S. Ct. at 1814. And even when courts consult legislative history, they accept only “clear evidence of congressional intent.” *Milner v. Dep’t of Navy*, 562 U.S. 562, 572 (2011). Floor statements by individual Senators are not enough. Such statements “rank among the least illuminating forms of legislative history.” *NLRB v. SW Gen., Inc.*, 137 S. Ct. 929, 943 (2017); *accord Advoc. Health Care Network v. Stapleton*, 137 S. Ct. 1652, 1661 (2017).

III. Election Event Contracts Promote the Public Interest.

If the Commission determines that Kalshi's contracts involve gaming, we submit that the Commission retains the discretion to find that they are not contrary to the public interest. It should exercise that discretion to approve them.

A. Rule 40.11 Permits the Commission to Consider the Public Interest Here.

Nothing in the CEA or the Commission's regulations prohibit it from approving individual contracts that fall within Rule 40.11(a). Rule 40.11(a) forbids a “registered entity” to “list” for trading a contract that involves gaming (emphasis added). It says nothing about what the Commission can do. Rule 40.11(c) requires the Commission to “issue an order approving or disapproving” the contract by the end of the 90-day review period. But it does not identify the standard by which the Commission must approve or disapprove requests or otherwise limit the Commission's discretion in any other way. Thus, nothing in Rule 40.11 prevents the Commission from approving a contract involving gaming on the ground that the contract is consistent with the public interest. Nor does any provision of the CEA. To the contrary, the Act requires the Commission to determine the public interest on a case-by-case basis. 7 U.S.C. § 7a-2(c)(5)(C)(i); *supra* Part II.A.

B. The Predictive Value of Election Event Contracts Serves the Public Interest.

As the Commission recognized in its *Nadex* Order, the public-interest standard is not limited to the narrow question of whether a contract satisfies the economic purpose test. Slip op. at 4. Despite recognizing this general principle, the Commission has not yet publicly



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considered the benefits of election event contracts beyond whether it has an economic purpose. Such contracts have a separate and unique benefit to the public—they provide a mechanism for accurately predicting election results.

An academic study of the Iowa Electronic Markets found that the markets have “no obvious biases” in forecasting election results and have “considerable accuracy.” J. Berg et al., *Results from a Dozen Years of Election Futures Markets Research*, in 1 *Handbook of Experimental Economics Results* 742, 746 (Charles R. Plott & Vernon L. Smith eds., 2008). The Iowa Markets consistently outperform conventional polls, predicting presidential election results within 1.5%, compared to 1.9% on average for polls. *Id.* The Iowa Markets are also “more stable than polls over the course of election campaigns.” *Id.* at 747. And their prices “do not follow poll results”; rather, they “predict changes in polls.” *Id.* at 749.

More accurate predictions promote the public interest. Accurate information about the future is as vital to politics as to business. Politicians and the public both rely on predictions about elections in the form of polls and expert commentary to shape their behavior. Politicians use this information to understand whether their message is resonating with the public and to reshape it as needed. The public uses this information to know what candidates and events are worth paying attention to, and to make decisions as to how to most effectively allocate scarce resources. By providing more accurate predictions, election event contracts can only improve our democracy. The CEA recognizes that commodity futures trading serves the “national public interest by providing a means for ... discovering prices” and “disseminating pricing information through trading.” 7 U.S.C. § 5(a). Election events contracts provide an analogous public benefit in the political arena, in addition to the price-discovery benefits discussed below.

Election event contracts can be particularly useful in down-ballot races and for less-established candidates. National polling firms are less likely to conduct polls for district-level and local races. Whatever polling is conducted is less accurate, and campaigns have to spend money to conduct internal polling that is not released to the public. According to academic researchers, election prediction markets remain “extremely accurate” even at the district level. J. Wolfers & E. Zitzewitz, *Prediction Markets*, 18 *J. of Econ. Perspectives* 107, 112 (2004). Election event contracts would thus allow the public and candidates with lower levels of funding to have accurate predictions in races that would otherwise be neglected. Democratizing the availability of accurate predictive information for less well-funded candidates and races in smaller markets serves the ends of democracy by helping to level the playing field for these otherwise marginalized candidates and races.

Election prediction markets promote democratic values and expand participation in our democracy in additional ways. To obtain analysis of future election results today,



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members of the public largely have to rely on polls conducted by a small number of elite firms and a small class of expert commentators in the media. If election event contracts were to become more widespread, ordinary members of the public would be able to improve political discourse and learn from their fellow citizens through participation in prediction markets. Election event contracts have the power to harness the wisdom of the crowd and to open up a new avenue of political participation that would not otherwise exist.

The Commission's rationale in *Nadex* for concluding that the contracts at issue there harmed the public interest was that those contracts could create "monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter's political view of such candidates." Slip op. at 4. Naturally, this would be concerning if it took place on a large scale, but it seems unlikely to occur in any given case. The effect of a single vote on any election is negligible, so any financial incentive to vote against one's political views would likewise be negligible. And to the extent someone tried to guarantee a favorable outcome on a contract by buying the votes of others, that would be a crime under federal law. 18 U.S.C. § 597.

C. Election Event Contracts Pass the Economic Purpose Test.

In any event, election event contracts serve the public interest even under the economic purpose test. In *Nadex*, the Commission asserted that "the unpredictability of the specific economic consequences of an election means that" the contracts *Nadex* had proposed "cannot reasonably be expected to be used for hedging purposes." Slip op. at 3. But the Commission did not explain its reasoning on this point, and there are good reasons to think otherwise.

First, on an intuitive level, it is easy to see how even one election result can have significant economic consequences for certain firms and individuals.⁴ Although there are many elected officials in America, much of the law governing business today comes in the

⁴ Many individuals have commented in this proceeding identifying consequences of elections against which election event contracts would allow them to hedge. See, e.g., Comment of Ian W., No. 69730 (Sept. 22, 2022) (explaining that Congress this term "was literally *one vote* away from changing the capital gains tax treatment" that applied to him); Comment of Valentin Perez, No. 69725 (Sept. 21, 2022) (as a small business owner, taxes and immigration policy); Comment of Jacob Faircloth, No. 69683 (Sept. 13, 2022) (explaining that the SALT deduction is unlikely to be fully restored in the near future unless the Democrats control Congress); Comment of Mike Ee, No. 69681 (Sept. 12, 2022) (explaining that changes to Medicare funding would affect the income of his wife, who works at a hospital); Comment of Amir K. Kaushik, No. 69656 (Sept. 5, 2022) (as an international student, immigration policy).



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form of regulations issued by administrative agencies. Administrative agencies largely answer to one person: the President. Presidential candidates can have starkly different positions on how certain industries should be regulated, meaning the outcome of the presidential election can have significant financial consequences for firms in those industries. Control of Congress, the subject of Kalshi's proposed contracts, has similarly observable consequences. Which party controls Congress after the midterms will determine whether the country will have a united or divided government for the next two years, and economically significant legislation favored by one of the two major parties is much more likely to pass under a united government. And on many issues, the major parties have clear differences in their platforms that party leaders ensure are followed once they are in power, so one can often foresee the sorts of policies a united government will enact into law.

Second, there is concrete empirical evidence of the economic impact of elections. One study, for instance, examined the equity prices of 41 firms whose activities would be favored under the policy platforms of George W. Bush and 21 firms favored under those of Al Gore in the wake of the 2000 presidential election. Brian Knight, *Are Policy Platforms Capitalized into Equity Prices? Evidence from the Bush/Gore 2000 Presidential Election 2* (Nat'l Bureau of Econ. Res., Working Paper No. 10,333, 2004). The study found a statistically significant effect: on average, the value of Bush-favored firms was 3% higher than they would have been under a Gore administration, while the value of Gore-favored firms was 6% lower. *Id.* at 9–10. The difference was more pronounced in industries where the difference in the candidates' policy views was greater. Tobacco firms, for instance, were worth 13% more under Bush relative to Gore. *Id.* at 11. For firms sensitive to regulation in areas where candidates have significant policy disagreement, election event contracts would easily be able to serve a hedging function.

* * * * *

We again thank the Commission for seeking public input on these important questions. We urge the Commission to approve Kalshi's proposed contracts because they do not involve gaming and are not contrary to the public interest.

Very truly yours,

Caesar A. Tabet
Partner

direct dial: 312.762-9480
email: ctabet@tdrlaw.com



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cc: The Honorable Rostin Behnam, Chairman
The Honorable Kristin N. Johnson, Commissioner
The Honorable Christy Goldsmith Romero, Commissioner
The Honorable Summer K. Mersinger, Commissioner
The Honorable Caroline D. Pham, Commissioner



Dear Commissioners of the Commodity Futures Trading Commission,

My name is Vivek Ranadivé. I am the co-owner and chairman of the NBA's Sacramento Kings. I am also the founder and former CEO of the business intelligence software company TIBCO Software, which was one of the first companies to facilitate instant communication in financial markets. In 2016, I founded an early stage investment firm called Bow Capital. I have a long time interest in the domain of business prediction. In 2006, I wrote a book called *The Power to Predict* about the importance of anticipating the future for business success. In 2011, I followed up that book with *The Two-Second Advantage: How We Succeed by Anticipating the Future—Just Enough*. This belief that predicting the future is absolutely crucial to commercial success has convinced me to support Kalshi's submission to the CFTC to list contracts on the outcome of Congressional elections.

I have no political affiliations and these contracts are not partisan. I have worked with politicians on both sides of the aisle, including joining then President Obama on his trip to India for Republic Day. People of all political persuasion should recognize the economic benefits these contracts provide, and allow them to proceed.

Specifically, these contracts give America's business owners the ability to reduce the risks they face through two key channels.

The first is direct hedging. As an investor and a business owner myself, I have seen time and again the way that federal policy can make or break a business. A business may be thriving until a tax break that they (or their customers) were relying on is cut in a last minute budget deal and the entire economics of their business go under. For example, the Wind Production Tax Credit (PTC) currently provides a rebate of up to 2c per kilowatt-hour (kwh) for the first ten years of a utility-scale wind farm's existence, and the Investment Tax Credit provides a tax credit of up to 30% of investment costs. Considering a single turbine can produce over 6 million kwh a year, the PTC alone could result in over \$100,000/turbine a year in tax benefits. There are many utility-scale wind-projects whose economics simply do not work without that tax break as the margins are too thin. As a result, they are rather vulnerable to changes in Congressional control, as the probability that the tax break gets cut or eliminated changes depending on who is in power. Even if the tax remains in place, potential investors may be skittish to invest if a less wind-friendly Congress is in place for fear that changes might take place (incidentally, this expectations channel answers the second question under CFTC Question 6 about policy predictability—not all of the harms manifest through policy actually getting enacted). Considering how capital intensive many industries like wind power production are, the nervousness from investors (and the corresponding increase in interest rates they will demand to compensate them for the extra risk) might be even more damaging than the tax cut even being cut. Wind, of course, is far from the only example. The recent Inflation Reduction Act had a \$7,500 tax rebate for electric vehicles, which could have enormous effects for a dealer or producer of those cars. But that tax break has very specific rules for which vehicles qualify (such as rules regarding the sourcing of the minerals used to make the battery). Minute adjustments to that tax break, then,

could have huge effects for many businesses. An election contract would allow these firms to reduce their risk exposure and manage it more appropriately.

The second is through improved prediction. As I argue in my book *The Power to Predict*, being able to anticipate and plan for future business risks is one of the biggest competitive advantages a company can have. As noted above, electoral risks *are* business risks. An event contract market, by aggregating the wisdom of thousands of traders trying to gain an edge by being ever so slightly more accurate than their competition, would provide a valuable data point to make the best business decision possible. An investor in renewable energy projects, for instance, may want to charge a developer a higher interest rate for fear that the wind tax breaks might be reduced. But if the investor can see that the odds of a wind-hostile Congress entering power is relatively low, they may feel the investment risk is lower and thus feel more comfortable submitting a lower bid. The consumer surplus from fewer businesses making imprudent financial decisions because they had incorrect information about the status of future policy could be enormous, as small improvements in the allocative efficiency of capital can be large in an economy as large as the United States's.

There remains a question about whether these contracts create perverse incentives regarding the integrity of the election. However, Britain has hosted these contracts for decades—are there major questions about the integrity of Liz Truss's recent election due to the presence of these markets? I have yet to see any proof of that. While it's true that a market such as this requires surveillance to ensure no candidate for Congress is participating and insider-trading on the market, that claim would be true for *all* event contracts, and is not unique to a Congressional control market.

This contract promotes the public interest by helping businesses anticipate and reduce the risks they face. I would urge the Commission to consider these facts when deciding the status of its application.

Vivek Ranadive, Sacramento Kings

September 23, 2022

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

Dear Chairman and Commissioners of the U.S. Commodity Futures Trading Commission (CFTC):

I write in support of the Commission approving Kalshi's proposal for electoral prediction markets.

My name is Daniel Gorfine, and I am the former chief innovation officer and director, LabCFTC at the U.S. CFTC. I am the founder and CEO of Gattaca Horizons, co-founder of the Digital Dollar Project (DDP), and adjunct professor at the Georgetown University Law Center.

The Commission is receiving many letters in support of Kalshi's application from esteemed academics, economists and leaders, including Jason Furman, former Chairman of the Council of Economic Advisers under President Obama.¹ I agree with the arguments made by Mr. Furman and others in terms of the informational and hedging value provided by prediction markets, including with respect to election outcomes. Additionally, contracts regarding generalized election outcomes that are well-regulated with proper contract limits should mitigate any perceived risks related to election integrity.

Rather than repeat what the Commission no doubt will hear from many regarding the value, efficiency, and accuracy of election prediction markets, I will focus on two discrete items worth additional consideration.

The first is that the Internet has created new public forums whereby individuals can exchange value and information seamlessly. We have seen the proliferation of social media, e-commerce and related consumer review platforms, forums that allow discussion on a range of topics, and even crowdfunding platforms for raising or investing money. Underpinning much of this democratization is the hope that there is "wisdom in the crowd."

Unfortunately, as we have seen far too often, there are a range of motivations and incentives that may result in the propagation of misinformation across Internet and mobile platforms, whether by way of fraudulent reviews, fake news, poor-quality polling, or fraudulent postings intended to manipulate markets.

¹ <https://comments.cftc.gov/PublicComments/ViewComment.aspx?iD=69708&GUID=264324ae75cb-4c97-9d45-62baa1877335>.

One solution that can help solve many of these challenges is requiring people to “put their money where their mouth is.” In other words, informational models that require contributors to have “skin in the game” when opining or contributing to public discussion is a great way to disincentivize the propagation of misinformation. The overall integrity of such informational exchange should accordingly yield cleaner and more accurate information across whatever subject is being considered.

Against this backdrop, election prediction markets can cut through the noise of those peddling misinformation regarding important election events that undoubtedly impact the American economy and individual economic planning. The information resulting from such markets can be used to counter or check other sources of information, and provide individuals, researchers, market participants, and policymakers another key data point when making decisions. This value should not be underestimated.

A second consideration is that it is always preferable to channel activity with societal benefit into well-regulated constructs rather than suppressing such activity and driving it into the shadows. More specifically, demand for election prediction markets will likely spill into unregulated markets or offshore marketplaces outside the purview of U.S. regulators, as we have already seen. For this reason, it would be far better policy to subject such activity to oversight, monitor and measure outcomes, and then tailor regulations to solve for any risks that are identified.

I thank the Commission for the opportunity to provide comment on this issue and urge approval of what would be a beneficial innovation for markets, hedging, and information gathering.

Sincerely,



Daniel Gorfine

September 23, 2022

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

Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

I am writing to support the Kalshi Exchange's request to list contracts related to the outcome of Congressional elections.

My name is Greg Kuserk, and I served at the Commission for 33 years in various capacities. My career there began in 1987 in the Research Section of the Division of Economic Analysis, where I eventually served as a Senior Economist. I served as the Economic Advisor to Commissioner Sharon Brown-Hruska and as her Chief of Staff during her tenure as Acting Chairman. I also served as Deputy Director of Market Surveillance in the Division of Market Oversight (DMO) and as Deputy Director of Product Review, also in DMO. Now retired, I am grateful for the time I was able to serve at the Commission and the accomplishments I was part of over the years. These accomplishments included fostering major industry innovations, such as the development of regulations for hybrid instruments/structured notes and swap contracts that produced meaningful value to market participants and the public. I also worked closely with the Division of Enforcement as both an expert witness and consultant on numerous actions related to illegal off-exchange activity. My interest in providing the comments below is to be able to share the institutional knowledge I developed over my years at the Commission to assist you in reaching a decision with respect to the products before you.

I encourage the Commission to recognize the value and importance of election markets. Although Event Contracts have not historically been the type of instruments that the Commission has been charged with regulating, Congress more recently in Dodd-Frank has seen it appropriate to authorize the Commission to regulate these markets. As the Commission has recognized through its various enforcement and similar actions—for example Intrade, the Iowa Electronic Market, PredictIt, and Nadex—on election markets, these markets have been appropriately determined to be within the Commission's jurisdiction under the Commodity Exchange Act. While Event Contracts are relatively new, the Commission is the appropriate choice of regulator. I believe that the Commission, through its staff, has significant expertise in regulating important and valuable markets, and I have no doubt that it can successfully regulate these markets too.

What I would like to offer to the Commission in this comment letter is an expansion on my views as to what I see as the most important issues involved in approving these election contracts. I see three issues. First, I want to clarify that Event Contracts differ from futures and options contracts and present different considerations. Second, even though they are new to the scene, Congress has placed these contracts under the Commission's jurisdiction, and the Commission has acted on that grant. Third, these contracts are not gaming, and are in the public interest because they essentially are a competitor to opinion polls, and likely a better product.

Futures or Options

Event Contracts are not futures or options and they do not have the hallmark of futures and options of being based on a price. As an example, if the price of corn goes up by x or down by y, the price of the futures contract will roughly change by x or y. For an option, the contract will go in- or out-of-the-money based on the price change of the underlying commodity. If in-the-money it will rise or fall in sync with the underlying price change. Event Contracts are not based on an underlying price. Given that these are not traditional futures or option contracts the question is whether Congress has given the Commission the authority to regulate them and whether the Commission has assumed that authority. I address this question next.

Congressional and Commission Approval

While I am not offering a legal opinion here, as discussed above I do believe that the language in the Act regarding Event Contracts shows that Congress entrusted the Commission with regulating these markets. I also note that actions taken by the Commission do establish that the Commission, more likely than not, has jurisdiction over these contracts. Regardless of how the Commission ultimately decides on the products before its consideration now, I encourage that you take this opportunity to clearly state the Commission's position on these contracts.

These Election Contracts are Valuable Contracts and are not Gaming

Because Event Contracts are not futures or options, they present different considerations to the Commission. One useful factor that the Commission can use in deciding whether to approve an Event contract is if the contracts are valuable in a public interest sense. That leads to the question of whether election contracts are valuable in a public interest sense. I argue yes.

These contracts are not gaming. Elections are events that are very important to the public, and there is a very strong public interest in having accurate data regarding elections. This is clear from the very prominent place that election polling plays in society. As stated above, these contracts will benefit the public interest by giving the public data that would complement or even compete with opinion polls, but with the advantage that participants in the market have a

monetary stake in their opinion. Elections have far more importance in a public interest sense than sporting events or other trivial matters. The public is better served by a regulated market that is subject to oversight and surveillance than by opinion polls that are unregulated and where participants have no incentive in providing sincere responses.

My recommendation is that the Commission approve the request by the Kalshi Exchange to list political event contracts and election contracts. I would also encourage the Commission to take this opportunity to revisit the 2008 Concept Release (73 Fed Reg 25669) and provide additional clarity on the types of events that are appropriate for Commission regulation.

I am grateful for the opportunity to give input on this matter, and am confident that these important markets will be an important addition to the markets that thrive under the Commission's regulation.

Sincerely,

Gregory Kuserk

Dear Commissioners,

My name is Greg Sirotek. I am the co-founder and CEO of Moneytree Power, an industry leader in bringing solar power to rental properties. We work with owners and renters of rental properties to find the right solar panel financing structure—either lease or ownership—to maximize total returns. We handle all of the installation work, as well as billing, payments, onboarding, performance monitoring and more. Political control has a major impact on my company's financials, and the CFTC should permit contracts that allow businesses and individuals to manage that risk to be publicly accessible for trading.

Congress has an incredible influence over the future of the zero-carbon energy industry, particularly the solar industry. The recent passage of the Inflation Reduction Act (IRA) was a major step forward, but it was only part of the battle.¹ Specifically, the IRA entitles taxpayers to an uncapped, nonrefundable credit equivalent to 30% of eligible expenses. The bill also temporarily extends the Section 45 Production Tax Credit for solar production.² These renewable energy credits can always be shrunk or expanded by future Congresses. The IRA may have created a \$27 billion green bank, but a future Congress can always slash its budget (or grow it, depending on their political inclinations).

Naturally, the existence and size of these credits has a large impact on our company's finances. The credit de facto makes all solar purchases 30% cheaper for buyers. As a result, a purchase is far more attractive to millions more people than before. Running a company that's in the business of working with rental property owners to buy/rent, install and manage solar panels, if the universe of potential solar customers grows, the universe of our customers do as well. These credits are an incredible boon to our bottom line. One report from researchers Princeton, Dartmouth, Evolved Energy and Carbon Impact Consulting³ estimates that the Act's provisions will *double* total investment in wind and solar photovoltaic power compared to the baseline without the act. Any risk that these temporary credits, subsidies and investments could expire or get cut would thus be highly detrimental to our bottom line.

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. While it's true that not all traders in the markets will be hedgers like myself, those non-hedgers are crucial as they become the individuals who accept the risk transfer from hedgers. Risk management tools shift

¹<https://thehill.com/opinion/congress-blog/3611091-passing-ira-was-half-the-battle-now-the-real-work-begins/>

²<https://www.wiley.law/alert-The-Inflation-Reduction-Act-Provides-Potential-Game-Changing-Benefits-for-US-Solar-Industry>

³ https://repeatproject.org/docs/REPEAT_IRA_Preliminary_Report_2022-08-04.pdf

risk from one party to another—as someone who would like to offload risk, I need people on the other side willing to accept it.

Election contracts serve the public interest by giving business owners like myself the ability to manage and reduce my financial risks, allowing me to focus on delivering the best product available to my customers. I hope the CFTC recognizes that reality and allows them to proceed.

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

Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

I am writing in support of the Commodity Futures Trading Commission approving Kalshi's proposal for electoral prediction markets.

I serve as a strategic advisor to entrepreneurs, policymakers, investors, and philanthropists who are working on a wide range of issues in regulated sectors such as education, workforce training, climate technologies, and telecommunications. I am also a non-resident senior fellow at the American Enterprise Institute and previously served as a White House domestic policy advisor for President Bush and as Deputy Policy Director for the Secretary of Commerce.

Many of the organizations I work with develop multi-year policy agendas that seek to advance reforms to address pressing societal challenges. This often involves assessing the political environment and forecasting emerging political trends that might necessitate a change in strategy, grantmaking, or coalition building. I frequently use prediction markets, when they are available, to complement other sources of information to help inform these decisions and strategies.

Predictions markets provide valuable forecasting.

Political prediction markets provide valuable forecasting data that contributes to a better understanding of current events and possible future outcomes. An electoral prediction market does not replace other methods of forecasting or analyzing information; it rather adds an important tool to help make better informed decisions.

Prediction markets are similar in many respects to other markets. The price of a stock, bond, or a commodity future is in a sense a forecast of the value of an unknown future, be it the value of a commodity, the expected revenues of a business, or the business outcome resulting from an acquisition. The forecasts represented by these prices provide information that drives decisions in a variety of sectors. Farmers, for example, routinely use futures markets to make decisions about which crops to plant. Political prediction markets can do the same for those who are navigating a constantly evolving political landscape in order to manage risk and maximize their impact.

Prediction markets offer several benefits.¹ First, the market mechanism allows for near real-time incorporation of new information. In contrast, other tools, such as public polling, only offer a snapshot in time and can lag in reflecting the shifts in public sentiment as situations change.

¹ Erik Snowberg, Justin Wolfers, and Eric Zitzewitz, "Prediction Markets for Economic Forecasting," (National Bureau of Economic Research, July 13, 2012), <https://www.nber.org/papers/w18222>.

Second, the market mechanism creates a financial incentive for individuals to express what they *believe* will happen, not what they *hope* will happen or even necessarily want to have happen. This too is better than relying on many of the alternatives. For example, political analysts can provide insight but may have incentives to generate support for a particular position or outcome. Or social pressure sometimes leads individuals to share what they believe is the “right” opinion even if it differs from their private views. Recent research has found that across all demographics, every subgroup had multiple issues with a double-digit gap between public and private opinion.² One consequence is that individuals may publicly misrepresent their own private views in public polling or focus groups.

Finally, participants may not individually have all the needed information, but the market mechanism creates an incentive to reveal what they know, which is then pooled to produce the best estimate or forecast.

Political election markets have practical applications.

We need a clearer regulatory roadmap that would allow for more, not fewer, prediction markets to contribute to our understanding of emerging events and outcomes.

For example, prediction markets could play a greater role in our pandemic response. A 2005 prediction market correctly predicted the then-current level of seasonal flu activity 71 percent of the time nearly two weeks ahead of clinical data.³ Such a market would have been invaluable to inform our nation’s pandemic response and indeed could still be valuable information given the uncertainty of future waves and variants. Steven Phillips, a medical epidemiologist and the vice president for science and strategy for the Covid Collaborative suggests that “applying a detached prediction market lens approach may produce provocative — and perhaps more accurate — pandemic forecasts than pure evidence-driven approaches.”⁴

There are numerous public benefits to the information provided in election prediction markets including helping organizations forecast the political landscape in order to make better strategic decisions. This is true not only for businesses and trade associations, but also philanthropies and non-profits in heavily regulated sectors that need to navigate dynamic policy and political environments.

Election markets also provide important information that entrepreneurs and investors can use when assessing the regulatory and political risk associated with new business ventures. Reducing even a little uncertainty can be the difference in unlocking the capital to support

² “Populace Insights: Private Opinion in America” (Populace), <https://populace.org/research>.

³ Philip Polgreen et al., “Use of Prediction Markets to Forecast Infectious Disease Activity” (Clinical Infectious Diseases, January 15, 2007), <https://academic.oup.com/cid/article/44/2/272/330878>.

⁴ Steven Phillips, “Prediction Markets and the Future of Covid-19” (Stat, September 2, 2022), <https://www.statnews.com/2022/09/02/prediction-markets-and-the-future-of-covid-19/>.

entrepreneurs tackling climate change, improving student education outcomes, or expanding access to healthcare.

Benefits outweigh the risks.

Kalshi's proposal does not pose a risk to the integrity of the U.S. election system. Election trading is a normal procedure in other established, strong democracies like the U.K., Australia, and Ireland. PredictIt and other tests in the United States have proven fruitful for researchers and the public. The valuable insights provided through a regulated election market far outweigh any of the potential risks.

Election markets in particular have proven to be a powerful tool for forecasting elections and are typically more accurate, timely, and complete than alternative methods such as polling. They would provide significant benefits to voters, the media, philanthropies, non-profits, investors, and private business. Approving Kalshi's submission would be a step in the right direction for the Commission and promotes the public interest.

Sincerely,

John Bailey

From: Alex Bouaziz
Organization(s): Deel

Comment No: 70749
Date: 9/23/2022

Comment Text:

To who it may concern,

I'm Alex Bouaziz, the CEO & founder of the Deel, the world's leading payroll and expense management software company. We are writing to support the legalization of election prediction markets in the United States.

As business owners, we are well aware of the impact of government changes on the bottom line of American businesses. Changes in tax law, for instance, do not simply affect the amount one has to pay today. They may affect the viability of a vast number of investments that a business may make as well. In addition, changes in immigration law may harm the ability of a tech startup to attract the best talent from around the world, if those changes limit the accessibility of H-1Bs or other visa categories. Game-changing engineers can be anywhere in the world, and any constraint on a startup's ability to find and hire them could cause a major financial loss. As a result, greater restrictions on immigration would harm Deel and many other companies. In particular, since Deel is a company that helps firms hire the best candidates from all around the world, we are particularly impacted by changes in immigration law. These two examples are far from exhaustive, but constitute two representative substantiations of the broader principle that the economic consequences of federal policy can be very real.

Perhaps the biggest channel by which federal policy transmits to small businesses are changes in the overall business environment. Federal policy regarding automatic stabilizers, fiscal stimulus, the federal debt, and public infrastructure can affect the level of growth in the economy, the national interest rate and the overall level of price growth. Those variables in turn can have enormous impacts on a company like Deel, which provides expense management and payroll services to many fast-growing startups. If the number of startups shrinks due to a hostile business environment, then that would harm our bottom line.

Over the last year, we have seen numerous policy priorities from members of Congress on both sides of the aisle that make those differences stark to even a casual observer. These represent risks to our balance sheet, and to millions of others. A product that would help us reduce our exposure to political changes would thus help manage our risk, and allow us to focus on delivering the best product we can to our customers.

ARISTOTLE

Now You Know™

205 Pennsylvania Ave., SE
Washington, DC 20003

September 23, 2022

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: Questions on the KalshiEX, LLC “Will <party> be in control of the <chamber of Congress>?” Contracts for Public Comment

Dear Chairman and Commissioners:

Aristotle International, Inc. (“Aristotle”), which acts as clearing house and service provider to Victoria University of Wellington’s PredictIt market, supports offering political event contracts on regulated exchanges.

Background

Kalshi cited trade statistics from the PredictIt Market in its application to the CFTC. Aristotle agrees that the history of the operation of the PredictIt Market and its regulatory treatment by the CFTC are relevant to the CFTC’s decision to approve or decline Kalshi’s proposal.

PredictIt began operating pursuant to a No Action Letter issued to Victoria University by the Division of Market Oversight in 2014.¹ Market statistics have been widely cited in media and among investment analysts often as superior to polling or election models.² PredictIt data has

¹ CFTC Letter No. 14-130.

² See, e.g., A Betting Man with a Plan for America, *Wall Street Journal* (Sept. 9, 2022) <https://www.wsj.com/articles/a-betting-man-with-a-plan-to-save-america-poker-odds-school-choice-war-climate-policy-donor-markets-prediction-invest-11662755750>; Bernard Stanford, There’s a Glorious Website Where You

Aristotle Comment on Kalshi Congress Filing, Page 1

been used by students and academics at over 130 universities across a wide range of subjects including microeconomics, political behavior, computer science, and game theory.

In May of 2019 Aristotle submitted a petition, supported by Victoria, urging the Commission to use its 4(c) authority to develop a tailored regulatory regime for event markets consistent with the Commission's 2008 concept release on event markets.³ Regrettably from our perspective the 4(c) petition received no formal response from the Commission or staff. In 2021 Aristotle filed an application for recognition as a Designated Contract Market, recognizing that certain questions that historically had been listed on PredictIt were by then permitted on DCMs. The Victoria NAL was withdrawn by the CFTC in August of this year with a direction to stop all trading by February 15, 2023.

Aristotle is contesting the withdrawal of the Victoria NAL and views the precipitous effort to end the Market as unfortunate, unnecessary, and unexplained. The NAL structure did and still can provide room for experimental, educational, and emerging markets and as a potential prelude to more fully regulated activity. At the same time, Aristotle supports efforts to stand up an improved regulatory structure for prediction markets.

Among the lessons bearing on Kalshi's petition that the Commission can draw from PredictIt's experience are:

- Efficiently run political prediction markets are not readily susceptible to manipulation (Commission Question 16) and
- Political prediction contracts are in the public interest (Commission Question 12) as evidenced by the high degree of investor interest, the use of market data by investment analysts and news media, and the use of market data by academic researchers.

In summary, the experience of Victoria and Aristotle with PredictIt shows that there is huge interest among American voters and investors in political prediction markets, that there is tremendous social and economic value in those markets,

Commission Question 1: The Proposed Contracts do not Constitute Gaming as Referenced in Commission Regulations and the Commodity Exchange Act.

Before addressing statutory and regulatory definitions of gaming, there is an obvious and critical distinction between binary prediction markets as operated by PredictIt and Kalshi and

Can Bet on Politics, and the U.S. Is About to Kill It, Slate (Aug. 14, 2022), <https://slate.com/business/2022/08/predictit-cftc-shut-down-politics-forecasting-gambling.html>; Victor Reklaitis, Betting Markets Now See Democrats Keeping Their Grip on Senate in Midterm Elections, MarketWatch (Aug. 4, 2022), <https://www.marketwatch.com/story/betting-markets-now-see-democrats-keeping-their-grip-on-senate-in-midterm-elections-11659542352>; A.G. Gancarki, Donald Trump Retakes 2024 Prediction Market Lead from Ron DeSantis, Florida Politics (July 7, 2022), <https://floridapolitics.com/archives/537385-donald-trump-retakes-2024-prediction-market-lead-from-ron-desantis/>; UBS Editorial Team, ElectionWatch: Potential Outcomes of the Midterms, UBS Wealth Management USA (Apr. 22, 2022), <https://www.ubs.com/us/en/wealth-management/insights/market-news/article.1563885.html>.

³ Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 Fed. Reg. 25669 (May 1, 2008)

gaming. Prediction market positions are tradeable. Gaming bets and wagers generally are not. While the final payout structures in gaming and prediction markets are similar -- all to the correct side, and nothing to the incorrect side -- the free tradability of prediction market positions prior to close makes the uses and behavior of prediction market positions quite different from gaming. To take one example from PredictIt, in the 2020 Presidential Market, there were 155,534,732 shares purchased. Of that total, 95,183,440, over 61%, were sold before expiration. The typical trader in that market did not buy and hold shares to the payout date for an all or nothing result, but instead made an investment, observed a profit or loss, and exited the market via a trade with a payout of some amount other than the binary \$0 or \$1. Similar behavior is evident in non-binary futures markets where many traders take and then exit positions before settlement dates.

Free tradability and the ability to exit positions prior to the triggering event is such a fundamental distinction from ordinary gaming that parsing of the meaning of whether a binary prediction contract “relate[s] to” gaming seems unnecessary. But we believe that a correct reading of the statute, especially in light of the development of trade practices since 2012, also leads to the conclusion that binary prediction contracts such as those proposed by Kalshi are not gaming nor do they relate to gaming.

Commission Regulation 40.11(a)(1) prohibits contracts that “involve, relate to, or reference... gaming.” In its Nadex order, the Commission rejected the commonsense reading that the underlying commodity behind the contracts needed to be based upon the outcome of a game (such as cards or football) to fall within the prohibition and stated that allowing the contracts would be akin to allowing gambling on elections. Per the Nadex order, elections themselves were not gaming, but the act of investing in the proposed contracts on elections constituted impermissible gaming. This, of course, is the same economically uninformed argument that has been made against commodity markets from their inception. Similar arguments could be made regarding any contract on an event that lacks underlying cash value, but the Commission has approved or allowed hundreds of such contracts.

Consider several contracts that are currently or have recently been hosted on Kalshi. On this exchange, traders can speculate as to the temperature in New York City,⁴ the number of major hurricanes in 2022⁵, whether a Category 3 hurricane will hit New Jersey in 2022,⁶ whether the federal government will shut down,⁷ who will win the Oscar Awards⁸, and whether certain bills will pass⁹, among others. Cantor Exchange also lists similar binary options, including hurricane landfall, rainfall, and snowfall event contracts.

One would struggle to come up with a definition of gaming that excludes questions about future weather events or the Academy Awards but includes the composite outcome of the midterm elections. The Nadex order cited the Unlawful Internet Gambling Enforcement Act to

⁴ <https://kalshi.com/events/HIGHNY-22SEP16/markets/HIGHNY-22SEP16-T76>

⁵ <https://kalshi.com/events/HURCTOTMAJ-22NOV30/markets/HURCTOTMAJ-22NOV30-T1>

⁶ <https://kalshi.com/events/HURNJ-22NOV30/markets/HURNJ-22NOV30-T3>

⁷ <https://kalshi.com/events/GOVSHUT-22OCT01/markets/GOVSHUT-22OCT01>

⁸ <https://kalshi.com/events/OSCARPIC-22/markets/OSCARPIC-22-PIZZA>

⁹ <https://kalshi.com/events/TECHREG/markets/TECHREG-23JAN03>

argue that the terms “bet” and “wager” can be defined as “the staking or risking by any person of something of value upon the outcome of a contest of others.”¹⁰ Even if one accepts that those terms are equivalent to the term “gaming,” this definition cannot be read to be consistent with the current regulatory environment. Both the outcome of the Academy Awards and the passage of legislation clearly constitute the outcome of a contest of others.

Event markets are also distinguishable from gaming because event markets serve an economic purpose. Traditional gaming provides a venue for participants to place a bet on the outcome of a sports contest or other event, and its primary and ultimate purpose is to benefit the trading participants and the operator of the venue who is the counterparty to the trade. Gambling casinos, moreover, do not release their trading data or aggregate such data to provide non-participants any benefit from the gambling activity. On the other hand and as discussed further below in response to Commission Question 11, event markets serve as information aggregation vehicles for the benefit of both participants and non-participants.

Commission Question 6: Election Contracts Serve an Economic Function

The Commission asks a series of questions related to hedging with only the fifth of those questions referring to economic utility. As discussed below, we believe that political event contracts have hedging utility. While hedging is the most commonly cited economic purpose of commodities contracts this series of questions suggests an unreasonably narrow view of economic purposes restricted to cash financial exchanges. Economic purposes are found in many non-financial exchanges.¹¹

In the case of political prediction markets, the social utility of the market is the information generated on the likelihood of a particular political outcome. Investors, the news media, political actors, and citizens are all intensely interested in advance predictions of election outcomes as evidenced by the great interest in polling and political modeling as well as by extensive media punditry. Some of that interest is directly related to likely economic impacts of election results but much of that interest is related to citizens’ stakes in their own government and the Commission should not dismiss that interest simply because it is not hedging activity. Because prediction markets have been shown to produce more accurate forecasts than polling, pundits, or election models, the Commission should recognize that there is an economic purpose in well-functioning election prediction markets regardless of the amount of hedging carried on in those markets generally or in particular products, however designed or marketed.

Consider, for example, that in the lead up to and on election nights, PredictIt receives many times more visitors than the number of users actively trading on elections. There is a great deal of interest among individuals, many of whom find it difficult and confusing to understand partial election returns as they come in, in using event markets to determine which candidates have an

¹⁰ 31 U.S.C. §§ 5361

¹¹ See, e.g., The Economics of Dating, Institute of Economic Affairs (2019) <https://iea.org.uk/wp-content/uploads/2019/07/The-economics-of-dating.pdf>

edge at any given time. In this sense, event contracts provide a similar service to that of traditional news media, who offer election night programming featuring data experts explaining the meaning of partial returns.

Political prediction markets do, however, have hedging utility. Commentary on “red” and “blue” stocks is widespread in financial literature.¹² A 2013 paper concluded that 4.35 percent of US companies could be labeled as blue meaning their stocks perform better under a Democratic President. Red firms constitute 5.11 percent of stocks. Red and blue stocks are subject to 48 percent higher volatility than colorless ones in election years. An investment strategy of longing and shorting opposite-colored stocks at the beginning of a new administration was projected to generate an abnormal return of 9.3 percent per year.¹³ A projected Alpha of 9.3 percent clearly presents a hedging opportunity to seek returns or protect against losses in advance of changes in administrations.

To give a concrete recent example, President Biden issued an Executive Order revoking the permit for the Keystone XL Pipeline on his first day in office.¹⁴ The fate of the Keystone pipeline was frequently discussed during the campaign, so Biden’s EO was not unexpected. Investors in Keystone’s operator and related companies clearly could have hedged their positions based on projected outcomes in the Presidential race.

Partisan control of Congress has similarly predictable if less immediate consequences for red stocks (defense sector, fossil fuels) and blue (health care, renewable energy) leading to obvious hedging opportunities. Consider, for example, the policy changes that followed the change in Senate control after the 2020 election. Upon learning that that Democrats had won both Georgia runoff elections and thus had taken control of the chamber, House Speaker Nancy Pelosi said that the results “change the dynamic in the Senate, but also in the country.”¹⁵ Senator Wyden (D-OR), the current Chairman of the Senate finance Committee, said that the change in Senate control “gives us the opportunity to have a very different set of choices.”¹⁶ Among the choices made possible by unified Democratic control of Congress was passage of the American Rescue Plan and the Inflation Reduction Act. This legislation included \$1.843 trillion^{17,18} in new spending through 2031 along with reductions in spending on prescription drugs and new tax credits for renewable energy and electric vehicle investment.

¹²See, e.g. Do Blue or Red Stocks Perform Better? How Political Polarization Impacts Your Stock Returns, UCI Merage School of Business (October 26, 2021) <https://merage.uci.edu/news/2021/10/Do-Blue-or-Red-Stocks-Perform-Better-How-Political-Polarization-Impact-Your-Stock>Returns.html>

¹³ Red vs. blue stocks: politics and profitability of firms, Yuxing Yan, http://datayyy.com/doc_pdf/red_vs_blue_stocks.pdf

¹⁴ Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis (January 20, 2021) <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/executive-order-protecting-public-health-and-environment-and-restoring-science-to-tackle-climate-crisis/>

¹⁵ <https://www.politico.com/news/2021/01/06/congress-democratic-takeover-georgia-senate-455333>

¹⁶ <https://www.politico.com/news/2021/01/08/georgia-senate-democrats-powerful-weapon-budget-456116>

¹⁷ https://www.cbo.gov/system/files/2021-03/Estimated_Budgetary_Effects_of_HR_1319_as_passed_0.pdf

¹⁸ https://www.cbo.gov/system/files/2022-08/hr5376_IR_Act_8-3-22.pdf

Markets already anticipate these effects. The iShares Global Clean Energy ETF (\$ICLN), an index of equities in the clean energy sector, rallied after Democrats won control of the Senate, increasing by a full 17% between December 31, 2020, and January 8, 2021, far outpacing the Dow Jones Industrial Average which rose by 1.6% during the same period. The Global X Lithium & Battery Tech ETF (\$LIT), which tracks companies involved in the production and processing of Lithium, a key element of electric vehicle and other battery production, rose by 14.5% during this same period. Enabling investors to take positions on House and Senate control before elections would allow investors to extend then period and the means with which they could hedge such important policy changes.

Asking whether there are risks that can be hedged only by questions on political control suggests an unreasonably narrow view. If a contract can be used for hedging, it has an economic purpose. The fact that other contracts, alone or in combination, might serve similar hedging purposes does not deprive the congressional control contracts of an economic purpose.

The reality of active hedging related to political outcomes is also demonstrated by the political risk insurance market. There are approximately 60 insurers operating in this market globally offer coverage of up to \$1.5 billion per risk.¹⁹ Political risk is also a staple topic at leading business schools including Wharton,²⁰ Stanford,²¹ and Harvard.²² While political risk insurance has traditionally been offered to US or European-based companies doing business in Africa, Latin America, and parts of Asia, coverage for US-based risks is now under discussion.²³ Insurance clearly is a form of hedging. The large and active political risk insurance market demonstrates incontestably that hedging against political risks has economic value and occurs routinely. Regrettably, political developments in the United States have made the need to hedge against US political risks more pertinent to businesses and investors. Contracts such as those proposed by Kalshi will serve to meet that need both directly and informationally, by informing investors of the likelihood of particular political outcomes.

Commission Question 10: Broader Questions Regarding Contract Design are Suitable for Rulemaking

¹⁹ Political Risk Insurance, NAIC Updated February 25, 2021 <https://content.naic.org/cipr-topics/political-risk-insurance>. See, e.g. <https://starrcompanies.com/Insurance/Casualty/Political-Risk>; https://www.allianz-trade.com/en_global/news-insights/business-tips-and-trade-advice/what-is-political-risk-and-how-to-protect-against-it.html; <https://www.aig.com/business/insurance/political-risk>; <https://www.lloyds.com/conducting-business/risk-locator/business-guidance/political-risk>; <https://www.marsh.com/us/services/political-risk/insights/political-risk-map-2021.html>; <https://www.aon.com/risk-services/crisis-management/political-risks.jsp>.

²⁰ <https://knowledge.wharton.upenn.edu/article/companies-can-successfully-navigate-political-risks/>.

²¹ <https://fsi.stanford.edu/publication/political-risk-how-businesses-and-organizations-can-anticipate-global-insecurity>.

²² <https://hbr.org/2018/05/managing-21st-century-political-risk>.

²³ <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/political-risk-coverage-for-us-may-be-live-issue-after-riots-shake-country-62627872>; <https://www.policyholderpulse.com/insuring-political-risk-united-states/>.

Questions such as whether binary contracts are useful for hedging non-binary economic events may well be suitable for a rulemaking such as the one Aristotle suggested three years ago or a similar undertaking. As we suggested then, there may be aspects of event contract markets that merit different regulatory treatment than existing Commission regimes. That question is not, however, relevant to Kalshi's request for approval of two contracts on non-economic events with binary outcomes. CBOT has been trading options on the Federal Funds rate, a non-binary economic event, since 2006²⁴ and CME recently initiated trading in event contracts across a wide range of its offerings.²⁵ While the CME products are technically options on futures, the contracts are economically and operationally identical to binary options. If the Commission has questions about trading activity which has been ongoing for 16 years on the largest market it regulates, it should address those inquiries in a broader proceeding. Such questions are not, however, a valid reason to delay action on Kalshi's request.

Commission Question 11: Event Markets Serve an Information Aggregation Function Equivalent to Price Discovery²⁶

As discussed in response to Question I, many existing event contracts do not have associated commodity or service prices. Elections are not bought and sold and will not be bought and sold if these contracts are allowed. The likelihood of a particular election outcome is, however, as important in its context as projected pricing for traditional commodities. Traders' collective assessments of the likelihood of a particular political outcome have economic and social value that can be captured, distilled, and made available to the public via well-functioning political prediction markets.

Event markets serve an information aggregation function for members of the public—academics, companies, and governments—who use them to further their research, manage their business operations, and set policy. The “price” of the event contract reflects the probability of the specified event or outcome happening. By aggregating individuals' beliefs with respect to an unknown future outcome, event contracts incorporate a wide diversity of thoughts and opinions that serve as a predictive tool for those who use them.

First, researchers use event markets for their studies because the real-time, constantly updating nature of event markets provides a highly refined measure that polls, expert surveys, and other methods of aggregating beliefs cannot easily replicate. For example, when presidential candidate Rick Perry made a gaffe during a 2012 Republican primary debate, an event market contract on his chances of winning the GOP nomination changed within minutes, and the odds of him receiving the nomination “halved within seconds.”²⁷ More recently, PredictIt odds on Brett Kavanaugh's Supreme Court nomination changed dramatically while Christine Blasey Ford was

²⁴ https://www.cmegroup.com/media-room/press-releases/2006/8/21/cbot_binary_optionsonfomctargetratecontractssetnewvolumerecord.html

²⁵ <https://www.cmegroup.com/activetrader/event-contracts.html>

²⁶ Portions of this response reiterate material from Aristotle's 20194(c) petition.

²⁷ Catherine Rampell, Rick Perry's Intrade Flash Crash, N.Y. TIMES (Nov. 10, 2011), <https://economix.blogs.nytimes.com/2011/11/10/rick-perrys-intrade-flash-crash/>.

testifying.²⁸ Event markets also have a more successful record of forecasting election outcomes than poll aggregators and can provide additional insight into market events. One study found that prediction markets are more accurate and have half the forecast error when compared to polls.²⁹ Another study used PredictIt data to find that more political amateurs entered congressional races as Donald Trump's nomination for president became more likely, suggesting that his nomination had important consequences that went beyond the presidential race.³⁰ In the 2018 U.S. midterm elections, PredictIt outperformed FiveThirtyEight, a popular political analysis website focused on reviewing and aggregating public opinion polling, in correctly predicting U.S. Senate races.³¹ These types of objective, up-to-the-minute, and accurate forecasting assessments are unique to event markets and prove their value to researchers.³²

Businesses and government agencies also use event markets to forecast internal and external events, showing the economic and social utility of these markets beyond mere price signals.³³

Commission Question 12: Proposed Contracts Serve the Public Interest

As outlined in the Background section above, the strong investor, media, and academic interest in political prediction markets demonstrates that these markets are in the public interest. The Commission's statutory test is to determine that proposed markets are not contrary to the public interest. The test is stated as a double negative because of a presumption that the primary purpose of most markets is to serve private interests, which is permissible so long as that activity is not contrary to the public interest. In the case of political prediction markets, however, the public interest served is arguably at least as important as the private interests involved. The public benefits from reliable, accurate, widely available, and transparent information about likely

²⁸ Brett Kavanaugh May Have Fared Better with Senators than Voters, THE ECONOMIST (Sep. 28, 2018), <https://www.economist.com/graphic-detail/2018/09/28/brett-kavanaugh-may-have-fared-better-with-senators-thanvoters>.

²⁹ Erik Snowberg et al., *Partisan Impacts on the Economy: Evidence from Prediction Markets and Close Elections*, NAT'L BUREAU OF ECON. RESEARCH (Jan. 2007), <https://www.nber.org/papers/w12073.pdf>. See also Concept Release, supra note 8, at 25670 ("Indeed, trading data generated by some . . . election contracts arguably have produced better predictive indicators than data obtained from professional polling organizations."); Joyce E. Berg et al., Prediction Market Accuracy in the Long Run, 24 INT'L J. FORECASTING 285, 286 (2008), <https://www.sciencedirect.com/science/article/pii/S0169207008000320> (finding that political event markets are more accurate than political polls in forecasting elections in the long-term).

³⁰ Gavin Riley & Jacob Smith, *The Trump Effect: Filing Deadlines and the Decision to Run in the 2016 Congressional Elections*, J. OF APPLIED RESEARCH IN CONTEMPORARY POLITICS (Aug. 30, 2018), <https://doi.org/10.1515/for-2018-0019>.

³¹ Harry Crane, *Polls, Pundits, or Prediction Markets: An Assessment of Election Forecasting*, RESEARCHERS.ONE (Nov. 9, 2018) (Under Review), <https://www.researchers.one/article/2018-11-6>.

³² See also Erik Snowberg et al., *Prediction Markets for Economic Forecasting*, BROOKINGS (June 13, 2012), <https://www.brookings.edu/wp-content/uploads/2016/06/13-prediction-markets-wolfers.pdf> (arguing that prediction markets have a number of attractive features: they quickly incorporate new information, are largely efficient, and impervious to manipulation); Erik Snowberg et al., *How Prediction Markets Can Save Event Studies*, NAT'L BUREAU OF ECON. RESEARCH (Apr. 2011), <https://www.nber.org/papers/w16949.pdf>. (arguing that "by augmenting event studies with prediction markets, other scholars will no doubt come up with creative ways to address many other unanswered questions").

³³ See, generally, Aristotle 2019 4(c) petition

political developments far more directly than the public generally benefits from similar information about future economic developments. The possibility that the yield curve is inverted, as important as that indicator is, is of intense interest to a limited set of investors but of little note to most Americans. The possibility that party control of Congress is likely to switch is of great interest to most Americans. In the case of these contracts the relatively small proportion of Americans likely to invest will be producing information of great value and great interest to the broader public.

Commission Question 13: The Trading of the Proposed Contracts will not Affect the Integrity of Elections.

In its 2012 order on Nadex's previously proposed political control contracts, the Commission raised concerns that political event contracts had the potential to affect the integrity of elections. Among other concerns, the Commission speculated that positions in prediction markets might give voters a financial incentive to support candidates they otherwise would oppose. The speculation is undermined by the observed behavior of partisans in the PredictIt market. What we see on PredictIt is that individuals bring their political dispositions into the market rather than exporting their profit incentives into their voting behavior. The willingness of partisans to wager in favor of their preferred candidates is a key element of the information gathering function of the market.

Further, the contracts proposed by Kalshi relate to outcomes that are determined by, not merely one election, but hundreds of individual elections that are determined by hundreds of millions of voters. The proposed contracts relate to the composite outcomes of the 2022 House and Senate Midterm Elections. In the 2018 Midterm Elections, over 131 million individuals cast ballots in 435 individual House of Representatives elections and delivered control of the House of Representatives to Democrats.³⁴ That same year, over 86 million individuals cast ballots in 35 individual Senate elections and reaffirmed Republican control of the Senate. It is self-evident that the individuals who will choose to trade on these contracts will simply not have the ability to significantly affect their overall outcomes. Although the Commission may have reasons to be concerned about contracts that relate to local elections that involve far fewer voters, the size of the federal Senate and House elections makes them impervious to manipulation of the type that concerns the Commission.

Contracts proposed by Kalshi are subject to Kalshi's position limit of \$25,000. Compare this position limit to the estimated \$5.7 billion spent on the 2018 midterm elections,³⁵ or the \$9 billion that may be spent in the 2022 midterm elections.³⁶ The numbers involved paint a clear picture: it would be impossible for any individual, or even a consortium of individuals, to influence the midterm elections in a cost-effective manner in support of a \$25,000 position.

³⁴ <https://history.house.gov/Institution/Election-Statistics/Election-Statistics/>

³⁵ <https://www.cnn.com/2019/02/07/politics/midterm-election-costs-topped-5-7-billion>

³⁶ <https://www.bloomberg.com/news/articles/2022-08-10/political-ad-spending-for-midterms-set-to-hit-record-9-billion>

There may be a position size at which manipulation of elections would become a live concern, but Kalshi's \$25,000 limit does not remotely approach that level.

Concerns about election manipulation are actually best addressed through appropriate regulation and oversight of political event markets. Offshore markets, to which this activity will continue to flow absent CFTC approval, lack position limits and other anti-manipulation controls.

Commission Question 14: The Proposed Contracts Would Not Facilitate Violations of, or Otherwise Undermine, Federal Campaign Finance Laws or Regulations

The Commission's question about whether the proposed contracts would make it easier for political action committees to sidestep rules limiting or prohibiting coordination with candidate campaign committees appears to be based on a lack of understanding about those rules and how they work in practice. Those rules are concerned with communications between candidates and other political actors, including Super PACs, who run ostensibly independent advertising.³⁷ If those ads in fact are at the request or suggestion of a candidate or result from substantial discussions with a candidate,³⁸ they are treated as contributions to the campaign subject to various contribution limits and prohibitions.³⁹ By their nature then, violations of the Federal Election Commission's coordinated communication rule involve secret, undisclosed communications between a campaign and a PAC or other entity running a campaign ad. A purchase on a prediction market is between one buyer and an unknown counterparty. There is no mechanism by which a PAC or other actor could in purchasing or selling event contracts to an unknown counterparty receive from or exchange with a campaign any information whatsoever.⁴⁰ Moreover, the identity of buyers and sellers is known to the clearing house and, if necessary, to regulators, thus the secrecy between parties that is essential to a successful violation of the coordination rules could not be maintained in a regulated market.

Commission Question 15 and 16: Allowing the Proposed Contracts to Trade on Regulated Markets will Reduce Their Susceptibility to Insider Trading and Manipulation.

The Commission is concerned that political event contracts are susceptible to manipulation via insider trading by individuals with access to information that is not readily available to the public. The possibility that individuals or groups may trade on internal, non-public polling data is itself a reason why the Commission should approve these contracts.

The Kalshi Rulebook, in compliance with federal laws and regulations, explicitly prohibits any individual defined as an Insider who is in a position to have material nonpublic information

³⁷ 11 CFR § 109, Subpart C.

³⁸ 11 CFR § 109.21(d).

³⁹ 11 CFR § 109.21(b).

⁴⁰ Further, campaigns already have a very efficient, if controversial, mechanism for sharing information with third parties known as "redboxing." See, e.g., *Voters Need to Know: Assessing the Legality of Redboxing in Federal Elections*, Kaveri Sharma, YALE LAW JOURNAL, Volume 130, No.7 (May 2021)

<https://www.yalelawjournal.org/note/voters-need-to-know>

from trading on a contract that relates to said information. (Rule 5.13(s)). There is almost nothing, however, from stopping that same individual from trading a comparable contract on an unregulated exchange. Event markets operating with regulatory supervision are thus in a better position to police the manipulation of markets by insider trading than the unregulated offshore exchanges (such as Polymarket) that currently serve as liquid exchanges that host a significant share of these trades. Bringing these trades onto federally regulated markets would mitigate the issues that the Commission is expressing concern over.

The Commission's question poses a classic insider trading scenario. There is no reason to suppose that insider trading by campaign staff poses any greater threat than insider trading by corporate insiders and the same rules and tools can be applied to prevent such abuses.

The Commission's suggestion that a *per se* ban on investing in control of Congress contracts should be imposed on political entities and persons working for such entities casts an unreasonably broad net. There is no more reason to hold *per se* that an individual working for a single House campaign possesses inside information material to control of the entire House involving approximately 800 general election campaigns⁴¹ than to hold *per se* that an employee of an individual company listed in a broad market index has information material to the direction of the S&P 500 or NASDAQ 1000 indices. Even the 34 Senate races in a typical cycle exceed the number of component stocks in the Dow Jones Industrial Average and no one has suggested that employees of component companies be *per se* prohibited from trading in DJIA Futures.

Commission Question 17: The Commission Should Consider the Widespread Availability of Offshore and Unregulated Political Event Contracts Involving US Elections in Determining that it is in the Public Interest to Encourage Those Transactions to Occur on Regulated Venues.

Despite the Commission's action against Polymarket,⁴² multiple unregulated or offshore venues continue to offer political prediction contracts to US investors.⁴³ MyBookie, for instance, currently lists odds on the 2024 Republican and Democratic Presidential nominations and on the Presidential general election outcome.⁴⁴ MyBookie has offered similar US political contracts at least since the 2018 midterm elections.⁴⁵ Another event market operating outside regulation, Augur, operates on the Ethereum blockchain and recorded trading of over \$2 million in political event contracts on the night of the 2018 midterm elections,⁴⁶ more than was traded on the same

⁴¹ Two candidates in most of of 435 House races, excluding uncontested races but adding additional candidates in jurisdictions such as Louisiana and Alaska where multiple candidates appear on the General election ballot.

⁴² <https://www.cftc.gov/PressRoom/PressReleases/8478-22>

⁴³ While some of these sites use geofencing or geoblocking, those restrictions are evaded easily using any one of several techniques including VPNs, smart DNS services, proxy servers, or the tor network combined with cryptocurrency accounts. See, e.g. <https://vpncentral.com/geo-fencing-restriction/>.

⁴⁴ MYBOOKIE, <https://mybookie.ag/> (last visited September 21, 2022).

⁴⁵ William Cummings, Smart Money is on Republicans Keeping Control of House, Betting Site Odds Say, USA TODAY (Oct. 28, 2018), <https://www.usatoday.com/story/news/politics/onpolitics/2018/10/28/midterm-electionsbetting-odds/1800052002/>.

⁴⁶ *Ethereum dApp Augur Records \$2 Million in Bets in US Midterms*, CCN (Nov. 7, 2018),

date on PredictIt. Augur continued their political prediction contracts during the 2020 Presidential campaign.⁴⁷ Moreover, large and sophisticated US-based firms are legally able to participate in UK and other markets allowing betting on US elections through non-US subsidiaries or affiliates. One large US investment fund reports having taken a \$500 million position on the 2020 US Presidential election outcome.⁴⁸ Where individual traders are able easily to participate in offshore or unregulated markets using cryptocurrencies and large entities are able legally to participate in and profit from overseas trading on US election outcomes the public interest clearly supports bringing this activity into a regulated US market.

Respectfully submitted,

John A. Phillips,
Chairman and CEO

<https://www.ccn.com/ethereum-dapp-augur-records-2-million-in-bets-in-us-midterms/>. This point is made, and reference cited in our 2019 4(c) petition.

⁴⁷ *Augur Users Bet \$111,000 on Presidential Elections After Biden, Trump Debate*, Crypto Briefing (September 30, 2020) <https://cryptobriefing.com/augur-users-bet-111000-presidential-elections-biden-trump-debate/>

⁴⁸ *A Betting Man with a Plan for America*, *Wall Street Journal* (Sept. 9, 2022)

Aristotle Comment on Kalshi Congress Filing, Page 12

DARTMOUTH

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September 24, 2022

SUBMITTED VIA CFTC PORTAL

Secretary of Commission
Office of the Secretariat
U.S. Commodity Futures Trading Commission
Three Lafayette Center
1155 21st St, NW
Washington, DC 20581

Re: Review of KalshiEx LLC's proposed Congressional Control Contracts pursuant to Commodity Futures Trading Commission Regulation 40.11(c)

Dear Chairman and Commissioners,

I am writing in support of Kalshi's application to run prediction markets on political outcomes. I will argue that prediction markets offer significant public benefits with minimal downsides.

I am a Professor of Economics at Dartmouth, and a significant component of my research agenda involves prediction markets. My work includes both studies of prediction markets themselves and research that uses prediction market prices as an input to an analysis. I attach a bibliography to the end of this letter.

I have found political prediction markets to be particularly useful in tracking the arrival of political news that influences other asset prices, allowing one to understand the economic effects of political outcomes. Examples include prospective analysis of the expected impact of the 2003 Iraq War (Wolfers and Zitzewitz, 2009) and the 2016 Presidential Election (Wolfers and Zitzewitz, 2016 and 2018), as well as retrospective analyses of other Presidential and Congressional elections (Snowberg, Wolfers, and Zitzewitz, 2007a and 2007b). Prediction markets on policy outcomes, such as the corporate tax rate, also informed my analysis of the post-event evolution of beliefs about the consequences of the 2016 election and Brexit vote (Fisman and Zitzewitz, 2019).

In the course of this research, I spoke with numerous financial market participants who find prediction market prices a useful input into their decision making. By aggregating information about political risk, political prediction markets allow investors to focus on other issues, potentially reducing asymmetric information and improving market liquidity. Research on emerging market corporate bond markets have found an analogous role for sovereign bonds (e.g., Dittmar and Yuan, 2008).

In order for markets to be useful, people have to trade in them. If traders are rational and only participate out of a profit motive, unsubsidized markets will unravel, as the less informed investors exit. Traders need to be willing to participate even when they should rationally expect to lose money. Three reasons why they might do so are entertainment, overconfidence, and hedging (Wolfers and Zitzewitz, 2006).

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Markets need to reach a certain scale before they are useful for hedging, and this will likely never happen unless we tolerate markets that are fun and/or on topics about which investors find it easy to be overconfident. Two of the three firms who ran the corporate prediction markets I studied in Cowgill and Zitzewitz (2015) included fun markets. Participants told us that they often started trading for the fun markets, but stayed for the serious ones.

These forces are, or were, clearly also at work at Tradesports, Intrade, Betfair and Predictit. Markets on topics such as sports, or the number of times President Trump tweets, arguably do not provide information on a topic of broad direct economic relevance. Yet they are often the “killer app” that brings traders to the markets that do.

Political prediction markets, however, are the rare combination: they are economically useful, but also fun to trade in and on topics that inspire strong and sometimes overconfident opinion. So the case for allowing Kalshi to run them is two-fold: they will both provide useful information in themselves, as well as likely augment the liquidity of the many other useful markets Kalshi is running, on topics such as COVID, climate change, and air transportation congestion.

Finally, your Question 13 raises concerns about politically motivated manipulation of the prices in the markets. As Hanson and Oprea (2009) correctly argue, manipulation encourages entry to trade against it. In the long run, this improves liquidity and the accuracy of prices. Moreover, the long run often arrives sooner than one might expect, as past suspected episodes of manipulation have involved relatively quick reversion of prices (see e.g., Rhode and Strumpf, 2008), consistent with the lab experiments of Hanson, Oprea, and Porter (2006).

In summary, I strongly support Kalshi’s proposal, and hope it, and other proposals like it, are approved.



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September 23, 2022

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Via Electronic Submission

Re: CFTC Review of Public Comment Period of KalshiEx Proposed Congressional Control Under CFTC Regulation 40.11 (Industry Filing 22-002)

Dear Mr. Kirkpatrick:

We thank the Commodity Futures Trading Commission (CFTC) for the chance to submit our perspectives. The Center for Effective Altruism's Long Term Future Fund, which supports our research, aims to influence the long-term trajectory of civilization by making grants that address global catastrophic risks. An important way that we can make progress on problems affecting the future is by making and gaining better access to accurate predictions. The Fund has made grants to a number of emerging prediction platforms that aggregate and refine predictions about future events, including Metaculus and Foretold, with the aim of systematically improving our ability to disseminate good judgments about the future.

Prediction markets in general—and the proposed contracts specifically—have unique hedging and price basing functions, allowing nonprofits to efficiently allocate resources and manage political risks associated with Future Impact projects. Additionally, we see prediction markets as an advanced forecasting and social consensus building mechanism still in its nascency. With time and space to mature, they can help humanity navigate an uncertain future.

Anticipating that the CFTC would solicit comments on this issue, we have, since June 2022, reviewed literature and interviewed a wide array of experts and stakeholders in the political prediction market space, including current and former CFTC staff, lawyers, forecasters, academics, industry leaders, platform operators and traders.

Our core finding is that the proposed election contracts specifically and prediction markets generally can serve the public interest under a reasonable regulatory regime. We hope the CFTC will develop efficient, fair and transparent regulations of event contracts that manage risks

associated with these markets while allowing a competitive industry for prediction markets to develop that serves the public good.

We are available to support, discuss and clarify any of the content in our comments with the CFTC.

Signed,

Pratik Chougule, Principal, Chougule Strategies; Contributor, Star Spangled Gamblers;
Consultant, Insight Prediction

Solomon Sia

With

Ozzie Goen, President, Quantified Uncertainty Research Institute

Nuño Sempere, Researcher, Quantified Uncertainty Research Institute; Forecaster, Samotsvety
Forecasting

Flip Pidot, founder and managing director, Sharp Square Capital, LLC

James Grugett, Cofounder & CEO, Manifold Markets

Stephen Grugett, Cofounder, Manifold Markets

Austin Chen, Cofounder, Manifold Markets

Linchuan Zhang, Research Manager, Rethink Priorities

1-4 Do the Contracts Involve Gaming

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 regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?

2. 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?

3. 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?

4. In determining whether any of these contracts involves 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?

Meaningfully distinct from pure gaming

During the 40.11 rulemaking comment period, the Commission agreed that the term “gaming” “requires further clarification and that the term is not susceptible to easy definition.”¹

We believe the proposed contracts have important characteristics that distinguish them from clear cases of gaming.

First, skill and knowledge predominate over chance in predicting party control of Congress over the long-run, which indicates that these contracts are distinct from games of pure chance. We know this through our long association, collaboration, and interviews with leading forecasters in existing political prediction markets—in some cases dating back to the Intrade markets. Academic models of prediction markets, such as *Learning Performance of Prediction Markets with Kelly Bettors*² also support that prediction markets will differentially reward participants with the most accurate hypotheses.

Second, election markets differ meaningfully from skill based gaming markets such as poker or sports betting because of their economic purpose, either as a hedge or for price basing. These arguments are discussed below in responses to questions 6 through 11.

¹ 76 Fed. Reg. at 44785.

² Alina Beygelzimer, John Langford, and David M. Pennock. Learning performance of prediction markets with Kelly bettors. In International Conference on Autonomous Agents and Multiagent Systems, pages 1317–1318, 2012.

Third, unlike most traditional gaming markets, election markets provide benefits to the public interest even to non market participants. These include: improved forecasting capacity, trust, aggregation, and information dissemination effects, which are discussed below in responses to questions 12 and 17.

Notably, the proposed contracts are similar to offerings that exist in traditional gaming venues in other countries today. For example, online gambling sites Betfair.com (in mainland Europe) and Smarkets (in the United Kingdom) currently offer political betting that is similar to Kalshi's proposal.³ The presence of similar offerings does not negate that political betting is meaningfully distinct from traditional gaming—for the reasons discussed above—and should not be a factor in the Commission's decision.

Instead, we believe speculators, disinterested gamblers and retail interests are part of a normal and healthy market. The speculation that exists on political event platforms today serves as liquidity provisioning that enables a hedging and price basing platform.

Exempt from state and federal gaming laws

Under an expansive reading of state and federal laws, most if not all financial instruments and event contracts currently allowed on Designated Contract Markets (DCMs) would be considered unlawful gaming activity. However, we believe that these political event contracts are not unlawful. We support former commissioner Dan Berkovitz's statement that "contracts involving gaming should be permitted to be traded on a DCM if they have an economic purpose."⁴

As discussed in a paper by ex-CFTC attorneys Dave Aron and Matt Jones, "The UIGEA Exclusions in a federal gambling statute appears to indicate that Congress recognized that sports bets bear more than a passing resemblance to financial products that are regulated by the CFTC ... and sought to ensure the preeminence of the CFTC regulatory scheme for derivatives over other federal and state regulation, even when that scheme called for an exclusion or exemption."⁵

The Unlawful Internet Gaming Enforcement Act, which would ordinarily define political event contracts as an unlawful bet or wager, specifically excludes from its definition any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act; or any transaction that is exempt from State gaming or bucket shop

³ See e.g. betfair.com - political betting on majority control of U.S. House and Senate: <https://www.betfair.com/exchange/plus/politics/market/1.179673535>

⁴ Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts, Commodity Futures Trading Commission (April 7, 2021), <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>

⁵ Dave Aron & Matt Jones, States' Big Gamble on Sports Betting, 12 UNLV GAMING L.J. 53 (2021).

laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.⁶

Therefore, we do not believe that the contracts, taken as a whole, involve, relate to, or reference “an activity that is unlawful under any State.”

Plain reading of the regulation

In a dissenting statement, Commissioner Pham put forth an argument whereby, based on plain reading of the regulation: buying or selling the contracts may be gaming, but the contracts, which are defined around control of the House and Senate, do not involve, relate to or reference gaming nor are similar to gaming.⁷

An alternate interpretation was used in the 2012 Nadex decision where the contracts and activity on the contracts were considered as a whole,⁸ based on Congressional intent,⁹ to grant the CFTC the power to restrict gaming that does not have an economic purpose.

Congressional intent is measured in several ways, the most important being the words of the statute. The words of the statute are unambiguous and the 2012 Nadex interpretation is potentially valid only given the legislative history represented by the colloquy, which is generally less probative.

Given the change in legal, economic, and social landscape since the colloquy and the 2012 decision—as detailed in the response to question 5—we prefer Commissioner Pham’s proposed interpretation.

5. Historical Precedent

5. Are the contracts substantively different from Nadex’s previously proposed 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>.

⁶ 31 U.S.C. § 5362(1)(E).

⁷ Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts, Commodity Futures Trading Commission (April 7, 2021), <https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement082622>

⁸ Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts

⁹ <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ffdocs/nadexorder040212.pdf> “WHEREAS, the legislative history of CEA Section 5c(c)(5)(C) indicates 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”

Although prior decisions and congressional intent are natural starting points for analysis, we believe that the CFTC should also remain flexible as circumstances change. This is necessary to fulfill the CFTC’s mandate to protect customers and encourage a well regulated market.

The contracts put forward by Kalshi are not substantively different from Nadex’s previously proposed contracts. However, the legal, social and technological context has changed since the Nadex decision in three major ways that, independently or collectively, should encourage a reassessment of the 2012 decision.

A transformed legal, social and economic landscape

The legal landscape regarding gambling has changed since the Nadex decision. As former Commissioner Berkovitz noted in 2021, the sports betting landscape today is “dramatically different from when Congress enacted the gaming provision and the Commission promulgated Regulation 40.11” due, among other things, to rapid expansion as well as increase in the dollar amounts being wagered.

The CFTC should base their interpretation of Congress’s intent in the context of the new legal and economic landscape, where many forms of gaming are no longer illegal under the PASPA, and therefore have a different analysis than the Nadex decision.

Public perception of gaming has changed since the Nadex decision. A 2020 Gallup poll, found that 71 percent of Americans consider gambling to be morally acceptable, the highest level of registered since Gallup started polling the question in 2003. News media regarding prediction markets specifically has also shifted towards a more positive tone, highlighting prediction markets’ value as a source of truth.¹⁰

Additionally, the forecasting industry and community has grown and matured significantly since the Nadex decision. Although blogs such as overcomingbias.com, marginalrevolution.com and lesswrong.com have existed since the 2000s, the rationalist community has grown since 2012 alongside increased attention to the value of prediction aggregators. Metaculus.com, a reputation based prediction platform hosting over a million forecasts, was founded in 2015. Replication Markets, a research replication prediction market, was founded in 2019. Google created an

¹⁰ See e.g. Holman Jenkins, “A Betting Man With a Plan for America,” *Wall Street Journal*, 9 September 2022, <https://www.wsj.com/articles/a-betting-man-with-a-plan-to-save-america-poker-odds-school-choice-war-climate-policy-donor-markets-prediction-invest-11662755750>; Harry Crane and K Coleman Strumpf, “Political prediction markets are an antidote to degraded public discourse”, 6 September 2022, <https://www.chicagotribune.com/opinion/commentary/ct-opinion-political-prediction-markets-public-discourse-2022-0906-1fuvzi3fnkfgw33lzhno4h4-story.html>; Rational Animations, *Prediction markets: can betting be good for the world*>. YouTube. https://www.youtube.com/watch?v=xA27x7GRMZQ&ab_channel=RationalAnimations

internal prediction market in 2022.¹¹ Nonprofit organizations interested in maximizing their long term impact such as Rethink Priorities, Open Philanthropy, and Effective Altruism Funds—none of which existed prior to 2017—are today collectively managing multibillion dollar budgets.

Mainstream acceptance of gaming coupled with increased awareness of the value of prediction markets increases the likelihood that the hedging, price basing and other positive social benefits of the proposed contracts will be realized. The CFTC should consider whether the proposed contracts pass the economic purpose test or are contrary to the public interest in the context of this new social landscape.

Finally, a variety of election markets have proliferated since the Nadex decision, creating a new regulatory landscape with unique dilemmas. PredictIt started operating with the benefit of a No Action letter after the Nadex decision in 2014. Congressional control markets on the site provide a highly relevant test case for considering theoretical concerns as well as the public interest implications of Kalshi's request.

Due to blockchain and other decentralized technologies, traders are using offshore and unregulated exchanges that feature election contracts with significant liquidity. An example of such a market is Augur which open sourced their code and whose decentralized design may allow it to sidestep regulatory difficulties. Soon after the platform launched, users had created death pools — or assassination markets — on famous people. Retail traders are leveraging VPNs with little evident fear of legal consequences. The extent to which these markets can be and will be regulated with meaningful sanctions and enforcement remains uncertain.

We feel strongly that the public would benefit from having these products traded on a well-regulated exchange. The lack of a regulated exchange will not prevent the risks posed by political event contracts; rather, it will push users towards less well regulated markets where it is harder to safeguard their interests. Prediction markets may, as a consequence, lose their value as a trust and aggregation.

The CFTC should consider whether these proposed contracts pass the economic purpose test or are contrary to the public interest against the backdrop of proliferating unregulated prediction markets. This analysis, in our view, points to different conclusions from the Nadex decision.

6-10 Hedging

6. Do the contracts serve a hedging function? Are the economic consequences of congressional control predictable enough for a contract based on that control to serve a hedging function?

¹¹ Dan Schwarz and Lindsay Taylor, "Creating a prediction market on Google Cloud", Google Cloud, <https://cloud.google.com/blog/topics/solutions-how-tos/design-patterns-in-googles-prediction-market-on-google-cloud>

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

7. 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?

8. What standard should the Commission use in reviewing the contract's 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?

9. Should the Commission consider contract and position size and the exchange's intended customer base to help assess whether a product is likely to be used for hedging in at least some cases? Are very small dollar value contracts targeted at individual retail customers likely to have hedging utility for such customers when the contracts offer positions on macro level national political events? Does whether contracts are margined or fully collateralized affect this analysis?

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

Reasonable expectation of hedging on a more than occasional basis

There is significant unhedged political risk today, and political event contracts can reasonably be expected to serve as a broad economic hedge against economic consequences on more than an occasional basis. A hedging function is sufficient, but not necessary for the proposed contracts to pass the economic purpose test. Price basing, as covered in the response to question 11, is also sufficient to pass the economic purpose test.

We favor a standard that the election contracts could theoretically be used for hedging. Based on the wording of the economic purpose test, either theoretical use for hedging or proven prior use for hedging is sufficient. We also believe that the theoretical standard best fits the standard the CFTC has used on similar proposals in the past.

The comments the CFTC has already received speak to the hedging utility of these political event contracts. In previous event contracts submissions such as ErisX sports betting and MDEX box office futures, prominent industry leaders explicitly declared that they would not use these

markets for hedging to any meaningful degree,¹² which influenced CFTC decision-making. However, the proposed contracts serve as a broad economic hedge for so many conceivable interests that it is unlikely that a similar hedging boycott is plausible. On the contrary, the comments file contains a variety of industry and retail interests coming forward to declare their intent to use the proposed contracts as an economic hedge.

In addition to the possibility that election contracts may provide a more correlated hedge for an umbrella of risks than traditional derivative products, election contracts may over time democratize hedging by making available a method more intuitive to retail and other classes of traders who cannot easily open spread accounts.

We believe retail customers are currently not well-educated on the hedging utility of election contracts, which helps account for why hedging in these markets is relatively rare. However, should the Commission approve these contracts on the condition that hedging (or price basing) will be demonstrated on a more than occasional basis, we believe Kalshi would embark on an educational campaign regarding the hedging utility of election contracts for an array of market entrants, including retail customers. Given the amount of unhedged economic risk today, such an educational effort could lead to a notable increase in hedging using election contracts.

Theoretical hedging - broad based economic risks

The Center for Effective Altruism (CEA) makes grants that seek to address global catastrophic risks through technical research, policy analysis, advocacy, and/or demonstration projects. Congressional control contracts are among the most predictable ways to hedge such risks because of the large number of relevant issues that are sources of partisan division. Examples include policy approaches to divisive issues related to pandemics, nuclear safety, and climate change.

If a party with an unfavorable stance from the perspective of global risk reduction should gain congressional control, it would have unique, tangible and predictable economic implications to CEA. More funding for research, analysis, advocacy and/or demonstration projects would be necessary to counteract these political headwinds. The proposed contracts would allow for the construction of a hedge against such political risks.

Even when issues are not front and center in a political campaign, Congressional control markets are a way of hedging myriad factors such as who will serve on relevant committees where

¹² See e.g. Shaun Raviv, "Box Office Bomb: The Short Life of Popcorn Prediction Markets", *The Ringer*, 15 November 2018, <https://www.theringer.com/movies/2018/11/15/18091620/box-office-futures-dodd-frank-mpaa-recession>; AGA Comment Letter at 2, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=64800&SearchText=>

political agendas are set, hearings are convened, and millions of dollars in appropriations can be allocated.

Theoretical hedging - policy analysis and advocacy

CEA grants include policy analysis and advocacy. The effectiveness of these individual grants and the value of the fund's overall grant portfolio are uniquely, tangibly and predictably tied to the economic event of congressional control. If the fund is overexposed with respect to its advocacy grants towards a specific political party, the proposed contracts would allow for the construction of a hedge against such political risks.

Many of the economic risks that concern CEA are tied far more directly to the outcome of congressional control than any derivative products on equities, debt, interest rates, tax rates, asset values, and other commodity prices.

Examples of hedging on prediction markets

We conducted a review of hedging on existing prediction markets. Few prediction markets today have high enough volume and liquidity (several million) to allow for meaningful hedging. Even relatively unregulated election markets in the UK appear not to be used to a significant degree for hedging, in part because these markets tend not to draw enough liquidity.

We did, however, identify notable exceptions. FTX recently saw an individual actor placing programmatic bets summing to more than \$100K on a \$931K volume prediction market on the Tokyo Olympics¹³—behavior consistent with a large actor hedging against the risk of the Tokyo Olympics being canceled.¹⁴ UK markets on Brexit drew enough liquidity to attract participation indicative of hedging, albeit less so than currency markets. Finally, Star Spangled Gamblers, a political betting podcast, has featured retail investors using Kalshi to hedge their student loan payments.¹⁵

Impact of contract size and design

Contract and position sizes will have a significant impact on whether a product is likely to be used for hedging. The proposed contracts have artificially low position limits that will constrain the hedging use case. In comparison, traditional commodity futures have minimal contract sizes that are multiples of the maximum of the proposed contracts, for example, hundreds of thousands of dollars on fund futures.

¹³ See snapshot of FTX Tokyo Olympics market with volume traded of \$931K:
<https://twitter.com/5egKS9lUrwVOqWX/status/1402456266321002499>

¹⁴ See <https://twitter.com/brianluidog/status/1374555912828985348>, which details the bot's behavior of persistently making 'no' hedges and keeping the probability of the Olympics at 75% despite strong evidence from superforecasters and other prediction markets that the probability of the olympics was higher.

¹⁵ <https://twitter.com/SSGamblers/status/1530217569348636675>

Very small dollar value contracts targeted at individual retail customers are unlikely to have practical hedging utility for all but a small minority of customers when the contracts offer positions on macro level national political events. Even if such hedging were to occur, the economic benefit would be minimal. This is an inherent mismatch, and we recommend higher position limits so hedging becomes feasible on an institutional scale.

In the same vein, we recommend margined contracts which naturally allow for greater hedging potential. We expect margined contracts and possibly even interest generating contracts¹⁶ will provide institutional users greater liquidity with which to hedge their political risk exposure.

We do not find issues with the proposed contract design. The economic event - whether <party> will control the <house or senate> - can be modeled as a binary event, so the binary contract design matches the binary economic event and is not an impediment to hedging.

More generally, contract design and payout are not major impediments to hedging. For example, a sufficient spread of binary contracts may be used to create a basis for hedging nonbinary economic events. Furthermore, subsequent proposed event contracts need not be binary, and there will be appropriate nonbinary event contracts to hedge nonbinary economic events.

11 Price Basing

11. 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?

The political event contracts can reasonably be expected to serve a price-basing function on a more than occasional basis. Furthermore, we understand that serving a price-basing function is sufficient but not necessary for the political event contracts to pass the economic purpose test.

Contrary to the CFTC's findings in the 2012 Nadex Ruling, we believe from our experience with post-2012 prediction market platforms such as PredictIt, Polymarket, Insight Prediction, and Manifold Markets that there are reasonable situations in which the proposed contracts' prices could form the basis for the pricing of a commercial transaction involving a physical commodity, financial asset or service.

Prediction markets provide value by forecasting the future

Election markets are a valuable source of insight when operating alongside current forecasting platforms. The core social value proposition of efficient prediction markets is the production of

¹⁶ See e.g. <https://manifold.markets/home> which gives interest payoffs to users holding long term positions to grant forecasters liquidity to maintain long term predictions, or the "no loss" contracts pioneered by Hedgehog Markets (<https://hedgehog.markets/no-loss/>).

accurate, calibrated and useful probabilities. The CEA acknowledges the potential for prediction markets to disseminate insight with trust, aggregation and clarity.¹⁷

In 2008, a group of 22 academics called for loosened regulations in an open letter to *Science*, describing a "virtually limitless" range of applications for government policy, business and public health. Four Nobel laureates were among the signatories, including 2013 economics co-winner Robert Shiller. Since the Nadex prohibition in 2012, play money and reputation-based prediction markets such as Metaculus and Replication Markets have tested and proven prediction markets' potential for actionable insight in a wide range of applications.

Prediction markets provide strong incentives for accuracy and timeliness by working according to the efficient market hypothesis. They incentivize participants to seek information that would give them an edge and aggregate insights from other forecasters. Market participants are also incentivized to integrate news quickly into a prediction market, leading to timely predictions. In addition, because prediction markets have a resolution date set in stone beforehand, dynamics where "the market stays irrational longer than you can stay solvent" arise to a much lesser degree, since a correct contrarian can simply buy the correct side and hold it until resolution.

In a review of corporate prediction markets Misha Yagudin, Nuño Sempere, and Eli Lifland noted that Google, Yandex, and Goldman Sachs, among others, had previously or currently run prediction markets.¹⁸ The outcome of these prediction markets were used by the companies to estimate the price of investments, broker acquisitions and set strategic direction. Ultimately the research found lower levels of corporate uptake, which the researchers hypothesized may have been due to the significant investments in effort and employee hours required to run an internal prediction market. Nevertheless, there are strong theoretical reasons why public prediction markets would be more cost effective in delivering forecasting value, as the information would be more relevant to a larger population of users. This is perhaps why Google has invested anew in their own internal prediction market, which has seen "over 175,000 predictions from over 10,000 Google employees"¹⁹.

¹⁷ See 2008 Event Contract Concept Release, supra note 40, at 25,672 ("As demonstrated by the [Iowa Electronic Markets ("IEM")], innovative event markets have the capacity to facilitate the discovery of information, and thereby provide potential benefits to the public.").

¹⁸ Nuño Sempere, Misha Yagudin, and Eli Lifland, "Prediction Markets in the Corporate Setting", Effective Altruism Forum, 31 December 20201, https://forum.effectivealtruism.org/posts/dOhjwHA7LhfE8YpYF/prediction-markets-in-the-corporate-setting#Value_proposition

¹⁹ <https://cloud.google.com/blog/topics/solutions/how-tos/design-patterns-in-googles-prediction-market-on-google-cloud>

Political event contracts have a price basing function

Efficient and well run markets on political event contracts provide many signals upon which to base prices for services. Examples of valuable signals include the likelihood of either parties' control of the House and Senate, the extent of that control, and the implied volatility of the outcome. These outcomes materially affect the strategic decisions of companies whose outcomes depend on these events.

Political prediction markets have become an important part of the political risk industry guiding private sector decision-making. Rethink Priorities CEO Peter Wildeford told us that political event contracts on Betfair and Predictit are the first thing his organization checks to forecast outcomes of elections—information used to steer the strategic direction of the nonprofit. The strong incentives to integrate accurate and timely information makes the markets, in his view, a unique resource.

Besides setting strategic direction, the signals also have a direct price basing function for physical commodities, financial assets or services. We will use for illustration the price basing function on investments for public good. As public good fund managers become more politically conscious, they increasingly consider two factors in their investing strategy. First, the impact that political parties have on investments; second, the expected return of direct investment in political parties.

An example is the impact that Democrat/Republican control of the House or Senate has on pandemic preparedness funding initiatives.²⁰ In addition to investments in forecasting, CEA also considers investments in pandemic preparedness. Republican/Democrat control of the House or Senate will directly influence the impact of the Biden administration's proposed Pandemic Preparedness bill, which in turn influences the relative value of funding provided for independent pandemic preparedness initiatives.

As another example, the Center For Election Science advocates for use of approval voting, instead of the "first-past-the-post" system implemented in most of the US right now. Approval voting would favor more centrist candidates which have appeal across party lines, and would avoid problems such as "spoiler" candidates. Because their advocacy might see differential success depending on which party is in power, funders deciding whether to donate to the Center for Election Science can use forecasts of election outcomes as an input into their decision-making.

Additionally, as institutions and individuals consider directly investing in political causes for the public good, signals from political event contracts influence the price they should pay for

²⁰ "Pandemic preparedness", Effective Altruism Forum, <https://forum.effectivealtruism.org/topics/pandemic-preparedness>

services such as lobbying and campaign management. Sam Bankman-Fried, for example, cited the risk of Trump winning the 2020 election as a direct influence on his political spending decisions.²¹

Current examples of price basing

Below are select practical examples of other prediction markets being used as price basing for physical commodities, financial assets and services today.

We considered the effectiveness of effort and money invested in developing a public comment to the CFTC. As part of our considerations, we reviewed an event contract by Insight Prediction structured around the likelihood of Kalshi offering U.S. election markets by October 25th.²² As the numbers leaned towards 50%, the expectation that such a public comment could influence the outcome increased, which forms a price basis for services to craft that letter. Based on the implied probabilities from that prediction market, which was 30% at the time of writing, we based the price we were willing to pay for expert and legal services to help us draft this comment letter.

Other prediction markets that exist today can reasonably be expected to have a price basing function. For example, a market on Manifold Markets at the time of writing estimates the probability that Elon Musk will buy Twitter this year at 28%.²³ This can easily be used as a price basing function for Twitter stock, which is a financial asset.

As another example, effective forecasts on the coronavirus pandemic such as those at the prediction platform pandemic.metaculus.com have a price basing function across a wide range of physical commodities, financial assets and services related to healthcare, tourism and commercial activity.

Finally, price basing for physical commodities may be more directly served by a future on the physical commodity rather than an event contract. However, the implied probabilities from an event contract may nevertheless be used as a basis for the price of such commodities. A theoretical example is a prediction market structured around Democrat or Senate control of Congress having a price basing function on corn or wheat.²⁴

²¹ Elena Schneider, "How the newest megadonor wants to change Washington", *Politico*, 4 August 2022, <https://www.politico.com/news/2022/08/04/democratic-megadonor-sam-bankman-fried-00049048>

²² <https://insightprediction.com/m/18609/will-kalshi-offer-a-us-election-market-by-october-25th>

²³ <https://manifold.markets/SG/will-elon-musk-buy-twitter-this-year>

²⁴ See e.g. David Rogers, "Senate Passes Democrat-Backed Bill To Raise Target Commodities Prices", 14 February 2022, <https://www.wsj.com/articles/SB1013625367351156440>

13-16 Election Integrity

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

We analyzed the historical and theoretical adverse effects of prediction systems on election integrity. We also interviewed traders and platform operators of existing election-based markets to understand election manipulation risks specific to election markets.

Our response considers the following integrity risks:

1. Prediction markets may serve as a mechanism to sway election outcomes through self-fulfilling (or self-defeating prophecies). This includes manipulating markets to sway voter sentiment and hence election outcomes and vote buying.
2. Prediction markets may serve as a direct financial incentive to manipulate elections (by means other than prediction markets).
3. Prediction markets may be subject to manipulation for profit, e.g. via the publication of false polls, which manipulates election outcomes as a byproduct.
4. Prediction markets may affect the perception of election integrity.
5. Prediction markets may facilitate violations of campaign finance laws.
6. Election insiders may manipulate outcomes to create profits on the market or trade on insider information.

Ultimately we believe the risk of election-based contracts on election integrity is negligible relative to the risks that already exist. Further, these risks are mitigated by effective regulatory oversight of these markets, and small relative to the economic and social utility of these contracts.

Self-fulfilling prophecies

One category of risk is the self fulfilling prophecy—or its inverse, the self defeating prophecy—where knowledge of the prediction affects the result.²⁵ The 2016 US presidential election offers plausible evidence for the self-defeating theory, where overconfident win predictions for Hillary Clinton, including in the prediction markets, may have lowered turnout enough to tip the election.²⁶

²⁵ Herbert Simon, Bandwagon and Underdog Effects and the Possibility of Election Predictions, *Public Opinion Quarterly*, Volume 18, Issue 3, Fall 1954, Pages 245–253, <https://doi.org/10.1086/266513>

²⁶ Nuño Sempere, “Real-Life Examples of Prediction Systems Interfering with the Real World (Predict-O-Matic Problems), *LessWrong*, 3 December 2020, <https://www.lesswrong.com/posts/6bSjRczjDxR2omHKE/real-life-examples-of-prediction-systems-interfering-with>

On the eve of the election, a letter from FBI director James Comey telling Congress he had reopened an investigation into Clinton's emails shook up the race with just days left in the campaign. Comey later acknowledged that his assumption that Clinton was going to win was a factor in his decision to send the letter.²⁷

The converse risk is the self-fulfilling prophecy. One could imagine a hypothetical scenario in 2016 where overconfident win projections for Hillary Clinton lowered turnout for Republican voters sufficiently to tip the election in her favor.

The arguments here speak more to the integrity risks of faulty prediction systems generally rather than the proposed contracts specifically. The incentives for prediction markets to seek and disseminate truth is greater than the majority of the more commonly referenced predictions in mainstream discourse such as pundit predictions. Because of their active mechanisms to combat overconfidence, we consider one of the primary benefits of election markets to be a decrease of unrealistic projections, thereby reducing the potential for incorrect electoral modeling to affect election integrity.

The CFTC should not ban political event contracts on the basis that they are better predictors of election outcomes or it may run into First Amendment concerns around political discourse (see response to question 12 & 17).

Deliberately swaying election outcomes

We searched for historical attempts to use political event contracts to manipulate the outcome of elections. We did not find any instances of manipulation in Congressional control markets but did discover examples in other markets. An aide on a presidential campaign in the 2016 primaries informed one of us on background that he and his colleagues placed bets on their candidate on PredictIt as part of the campaign's strategy. They did so both in order to respond to media coverage that their candidate's price was slipping in the markets as well as to garner favorable news coverage about the supposed prospects of their campaign. The betting limits and relatively low liquidity on PredictIt made this a relatively inexpensive decision in the short-term, but it proved impractical as their campaign failed to gain traction and traders became increasingly bearish on its prospects. Another likely instance of attempted manipulation occurred recently in the UK in markets in the London mayor race. Anecdotal evidence suggests that an obscure candidate may have facilitated bets in the market to pump his price, and therefore, support notions that he may be a viable candidate. The gambit failed when media and political observers treated the candidate's briefly inflated price as noise.

²⁷ Zeynep Tufekci, "Can We Finally Agree to Ignore Election Forecasts", *New York Times*, 1 November 2020, <https://www.nytimes.com/2020/11/01/opinion/election-forecasts-modeling-flaws.html>

The relatively inconsequential cases of manipulation we found in our research are consistent with the academic literature on this topic. Studies on the so-called “Romney whale” in the 2012 Intrade markets, a single pro-John Kerry manipulator in the 2004 TradeSports market, as well as surveys of earlier political stock markets indicate that manipulation can be detected by traders, media, and researchers, and that systematic manipulation is difficult beyond short time periods.²⁸ As the efficient market hypothesis indicates, given sufficient interest and liquidity, traders can be expected to bring the market price to a more efficient level relatively quickly.

We expect the proposed contracts on a regulated exchange would be less prone to manipulation than on PredictIt. Due to higher position limits, the markets will be more liquid. Moreover, Congressional control contracts hinge less on the fate of any one or handful of individuals than other types of markets that have been historical targets of attempted manipulation.

Our prediction in this respect is informed by our conversations with UK-based colleagues, who have monitored Congressional control markets with large amounts of liquidity over many decades. They reported no clear, consequential cases of manipulation in these markets. They observed, moreover, that while allegations of manipulation in sports betting in the UK have led to the creation of a nationwide integrity unit, nothing comparable exists in politics and there appears to be no meaningful demand for one even by the most vocal advocacy groups.

We believe that the existing evidence of failed manipulation is reason for cautious optimism. It suggests that prediction markets are considerably less likely to mislead the public than the less transparent mechanisms already available today such as push polling, reporting based on background sources, election analysis platforms, and proprietary models. Lying in a market that has an active mechanism to counter noise and fake news is a dubious strategy when considering the alternatives.

Even if cases were to arise of market manipulation, calls for outlawing election contracts on this rationale should be weighed against the benefits that isolated attempts at manipulation have from an academic/research perspective. They would further knowledge on when and under what circumstances traders seek to manipulate election markets and how consequential these efforts are.

²⁸ Rothschild, David M. and Sethi, Rajiv, Trading Strategies and Market Microstructure: Evidence from a Prediction Market (November 22, 2015). The Journal of Prediction Markets 10 (1), 1-29, 2016, Available at SSRN: <https://ssrn.com/abstract=2322420> or <http://dx.doi.org/10.2139/ssrn.2322420>; Rajiv Sethi, “The Romney Whale” 26 September 2013, <http://rajivsethi.blogspot.com/2013/09/the-romney-whale.html>; Rhode, P.W., Strumpf, K.S.: Manipulating political stock markets: A field experiment and a century of observational data. Working Paper (2008), [https://users.wfu.edu/strumpks/papers/ManipIHT_Junc2008\(KS\).pdf](https://users.wfu.edu/strumpks/papers/ManipIHT_Junc2008(KS).pdf)

Using event contracts to ‘buy votes’

In the Nadex Ruling, the CFTC declared that “Political Event Contracts can potentially be used in ways that would have an adverse effect on the integrity of elections, for example by creating monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter’s political views of such candidates.” A related argument is that, if the political event contracts truly worked as an efficient economic or emotional hedge, a voter could theoretically put enough money on one side or another such that they became wholly ambivalent to the outcome and abstain from voting.

This is not a well formulated integrity concern. It is in the nature of democratic elections that voters have the prerogative to weigh myriad personal incentives—including financial ones—in their choice of candidate. In an era in which the government has a profound impact on individuals’ financial future through tax, spending, and regulatory policy, the relatively small amounts of money at stake in an election market can be expected to be a secondary concern at most. The CFTC’s Nadex statement suggests that voters might voluntarily shape their own preferences and “steal votes from themselves”, which does not constitute an election integrity risk.

These concerns, moreover, are speculative, abstract, and almost entirely absent from our experience with political prediction markets. In large part due to the difficulty of generating high profits in election markets relative to other types of betting markets with more frequent and consistent events, traders tend to participate in election markets because of their preexisting interest in politics. While traders routinely acknowledge that they are trading against candidates who they personally support, we are unaware of traders who consciously base their personal political activities on their investments in the market. Indeed, discussions in the political prediction community are replete with traders who disengage from election markets when they have a strong opinion about one of the involved parties and do not trust themselves to place an objective bet.

A more coherent example of the CFTC’s concerns is as follows: a manipulator who wants people to vote Democrat could put a lot of money on Republicans winning, with the expectation of losing that money. Republican voters would see the easy money, and start betting on a Democratic victory, and thereby become incentivised to vote Democrat. Ultimately the Democrats win, and the manipulator has lost a lot of money on the prediction market but has effectively ‘bought votes’ and hurt the election integrity as a result.

This mechanism may appear dangerous, not least because it is indistinguishable from hedging behavior by an actor who hopes for a Democrat win but is hedging against a Republican win. However, this method of ‘vote purchasing’ is extremely impractical because there is no way to make the right amount of money go to the right people. A single individual, or even a

dispassionate corporate entity that has no voting power could take all the money without providing any return on investment. Again, there exist far more direct and reliable ways to sway election outcomes today.

Direct financial incentive to manipulate elections

Another integrity risk is that election-based contracts, by introducing a profit motive, may incentivize individuals with a stake in those markets to alter election outcomes in order to make money on the markets. If an entity has a large position on an outcome, it has a financial incentive to make that outcome come to pass.²⁹

This concern does not make sense given the size of the event contract positions (\$25K position limit per individual) relative to the incentives already at stake. Individuals and organizations already have strong reasons to sway an election and the policy outcomes at stake far outweigh any market gains available in the proposed contracts. We do not see direct financial incentives as an issue even at several multiples of the current proposed limit.

The CFTC may have recognized in 2012 that the election integrity fears based on additional incentives created by political event contracts were frivolous as it did not elect to mention them in the Nadex Ruling.

Nevertheless, we sought historical examples of individuals attempting to manipulate elections to make money on prediction markets. The closest one we found were death threats against Andrew Yang during his presidential campaign from an anonymous trader who was attempting to manipulate PredictIt's briefly operating market on how many times Yang would tweet. PredictIt's decision to offer the market in the first place went against advice from veteran political prediction market traders who reasoned, correctly, that this type of niche market was on dubious regulatory grounds and was more likely to incentivize foul play than the election contracts proposed by Kalshi.³⁰

Perception of the integrity of elections

We considered how the proposed contracts might affect perceptions of election integrity. As a meta point, considerations pertaining to the perception of election integrity hold much less weight than considerations of actual election integrity risk. Given logical analysis and reasoning, perception will approach reality—that is, that the proposed contracts have an insignificant impact on election integrity.

²⁹ A literary example is the Jules Verne novel 'Around the World in 80 Days', in which, as a bet, Phileas Fogg travels the world in 80 days by train and ship.

³⁰ <https://twitter.com/Domahhhh/status/1555320074524770304?s=20&t=8IPVPLjCs2ec5326j6n45w>

Nevertheless, we do not take it on faith that the public will automatically take the same reasoned analysis and come to the same conclusions we have described above. We discuss some reasons why prediction markets might be perceived as threats to election integrity.

First, the financial incentives caused by prediction markets are more direct than conventional political incentives, as there is a direct payout in response to one side or another winning. This direct mechanism could be perceived as higher risk relative to its actual risk.

Second, although public perception of gambling has improved in general and prediction markets are meaningfully distinct from gambling, a minority may take offense at a financial incentive mechanism they consider to be gambling. In this case there is a focus on the mechanism of election integrity violation rather than the likelihood of the actual violation.

Third, there is a natural inherent distrust of any new potential mechanisms of abuse, regardless of its risks relative to the mechanisms already available.

Fourth, by adding ‘skin in the game’ for market participants, the proposed contracts increase the emotional and financial investment in the outcome. When the outcome does not go according to their wishes or expectations, it increases the emotional response, which leads to stronger, albeit unfounded perceptions that the election integrity has been compromised. For example, in the 2020 elections, millions of Americans went to the polls believing that their preferred candidates would win by a comfortable margin. When the results defied their expectations, many “blue wave” traders lost money on PredictIt while suspicions about election fraud gained traction. Conspiracy-oriented traders flooded political prediction markets with bets on Republican candidates, only to suffer losses as more sophisticated traders took the other side of their bets.

Conversely, there are strong reasons to believe prediction markets will be a net positive to both election integrity and perceived election integrity, as follows.

First, because prediction markets are inherently non-partisan, aggregate perspectives democratically and have strong incentives towards accuracy, they are less likely to be demonized by one side or another. This is coupled with the insight and social consensus building incentives of prediction markets, as laid out in the response to questions 12 and 17. Doubts about the integrity of U.S. elections have risen in the past few years for reasons that have little if anything to do with political prediction markets. Because of the transparency of prediction markets and its active mechanisms to combat falsehood, we consider one of the primary benefits of a political prediction market to be the reduction of incentives and effectiveness of current methods to interfere with election integrity

Second, mainstream understanding and acceptance of gaming and the benefits of forecasting have improved since the 2012 Nadex contracts, as discussed in the response to question 5. Prediction market platforms such as Kalshi and influencers within the forecasting and rationalist community are strongly incentivized to educate the public. Once election-based contracts are effectively regulated, we intend to undertake a follow up project to educate the public on prediction markets.

Third, the opportunity to trade on election outcomes in the context of PredictIt has created powerful incentives for the public to become informed about the political process and be more cognizant of one's own ignorance and biases. This is easily observed in discussions in the political prediction market community, which are often far more sophisticated than those in the mainstream or even professional discourse. This creates financial incentives for market participants to be rational, which in turn moves their perceptions of election integrity closer to reality. We would expect the Kalshi contracts to continue to produce a new generation of citizens whose interest in political prediction markets leads them to engage constructively in the political process and to have reasoned opinions about election integrity.

Fourth, prediction markets themselves give signals on election integrity. In 2020, at a time when the president of the United States and a major political party were seriously entertaining the possibility that the election was "stolen", that Trump would serve a second term, and that key Senate race calls would be reversed, market prices indicated that traders understood better than many members of Congress that the election was conducted without a meaningful amount of fraud and that the United States would see a transfer of power to Joe Biden. Reflecting widespread concerns about election integrity among the electorate, candidates since Trump have decried election fraud after losing their congressional races, but election markets on PredictIt and elsewhere have hardly moved on this news. At the same time, Congressional markets are among the most valuable sources available today to assess whether and how federal and state inquiries into election integrity will proceed.

Although political prediction markets play a limited role currently in shaping perceptions of election integrity, recent history shows that they are more likely to increase rather than decrease confidence in U.S. elections when the public at large sees that the "smart money" is betting on the assumption of fair elections.

14. 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?

Facilitate or violate campaign finance laws

Over the course of extensive interviews with historians, practitioners, and industry leaders in both the United States and the United Kingdom, we did not come across any evidence that political prediction markets have been or are being used to facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations to any meaningful degree.

Relative to the existing mechanisms and loopholes by which parties may sidestep prohibitions governing coordination between candidate campaign committees and political action committees, the contracts do not offer a feasible mechanism to facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations.

Insofar as election markets carry the risk of undermining campaign finance laws, however, law enforcement officials are more likely to determine if this is occurring on a regulated exchange with a responsible stakeholder like Kalshi rather than a decentralized or offshore site with less incentive to police its site in line with American legal and political norms.

15. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements? For example, could candidate campaign committees or political action committees manipulate the contracts by trading on internal, non-public polling data?

16. Should campaign committees, political action committees, candidates for the House and Senate, and other entities involved in political fundraising and expenditures or likely to hold non-public information, or subject to Federal Election Commission oversight, be prohibited from participating in the contracts? Would such a prohibition fully address federal campaign law or manipulation and surveillance concerns? How would such restrictions impact the Commission's determination of whether the contracts are contrary to the public interest?

Market manipulation for profit

As part of our research for this comment, we sought examples of manipulation by insiders on existing prediction platforms.

A form of manipulation is the creation of fake polls by traders to move betting markets. Our British colleagues were not aware of fake polling being used to manipulate UK-based markets, but the phenomenon appears to be more common on PredictIt. FiveThirtyEight's report "Fake Polls Are A Real Problem" notes, as an example, that the price for one share — which is equivalent to a bet that Senator Debbie Stabenow will be re-elected — fell from 78 cents to as low as 63 cents due to a fake poll before finishing the day at 70 cents. Market motivations may have been secondary to the trolling factor, but the mere fact that the markets can be so easily

manipulated is arguably noteworthy.³¹ The paper “Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability” contains many more examples.³²

Ultimately, the phenomenon of manipulation via fake polls is of some concern to certain types of political prediction markets with limited information, few public polls, and low liquidity. Even in such markets, the incentives for market correction and exposure tend to override any attempts to manipulate the market.

The proposed markets would be even more difficult to manipulate through fake polls due to the abundance of information available to market participants, frequent polling by reputable firms, and the high liquidity they draw.

Manipulation is also possible through sound polling. We interviewed one PredictIt trader who commissioned a real poll to move the markets. The trader told us that the poll was real with a sound methodology, and was commissioned to correct what he believed to be an inefficient market. Ultimately the trader financially benefited from the process of discovering truth via his poll and taking a position before releasing the polling results. We take this example as evidence that prediction markets may also reward truth seeking and truth dissemination by financially motivating the commissioning of accurate polls.

Rules against insider trading

Prediction markets may incentivize insiders to put money on an unlikely outcome and make the outcome occur. For example, a frontrunner candidate may bet against themselves and then intentionally lose the election to reap a profit. We have not found any historical examples of candidates throwing an election in order to make a profit from prediction markets.

Prediction markets may also enable insider trading of non-public information. We learned of several instances of campaign aides in the 2016 primaries trading on PredictIt while working for presidential candidates. Often, aides were simply trying to profit personally, calculating (often incorrectly as it turned out) that their experience on the campaigns would give them an edge.

Insofar as we are interested in political prediction markets that express efficient pricing, we would oppose prohibitions on any entity’s participation in these markets given that they may have valuable information. A promise of election markets is that they will elicit knowledge from many market participants that wouldn't have otherwise been shared and that this knowledge will be used to make better decisions.

³¹ Harry Eten, “Fake Polls Are A Real Problem,” *FiveThirtyEight*, 22 August 2017; <https://fivethirtyeight.com/features/fake-polls-are-a-real-problem/>

³² Yeargain, T. (2020): “Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability,” *Missouri Law Review*, 85,140-150

If, however, the Commission determines that such a prohibition would alleviate concerns among regulators and/or the public regarding campaign finance law, manipulation, and surveillance, it may be worth enacting such a policy. This prohibition, in combination with Know Your Customer laws, may not completely prevent insider trading, but it would give regulators advantages in monitoring and taking action against the practice that they would not necessarily enjoy on unregulated exchanges.

12, 17 Public Interest

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

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

In the 2019 ErisX case, Berkovitz stated that the Commission has interpreted the “public interest” test in the CEA gaming provision as a restoration of the “economic purpose” test that was eliminated in the Commodity Futures Modernization Act of 2000 (CFMA), and that the Commission also has concluded it has “discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest.”³³

From Berkovitz’s statement, we also understand that the gaming component alone is not necessarily contrary to the public interest, as “contracts involving gaming should be permitted to be traded on a DCM if they have an economic purpose”³⁴

We understand the difficulty the Commission may have in selecting additional factors to consider. In his book *Go East, Young Man*, Justice Douglas opined, “I also realized that Congress defaulted when it left it up to an agency to do what the ‘public interest’ indicated should be done. ‘Public interest’ is too vague a standard to be left to free-wheeling administrators. They should be more closely confined to specific ends or goals.”³⁵

More so perhaps, than any other regulatory body, the Commission is well-positioned to undertake a holistic review of what election markets might mean for the public interest. The Commission has received and considered thoughtful public comments on the topic since the early days of the Iowa Electronic Markets and has been at the forefront of managing practical regulatory considerations in these nascent markets.

³³ Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts

³⁴ *Ibid*

³⁵ W. Douglas, *Go East, Young Man*, 216–217 (1974)

Valuable source of insight and aggregation

The proposed contracts serve as a valuable source of insight to the public, even if they do not participate in the contracts market directly. The arguments are described in the response to question 11 on price basing.

Social consensus building mechanism

The Commission should consider the divided nature of American politics today. Individuals and groups with poor prediction records and limited accountability are contributing to a status quo in which millions of Americans operate on different sets of facts, consume “fake news”, and live in different bubbles.

Institutions and modalities that Americans have traditionally been trusted to forecast elections such as experts and polls have seen drops in confidence in recent years. We urge the Commission to consider recent research demonstrating that political prediction markets in recent elections have outperformed polls, widely-covered election models based on polling aggregation, and pundit forecasts.³⁶

Election contracts can help build social consensus in three ways.

First, the market price can create at least a semblance of a reality that all sides recognize is a byproduct of bettors with a financial “skin in the game” and clear incentives for honest contributions. At their best, the market mechanism aggregates more information than what could fit in the working memory of any one individual. They form a natural waterline which can be taken as a readout of what market participants think about a certain topic.

Second, as discussed in the sections on election integrity, efficient prediction markets help drive consensus because they are more transparent and less likely to be manipulated than public opinion polls. Insights from prediction markets spill over and improve the overall discourse. Third, prediction markets are inherently more engaging than polls and forecasts as they invite active participation from a broad audience. The financial incentives for prediction markets reward knowledge seeking and accurate perceptions rather than partisanship, leading to a more educated population. As pundits choose to trade or not trade on a prediction market they signal to viewers their true degree of conviction.³⁷

³⁶ H. Crane and D. Vinson. (2022). Models vs. Markets: Forecasting the 2020 U.S. election. Researchers.One, <https://researchers.one/articles/20.10.00004>

³⁷ Alex Tabarrok, “A Bet Is a Tax on Bullshit”, *Marginal Revolution*, 2 November 2012, <https://marginalrevolution.com/marginalrevolution/2012/11/a-bet-is-a-tax-on-bullshit.html>

Build forecasting and decision-making infrastructure

The political event contracts proposed by Kalshi benefit the forecasting community by training and identifying forecasters. Forecasters in the Rethink Priorities community participate in and monitor trends in prediction markets to calibrate their long term forecasting skills. Success in prediction markets also creates a demonstrable track record that distinguishes forecasters, making them coveted candidates for recruitment and partnerships.

Forecasting researcher Nuño Sempere described the value of prediction markets as a way to incentivize forecasters. Relative to other platforms, prediction markets provide forecasters with a strong monetary incentive to make good judgments and are much more scalable. For example, a good forecast on a complex topic might take tens to hundreds of hours of research, which may only be enabled by the rewards available in prediction markets. Outside of prediction markets, the average forecaster is comparatively poorly compensated and the current supply of known-to-be-good forecasters is limited. For example, the Good Judgment Project pays \$50-100 an hour, and the process of attaining Superforecaster™ status is onerous—an aspiring forecaster must first do a year of free predictions. Assuming high liquidity, efficient prediction markets, forecasters are better paid and are incentivized to provide their insights as a public good.

Finally, because prediction markets serve as a platform and a source of sustained interest for predictions, markets can be created quickly in response to new events, attract forecaster interest, and disseminate insights to the public. An example is pandemic.metaculus.com which drew upon the existing forecasting community at metaculus.com to respond to the need for COVID forecasting.

Academic and research value

Election markets generate unique data that can produce cutting-edge academic research and serve as a pedagogical tool to encourage new methods of education and political engagement. Data made available through PredictIt is a case in point.³⁸ We encourage the CFTC to establish a regulatory regime that allows, to the maximum extent, academics to use election market data for research purposes. We believe that Kalshi would be more amenable to making its data available than the offshore books that will benefit from a Commission decision to deny Kalshi's contracts.

An example of prediction market and research partnerships is Manifold Markets' partnership with the Center for the Study of Partisanship and Ideology and the Salem Center of the University of Texas at Austin to identify top forecasters on economic, social, and political issues.

As a meta point, we view prediction markets as a new technology with public interest benefits that have yet to be fully realized or even discovered. We believe a bet on prediction markets is a

³⁸ Lukas Berg & John Chambers (2019) Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement, *Journal of Political Science Education*, 15:1, 2-16, DOI: 10.1080/15512169.2018.1446342

bet on the future with considerable upside. Prediction markets have significant potential to blossom into trusted forecasting and consensus building instruments with benefits that are not apparent at their current level of maturity and adoption.

For example, prediction markets may be used directly for decision making. Robin Hanson developed a proposal for governance called futarchy, where prediction markets are used for estimating the net benefit of strategic decisions, then the decision that leads to the highest welfare is chosen.³⁹ Prediction markets are already used by the rationalist community to make decisions today. An example is the partnership between Manifold Markets and Clearer Thinking Regrants, where forecasters help regrants decide which projects to fund.⁴⁰

By approving Kalshi's request, the Commission would be advancing its mandate of promoting responsible innovation by giving markets the space to experiment with election contracts as a hedging, price basing, forecasting, social consensus building and decision making instrument.

Injunctions against gaming do not apply to the proposed contracts

We believe the classic ethical, moral and religious injunctions against gaming are relatively inapplicable to the proposed contracts.

A common moral argument against gaming is that gaming is not constructive, is zero sum, and gives dishonest rewards. As discussed above, election markets are constructive, positive sum, and reward honest effort and skill, and on those merits do not meet the moral injunctions against gaming.

Another moral argument is that gambling is predatory and exploits human weakness. With classical gambling, there is an immediacy and instant gratification that leads to addiction. However, the proposed markets diminish the instant gratification component by focusing efforts on long term predictions leading to election day, thereby reducing the potential for addiction.

Political prediction markets in the UK tell an encouraging story on the relation between problem gambling and election markets. Sites such as Smarkets offer election lines and devote resources to marketing them even though they are nowhere near as profitable as contracts in sports and other areas. At the same time, they do not offer products such as casino games. Driven by a combination of reputational risk and company values, they have concluded that they have a long-term interest in contributing to the public interest, aggressively self-regulating to stay within the limits of gaming laws, and deterring problem gamblers from damaging their brands.

³⁹ Hanson, Robin. "Shall we vote on values, but bet on beliefs?." *Journal of Political Philosophy* 21, no. 2 (2013): 151-178.

⁴⁰ <https://manifold.markets/group/clearer-thinking-regrants>

We believe that the economic purpose and broad public interest benefits of the proposed contracts outweigh concerns related to problem gambling. At the same time, we recommend properly structuring prediction markets to reduce potential predatory and exploitative behavior.

First Amendment

Restrictions on political prediction markets may violate the First Amendment. When traders bet on parties and candidates, they are engaging in an expression of political and commercial speech. In a recent podcast episode on “new frontiers in the First Amendment”, Nico Perrino, Vice President of the Foundation for Individual Rights and Expression, raises the possibility that because political prediction markets “create information benefits for the public”, regulations on these markets would deny Americans access to potentially truthful political information and would therefore violate the First Amendment. Renowned First Amendment scholar at UCLA law school Eugene Volock responded by acknowledging that there were “plausible arguments for protection” of speech in these markets.⁴¹

If the Commission fails to allow the proposed contracts, it may invite constitutional challenges that could lead the courts to undermine the Commission’s jurisdiction over the prediction markets space. A ruling to protect the expression inherent in political prediction markets under the First Amendment—contemplated by legal academics well over a decade ago⁴²—would be consistent with the expansion of First Amendment rights by the Supreme Court since the Nadex decision.

⁴¹“Eugene Volokh and new frontiers in the First Amendment”, So to Speak: The Free Speech Podcast, <https://podcasts.apple.com/nz/podcast/eugene-volokh-and-new-frontiers-in-the-first-amendment/id1108027131?i=1000385548198>

⁴² Cherry, Miriam A. and Rogers, Robert L., Prediction Markets and the First Amendment. University of Illinois Law Review, Vol. 2008, No. 3, 2008, Available at SSRN: <https://ssrn.com/abstract=1130644>

Postscript - Transparent, effective and fair regulation

Despite prediction markets' theoretical appeal, lack of regulatory clarity has discouraged new entrants in the market. For example, Manifold Markets, created December 2021, elected to be a play money market due to regulatory uncertainty, as discussed in its Seed Round Memo. Insight Prediction, another promising company in the space, has been stymied in its ability to accept American accounts amid regulatory uncertainty.

We hope that the Commission will generalize its response to the proposed Kalshi contracts as an opportunity to establish a clear, transparent, and simple process that other companies can follow. We agree with Commissioner Pham's opinion that the Commission must apply principles of free competition and fair treatment to similar contract markets. We respectfully disagree with Commissioner Pham's implication that each political event contract submission should be evaluated independently, as that undermines the goal of promoting fair treatment to similar contract markets. We respectfully disagree with Commissioner Pham's implication that engaging in 36 meetings over nearly a year should influence the Commission's decision positively towards Kalshi. Instead, we should have consistent regulation across similar political event contracts, regardless of the number of meetings the party may have had with the Commission.

The Commission may find inspiration in the way the UK has approached the regulation of election contracts. Many of the concerns that animate the Commission's deliberations today weighed on British regulators in the mid-20th century in the context of political betting shops. The UK's thriving election markets, which have enriched British public life without threatening the integrity of the country's institutions, speaks to their potential in the United States.

With transparent regulation, enough prediction markets operating freely will increase the efficiency, usability and public awareness of these platforms, which in turn incentivizes the positive social value their insights can provide.

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September 23, 2022

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

Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

I am writing in support of the Commodity Futures Trading Commission approving Kalshi's proposal for electoral prediction markets.

There are essentially two approaches to predicting the future. One is *model-based*, and relies on sound scientific understanding of the data generating process. The other is *crowd-sourced*, and relies on the aggregation of decentralized information and beliefs.

The first approach works well for predicting regularly occurring events that are well understood, such as solar eclipses. But it is much less useful for predicting rare events that have a complex set of determinants, such as global pandemics or financial crises.¹ For example, different research teams have produced widely varying forecasts of Covid-19 cases over the past two years, and even ensemble forecasts that average these predictions "have not reliably predicted rapid changes in the trends of reported cases, hospitalizations, and deaths" over time.² In this latter set of cases, decentralized approaches to forecasting that harness the wisdom of crowds can provide useful information.

Electoral outcomes lie somewhere between these two extremes. They arise with regularity, so that forecasting models can be developed and estimated.³ But they also depend on idiosyncratic factors that are unique to each cycle, such as candidate quality or recent court decisions. Ever since the launch of the pioneering Iowa Electronic Markets in 1998 (operating

¹ Danielle Allen, Rajiv Sethi, and Glen Weyl, "Prediction and policy in a complex system." *Transmission T-007*, Santa Fe Institute, 2021.

² Centers for Disease Control and Prevention, *Covid-19 Forecasts: Cases*, March 13, 2022.

³ Merlin Heidemanns, Andrew Gelman, and G. Elliott Morris, "An updated dynamic Bayesian forecasting model for the US presidential election." *Harvard Data Science Review*, 2020.

under a no-action letter by the CFTC), prediction markets have been part of the forecasting landscape for elections. The forecasting performance of such markets has matched that of poll aggregates, and is competitive with the best available models.⁴

Prediction market contracts are extremely simple—they have binary payoffs with a fixed resolution date. In addition, the set of traders is relatively stable over short periods of time, and activity is sufficiently frequent to allow researchers to identify trading strategies. As long as the (suitably anonymized) trading data is made available these markets can serve as experimental laboratories that help us understand precisely how information comes to be absorbed by financial market prices.⁵

Electoral prediction markets reference positive feedback events—beliefs about the success of a campaign can affect the actual probability of success by influencing donations, volunteer effort, turnout, and other factors. Campaigns routinely try to manage these beliefs, for example by selectively disclosing internal polls. Prediction market data can help uncover this process of attempted belief manipulation. For instance, in the process of examining trading strategies using prediction market data, David Rothschild and I found that a single trader had placed a sequence of several thousand orders over the course of two years leading up to the 2012 election, with non-negligible price effects, a finding that was covered by several media sources.⁶

We are living in an age that is characterized by both ideological and affective polarization—people in different political camps don't just disagree on issues, they despise each other and rarely communicate.⁷ Some of this can be attributed to online echo chambers and filter bubbles, although more traditional media such as cable television are also implicated.⁸ Under these conditions, prediction markets play an interesting role. They are among the very few online forums that create strong incentives for people who disagree fundamentally about statements of fact to interact with each other. A prediction market in which only one perspective is represented with attract people who disagree, since they will consider contracts to be mispriced and will see

⁴ Joyce Berg et al. "Results from a dozen years of election futures markets research." *Handbook of Experimental Economics Results*, 2008; Rajiv Sethi et al. "Models, Markets, and Prediction Performance." Available at SSRN: <https://ssrn.com/abstract=3767544>, 2022.

⁵ David Rothschild and Rajiv Sethi. "Trading strategies and market microstructure: Evidence from a prediction market." *Journal of Prediction Markets*, 2016.

⁶ Neil King, "One Big Trader Lost Millions Betting on Romney, Study Finds," *Wall Street Journal*, 2013; Lucy McCalmont, "Study: Bettor lost \$4M on Romney," *Politico*, 2013; Abby Ohlheiser, "Why One Trader May Have Bet Millions on a Romney," *The Atlantic*, 2013.

⁷ Iyengar, Shanto, and Sean J. Westwood. "Fear and loathing across party lines: New evidence on group polarization." *American Journal of Political Science*, 2015.

⁸ Flaxman, Seth, Sharad Goel, and Justin M. Rao. "Filter bubbles, echo chambers, and online news consumption." *Public Opinion Quarterly*, 2016; Boxell, Levi, Matthew Gentzkow, and Jesse M. Shapiro. "Greater Internet use is not associated with faster growth in political polarization among US demographic groups." *Proceedings of the National Academy of Sciences*, 2017.

a profitable trading opportunity.⁹ And trading losses can cause even the most stubborn individuals to reconsider their beliefs.

In order to leverage the power of prediction markets, however, the CFTC should allow for a large range of contracts, including those that reference individual races and not just national outcomes such as congressional control. This will allow people with very specific local knowledge to transmit their beliefs, even if they don't understand the broader implications of what they know. In addition, it is important to have competition—multiple exchanges that offer similar contracts so that fees can be kept low and the implications of differences in market design can be investigated.

Thank you for the opportunity to comment.

Sincerely,



Rajiv Sethi
Professor of Economics
Barnard College, Columbia University
& External Professor, Santa Fe Institute

⁹ Rajiv Sethi, "Prediction Markets in a Polarized Society." Imperfect Information, 2020.

From: Oprea Ryan
Organization(s):
University of California, Santa Barbara
Comment No: 69739
Date: 9/22/2022

Comment Text:

My name is Ryan Oprea. I am the Maxwell C. and Mary Pellish Chair of Economics and the Director of the Laboratory for the Integration of Theory and Experiments at the University of California, Santa Barbara. I have published research on prediction markets and, in particular, on the manipulation of prediction markets. In my view, election prediction markets fundamentally serve the public interest by facilitating price discovery, improving social and economic decision-making and providing a rich source of important data to scientists. I am confident that they should be legalized in the United States and, indeed, encouraged.

MANIPULATION

In question 15, the CFTC asks about the risk of manipulation. They write,

"Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements? For example, could candidate campaign committees or political action committees manipulate the contracts by trading on internal, non-public polling data?"

I have published several pieces of research on the manipulation of prediction markets and so I may be able to help provide some useful perspective. It is first worth distinguishing between roughly three different kinds of market manipulation: (i) misinformation-price manipulation, (ii) momentum-price manipulation, and (iii) pure outcome manipulation.

In "misinformation-price manipulation," a trader first buys a position in the market, artificially raises the price through unethical means, and then exits that position for a profit. For instance, a manipulator might publish a fake Georgia Senate poll to raise the odds that the Democrats win the Senate, before exiting the market.

In my view, the likelihood of this kind of manipulation occurring is extremely remote. First, it is extremely difficult to reliably manipulate public opinion: the

market is already flooded with polls, statistical models, consultant reports and other coverage of elections and it is unlikely that a trader could shift public opinion enough to make a meaningful difference in a prediction market price. Traders in these markets have strong incentives to respond only to high quality information because they have money on the line. The quantity of existing high-quality information makes it extremely unlikely that a manipulator would be successful at convincing traders that an unvetted poll or piece of data is credible enough to trade on.

What's more, this concern is in no way special to prediction markets. The same strategy could be easily executed in any other already existing futures market (e.g. publishing an erroneous report about crop yields) and is equally unlikely to succeed for the same reasons. And if a manipulator wanted to manipulate specifically public opinions about an election outcome, they could make far more money trading on in traditional markets: bonds, currencies, commodities, and the stock market all respond to beliefs about election outcomes too. The manipulator would make far greater returns trading in such traditional markets than on a prediction market (like this one) with position limits of only \$25,000. On this basis, I conclude that this election market almost certainly produces no additional manipulation risk relative to those produced by already existing markets.

The second form of manipulation is "momentum-price manipulation" in which a trader takes a large position in the market to increase the price of a candidate, hoping to induce other traders to join them and move the price higher still. By exiting this cascade before it breaks, the manipulator can earn money on the momentum (a variation on a "pump and dump" scheme). If this price is publicized it may generate positive press for that candidate, influencing opinions. The latter concern is not possible for a Congressional control market like the one proposed, where the market is not on individual candidates. But nevertheless, it is useful to examine whether or not this kind of manipulation is likely to be effective even when possible. Many economists and political scientists have studied this question. As I wrote in a paper ("A Manipulator Can Aid Prediction Market Accuracy," *Economica*, 2009) that I co-authored with George Mason's Robin Hanson,

"Many others, however, have reported failed attempts to manipulate prices with trades, historically (Strumpf and Rhode 2004), in the field (Camerer 1998) and in the laboratory (Hanson et al. 2006; Oprea et al. 2007). A recent review article concludes that, 'none of these attempts at manipulation had much of a

discernible effect on prices, except during a short transition phase' (Wolfers and Zitzewitz 2004)."

In our own paper, we sought to understand why this kind of manipulation is so difficult. We argued that such attempted manipulation is likely to increase price accuracy, by increasing returns to being an informed trader. In particular, we show that a momentum manipulator functions as a kind of "noise trader" whom a smart, informed trader can profit by trading heavily against. As a result, even if such manipulation were to be attempted, it would likely incentivize sophisticated traders to enter the market and incentivize other traders to become more informed. As we write, "[B]y inducing more traders to become better informed, an increase in noise trading indirectly improves the accuracy of market prices (Kyle 1989; Spiegel and Subrahmanyam 1992). If the presence of manipulative traders similarly induced more effort by informed traders, this could help explain the typical failure of manipulation attempts." In additional joint work with Robin Hanson and David Porter ("Information Aggregation and Manipulation in an Experimental Market," *Journal of Economic Behavior and Organization*, 2006) we directly show that even when we pay participants directly to attempt to manipulate prediction markets, they are unsuccessful at doing so. The reason? Other traders get wind of the attempts and trade in such a way as to counteract the manipulation efforts. There are thus good theoretical and empirical reasons to believe this type of manipulation would be ineffective.

The third form of manipulation is pure outcome manipulation. In this scenario, a bad faith actor attempts to directly sway the election itself in order to make a profit off of the prediction market. There are many reasons to believe this fear is outlandish and should not be treated as a serious objection to the market being listed. First, billions of dollars are spent every cycle on elections (2020 saw over \$14 billion spent). Influencing and changing someone's vote is an incredibly expensive affair. Many donors individually spend more than nine figures each to even try to move the odds of their preferred party winning by a percentage point or two. The notion that anyone would attempt to manipulate the election in order to earn less than \$25,000 (the limit on this market), let alone do so successfully, strikes me as extremely far-fetched. Second, people already have large financial stakes in elections, sometimes many orders of magnitude more than the \$25,000 limits. These markets do not uniquely give people an economic stake in elections – the stake they give is in fact quite small. Third, if someone truly wanted to manipulate our elections for financial gain, they could (again) easily make far more money using traditional commodity, equity and bond markets.

In conclusion, the CFTC should not use fears about manipulation as a reason to prohibit this market from being listed. These markets simply do not create significant new incentives or means to manipulate election outcomes or the markets predicting them.

This response also answers two other questions that the CFTC posed, specifically questions 13 and 14. As far as I can tell, there is no way these kinds of markets can be used to sidestep campaign finance laws and I am deeply confused about where this concern comes from. Prediction markets provide no means by which traders can communicate with a candidate. The money from a position taken for a candidate does not go to the candidate him or herself. The proposed market also relates to overall Congressional control, not to individual candidates making these objections completely irrelevant. This also answers the question regarding the integrity or perceived integrity of the election. It is worth remembering that Britain has had markets on elections for decades without any resulting questions about election integrity.

PRICING

The CFTC asks in question 11 the following question:

"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?"

The weight of the academic literature suggests the answer to this question is yes, and it is not difficult to see why. Suppose someone is attempting to price the stock of a solar power company on January 2, 2021, the day before the Georgia runoff elections would decide the partisan composition of the Senate. If the Democrats win, the odds of a major green energy bill are certainly higher than the counterfactual where one Republican wins (giving the Republicans 51 votes). Suppose the stock is worth \$10 if both Democrats win, and \$9 otherwise. The actual price you are willing to pay for the stock is thus \$9 + the probability that both Democrats win office. If Democrats have a 50% chance of sweeping, then the fair price you would be willing to pay is \$9.50. If the probability is 25%, that fair price is \$9.25. This simple example illustrates the key intuition: insofar as the government has clear impacts on specific firms through its policy choices, the fair price for equities of those firms should depend on the probability of one party or another gaining control.

The price on the prediction market/event contract becomes a means by which one can price those financial assets accurately. It is not sufficient to use polls alone, as those are slow to react to major developments and have been shown to be less accurate than prediction market prices in many studies. Adding a prediction market would thus facilitate more accurate price discovery, and represents a clear public interest that the CFTC should be eager to promote.

PUBLIC INTEREST

The CFTC asks whether or not these markets promote the public interest. I think the clear answer is “yes.” Let me highlight three clear public interest benefits.

First, I would argue that the improvements in pricing (just discussed) directly promote the public interest. Making market prices more accurate has wide-ranging benefits to the public at large, preventing resources from being wasted and channeled to wasted use and producing more accurate information on the economy to its participants.

Second, and more generally, these types of predictions markets are likely to improve decision-making across society. Prediction markets produce valuable, public information that is highly relevant to the choices people make both in the economy and beyond. A company trying to decide whether or not to build a new factory, for instance, benefits by knowing whether the tax breaks they are relying on to build that factory will persist into the future. And since there are clear partisan differences on many important policy issues, knowing who will control Congress in the next two years is extremely valuable in forming these kinds of forecasts and making good decisions in the face of them. This illustrates one of the key benefits of markets: the information their prices produce do not benefit only those who trade in them. Every person in America whose decisions depend in part on who controls government can use these probabilities to make better decisions in advance.

Third, the prices from prediction markets are extremely valuable for researchers trying to understand how public beliefs evolve, what they respond to and how those beliefs influence major decisions. In the last decade or so, important research has demonstrated how useful prediction markets can be as a way of measuring these beliefs in a fine-grained way. Markets on political outcomes are especially valuable for this kind of academic research. To give one example, my colleague at UCSB, Kyle Meng used prediction market prices (from Intrade) for on the likelihood of a major piece of climate legislation passing to answer some

fundamental questions about the abatement costs of climate change policy. This important and influential research (“Using a Free Permit Rule to Forecast the Marginal Abatement Cost of Proposed Climate Policy,” American Economic Review, 2017) used these prediction market prices to infer market beliefs and thereby to back out accurate measurements of abatement costs. This kind of important research – with direct relevance to climate policy -- would have been impossible without a then-running political prediction market. Other research has followed similar strategies but their continuation depend crucially on the CFTC allowing these kinds of markets to operate. I view this as a major public interest benefit of these types of markets.

CONCLUSION

These markets serve the public interest by promoting accurate price discovery, improving decision-making and providing valuable data to academic researchers on important policy topics. Concerns about manipulation—either of the market, or of the election— are poorly founded and do not form a reasonable basis for rejection. In my view, the Commission should clearly allow these prediction markets to legally operate in the United States.

We are academic researchers who study prediction markets for both the value they provide in understanding the real-world events that they predict, and what they teach us about market design and usage that is widely applicable to numerous fields. We are writing in favor of allowing Kalshi (or any similar entity) to offer a broad range of political and policy event futures, including the election outcomes they are currently proposing.

Prediction markets work because they ask the right questions of the right people, who are properly incentivized both to answer them honestly and come back and update their positions when new information becomes available to them. Statistical models work very well in situations where there is high repetition along with stable and available data (for example: frequently companies can predict daily sales numbers in stable industries very well from historical sales data), but are untenable if the outcome or necessary data is idiosyncratic (for example: predicting the sales for one day at random pop-up stores or creating predictions of sales when the sales data is captured differently by store). Polling works very well at getting a snapshot of the people available to answer a given poll, but it is not a prediction of what will happen in a larger target population (for example: a poll cannot take into account unreachable populations or expected changes between now and the outcome of the event). Further, while polling was relatively stable for decades from the 1950's to 1990's, dramatic shifts in how pollsters try to reach people due to shifting technology, lower response rates, and increasing correlation with non-response and outcomes of interest have raised additional concerns about the quality and consistency of polling in recent years. Prediction markets take advantage of both models and input data like polling, but they also motivate experts to aggregate that available information along with dispersed information, and intuition about how idiosyncratic information will affect outcomes as the events unfold. And, by aggregating many independent experts together, using their marginal willingness to pay to help weigh them, prediction markets do a great job in making predictions in idiosyncratic situations, such as found in political and policy events.

Authors of this letter have written extensively in the academic and popular press about prediction markets.¹ We have documented how prediction markets-based predictions outperform other key predictions in: accuracy, latency, and time-granularity.² As a result, market-based predictions are uniquely impactful in event studies, such as politics and policy. Further, prediction markets are nimble and transparent, culminating with a pricing event, making them particularly attractive for research on how market design affects trading on various conditions.³ These learnings help improve the efficiency of a wide range of markets.

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

¹ Authors of this letter are author(s) on all of the papers referenced, which represent a small percentage of their body of work on the prediction markets.

² See research examples: Rothschild (2009), Rothschild (2015), Crane (2019), Crane and Vinson (2022), Strumpf and Rhode (2004).

³ See research examples: Rothschild and Pennock (2014), Rothschild and Sethi (2016), Schmitz and Rothschild (2019)

could price that risk, and, if they were allowed to flourish, could eventually grow to provide hedges where uncertainty is particularly acute.

Concerns that these types of markets could cause manipulations in the outcome, or be manipulated, are misplaced. First, the market caps are many magnitudes smaller than the amount of money influenced by these political and policy events: stakeholders with the ability to affect events will not be incentivized by the relatively small amount of money they could make investing against their public interests. Second, manipulating prediction market prices has proved to be very hard, transparent, and relatively short lived.⁴ With a transparent order book it is very easy to see if someone is attempting to manipulate a market, immediately mitigating the impact of any short-lived price manipulation. Thus, manipulations have had little impact on the derived underlying probability of the event, by those who follow the prices.

Signed,

Harry Crane, Professor, Department of Statistics, Rutgers University

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David Rothschild, Economist, Microsoft Research, and Fellow, CSS Lab, University of Pennsylvania

Koleman Strumpf, Burchfield Presidential Chair of Political Economy, Department of Economics, Wake Forest University

⁴ See research example: Strumpf and Rhode (2008)

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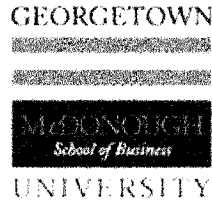
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September 22, 2022

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

Re: Industry Filing 22-002: KalshiEX request for approval of political futures contracts

Dear CFTC:

In summary:

- The KalshiEX contracts are in the public interest and should be approved without delay.
- The current CFTC should have the courage to correct the decade old Nadex mistake from a previous set of commissioners and approve these contracts.
- Elections have economic consequences. The contracts can be used by those exposed to energy and tax policy to hedge.

¹ All opinions are strictly my own and do not necessarily represent those of Georgetown University, FINRA, or anyone else. I am the Academic Director for the FINRA Certified Regulatory and Compliance Professional (CRCP®) program at Georgetown. Over the years I have served as a Visiting Academic Fellow at the NASD (later part of FINRA), served on the boards of the EDGX and EDGA stock exchanges, served as Chair of the Nasdaq Economic Advisory Board, and performed consulting work for brokerage firms, stock exchanges, market makers, issuers, and law firms. I've also visited over 80 stock and derivative exchanges around the world. As a finance professor, I practice what I preach in terms of diversification and own modest and well-diversified holdings in most public companies, including brokers, asset managers, market makers, and exchanges.

- The contracts serve a public purpose of information production and are likely to be better than polls.
- The contracts pose no risk of undermining election integrity.
- The long-standing existence of academic prediction markets with zero criminal sanctions is a *de facto* demonstration that such markets are legal.
- Even if one could construe this as gaming, The CFTC should use its exemptive authority to approve the contracts because they are in the public interest.
- The CFTC should approve these contracts immediately and not wait until October.

Background

Many years ago, a previous set of CFTC commissioners incorrectly said NO to a Nadex request to trade election futures contracts on the grounds that such contracts were gaming and thus illegal.² Now Kalshi is seeking to trade contracts that would allow users to speculate on or hedge on the results of elections. The CFTC is requesting comment on various questions related to these contracts, mostly related to whether or not the proposed contracts are related to gaming.³

The Supreme Court is not hung up on *stare decisis* and the CFTC should not be either.

As the recent overturning of *Roe v Wade* indicates, the Supreme Court is willing to overturn precedents when a majority of the justices feel a mistake has been made. Today's commissioners of the CFTC should also have the courage to undo the previous mistake that was made in denying election-based contracts. Yes, the doctrine of *stare decisis* does provide important predictability and stability in law and rulemaking. However, with a decade of additional consideration, it is now clearer that it is in the public interest to allow these contracts to exist. The current CFTC commissioners should not feel bound by an incorrect precedent made by a previous generation of commissioners.

Elections have consequences, and election contracts can provide a means to hedge them.

We live in a politically polarized world. The two major parties have very different policy objectives. Election outcomes can have a huge impact on the economic success or failure of an enterprise. For example, one party wants to promote clean energy and the other party wants to promote carbon-based fuels. Those with exposure to fossil fuels or to green energy companies might want to hedge their exposure with the proposed contracts. The different parties also have very different ideas on tax policy, and once again individuals and corporations might want to hedge with these contracts. It is in the public interest to provide these hedging tools.

² <https://www.cftc.gov/PressRoom/PressReleases/6224-12>

³ <https://www.cftc.gov/filings/documents/2022/orgkexppublicquestions220829.pdf>

It remains to be seen how much liquidity these contracts will have, which will affect their fitness of purpose for hedging. Even if the contracts are not big enough for Exxon to use for hedging, they will still have serious utility for smaller investors. The CFTC should let it up to the DCMs to design and self-certify the contracts, and restrain from the urge to micromanage contract design. The DCMs have the incentive to get it right, and the CFTC should allow them to experiment in each election cycle.

Better information about likely election outcomes is in the public interest.

It is no secret that public opinion polls have become less trusted in recent years as people are less likely to answer the phone.⁴ Nevertheless, there is a large hunger for information about what voters are likely to do. Better information can help candidates and parties better allocate their campaign resources. Better information can also help voters make voting and donating decisions. Better information can allow the media to make more informed decisions about how to cover candidates. For example, access to the platform of a political debate has been based on poll numbers.⁵

With better information from prediction markets, better decisions can be made. The information that an election is close can increase voter interest and turnout, thus increasing voter engagement in the election process. Similarly, the real-time nature of prediction markets can give voters and candidates nearly instant information about the impact of various events on a campaign. Such an improvement in information is in the public interest.

Markets can do a better job than pollsters because of their inherent financial incentives.

Potential voters have no incentive to answer a call from a pollster or even tell the truth about their voting intentions. This adds a large amount of uncertainty to poll results. Markets, on the other hand, provide a strong financial incentive for people to put their money where their information is. Profit-driven players will use all of the information at their disposal to make good trading decisions, and this allows markets to aggregate all of the information that is available. This means that election markets are likely to provide more accurate forecasts than polls.

Better information can improve election integrity.

Conspiracy theories often fly when election results differ from pre-election polls. Voters rightly ask “How did my candidate lose when they were leading in the polls?” With better forecasts of likely outcomes, voters are more likely to accept the final election results. As the election markets aggregate all

⁴ See <https://www.scientificamerican.com/article/why-polls-were-mostly-wrong/>.

⁵ See <https://www.debates.org/about-cpd/overview/>.

of the available information, they are likely to provide more accurate forecasts of the final results and thus help to assure voters of the integrity of the election process.

There is no financial incentive to manipulate a regulated prediction market to change the election outcome.

One concern is whether bad actors might attempt to manipulate a prediction market in order to create “momentum” for their candidate and influence the election. That would be a stupid thing for anyone to do, given the highly regulated nature of CFTC-regulated exchanges. The existence of a high-quality audit trail makes it very easy to identify any such manipulation. It would be far more cost effective for a manipulator to hire an army of social media bots than to attempt to manipulate an election via a prediction market.

The longstanding existence of various election prediction markets is *de facto* evidence that such markets are not illegal gaming.

Prediction markets have existed for many years that harness market forces to predict election outcomes. For example, the Iowa Electronic Markets have been in operation for over 30 years.⁶ The long-standing operation of such election prediction markets is strong evidence that election-based prediction markets are not illegal under state or federal law.

Elections are not chance events.

Gambling typically involves some outcome that is essentially random, and upon which the rules of probability apply. Examples include the spin of a roulette wheel, the roll of dice, or the drawing of a card from a well-shuffled deck. Such random activities provide little, if any, economic benefit beyond entertainment. Due to the damage that compulsive gamblers do to themselves and others, gambling is highly restricted or regulated in most jurisdictions.

Elections, on the other hand, are not based on random draws.⁷ They are the bedrock of our political process and have an important economic purpose. Elections select the leaders who will be making the important policy decisions that affect the economy.

⁶ See <https://iemweb.biz.uiowa.edu/>. Another example is predictit.org.

⁷ One exception is in the extremely rare case of a tie. In some jurisdictions, a random process can be used to break the tie. For an example, see <https://www.wglt.org/news/2021-04-26/hats-off-to-new-danvers-trustee-after-election-tiebreaker>

Uncertainty is not the same as gambling.

The outcomes of political elections, like future weather patterns, future crop prices, and future metal prices, are highly uncertain. The mere fact that an outcome is uncertain does not mean that an economic transaction tied to that uncertain outcome is illegal gaming. If that were the case, then all futures contracts would be connected to gaming and hence illegal.

Even if these contracts could be construed as gaming, the CFTC should use its exemptive authority to approve these contracts as in the public interest.

While these contracts are certainly not the type of gaming Congress envisioned in writing the prohibition in section §5c(c)(5)(C) of the CEA, one can see how some might think so. Fortunately, Congress has given the CFTC pretty broad exemptive authority to act in the public interest.⁸ It is highly unlikely that a serious court challenge would occur if the CFTC approves these contracts. It is in the public interest to approve these contracts, and the CFTC should do so without delay. Given the rapidly approaching elections, the CFTC should approve the contracts immediately and not wait until October.

Respectfully submitted,

James J. Angel, Ph.D., CFP®, CFA
Georgetown University

⁸ See 17 CFR § 140.99 - Requests for exemptive, no-action and interpretative letters.

Comment No. 72467

Christopher Greenwood, N/A

2023 Contract

From: Adam Ozimek

Comment No: 69731

Organization(s):

Date: 9/22/2022

Comment Text:

I would like to submit a brief comment in support of allowing KalshiEX to provide contracts on which political party will be in control of congress, as well as more broadly in support of allowing political outcomes to be on their platform.

In support I am submitting a paper I have written on the value to society and the economy of allowing political betting markets. In this, I provide an overview of how we learn from prediction markets, the benefits they generate, their advantages compared to other forecasts.

In particular, I would point to the following sections, however the entire paper is of relevance.

- 2.1. The Informational Value of Prediction Markets
- 2.2. Prediction Markets' Successful Record of Forecasting
- 2.3. The Advantages of Prediction Markets
- 2.4. Criticisms and Opponents of Prediction Markets

Thank you for your consideration,

Adam Ozimek

ROA0001484

No. 14-07
MARCH 2014

WORKING PAPER

THE REGULATION AND VALUE OF PREDICTION MARKETS

by Adam Ozimek



The opinions expressed in this Working Paper are the author's and do not represent official positions of the Mercatus Center or George Mason University.

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Abstract

Prediction markets are important information-aggregation tools for researchers, businesses, individuals, and governments. This paper provides an overview of why prediction markets matter, how they are regulated, and how the regulation can be improved. The value of prediction markets is illustrated with discussions of their forecasting ability and the characteristics these markets possess which give them advantages over other means of forecasting and information aggregation. The past, current, and future regulatory environment is surveyed.

JEL codes: D7, D8, C53, K2, G14, G13

Keywords: prediction markets, regulation, futures markets, forecasting

The Regulation and Value of Prediction Markets

Adam Ozimek

Prediction markets are exchanges where individuals trade what are sometimes called “event contracts.” Broadly speaking, these contracts specify some future event with different possible outcomes, define a payment structure based on those outcomes, and state a date when the contract expires. An example would be a contract that specifies “Barack Obama wins the US presidential election in 2012” and that pays out \$10 after the election if that outcome occurs or \$0 if it does not occur. The direct purpose of such markets is to allow individuals to bet on uncertain future events; however, these markets also produce prices that can provide valuable information. In fact, these markets are sometimes specifically created to gather the information that their prices reveal, rather than for the utility of trading to market participants.

Prediction market prices have informational value because they aggregate the beliefs of market participants and reveal what the market overall forecasts are the odds of the event at hand occurring. For example, if the aforementioned contract is selling at a price of \$5.50, it means that the market thinks the odds of Obama getting reelected are 55 percent. In the run-up to the election, the media and anyone interested in a market-based measure of the odds of Obama’s reelection could watch the prevailing prices in this market.

Prediction markets have generated forecasts for a wide variety of purposes beyond elections: who will win the Academy Awards, sales of a particular product, and how bad the flu season will be. This information is useful not only to traders wishing to profit from their forecasting and information-gathering abilities, but to researchers, businesses, governments, and others. Yet, despite the variety of ways that these markets have proven valuable, the regulatory

environment for prediction markets in the United States has been more skeptical than supportive. In particular, the recent blocking of movie box-office and political prediction markets indicates a worsening regulatory environment.

This paper provides an overview of how we learn from prediction markets, the benefits they generate, their advantages compared to other forecasts, and the regulatory environment. It then makes suggestions for regulatory reform.

1. How We Learn from Prediction Markets

1.1. Winner-Take-All Contracts

There are many types of prediction market contracts, each of which reveals different information. The most prominent by far is the “winner-take-all” contract.¹ The example of a contract for President Obama’s reelection represents such a contract. These contracts are similar to what in finance are known as “binary options.” In both, there is some event that will or will not occur. If it occurs, there is a specified payout to the contract holder, and if it does not occur, then the contract holder receives nothing. Other specific examples of these markets include the following:

- magnitude 9.0 earthquake to occur anywhere before midnight ET, Dec. 31, 2012
- successor to Pope Benedict XVI to be from Italy (expires on March 31, 2013)
- Arctic sea ice extent for September 2012 to be less than 4.3 million square kilometers
- any country currently using the euro to announce intention to drop it before midnight ET, Dec. 31, 2012
- Argo to win best picture at the 85th annual Academy Awards

¹ This section will follow the nomenclature defined in Wolfers and Zitzewitz (2004).

- The US debt limit to be raised before midnight ET Dec. 31, 2012
- Higgs boson particle to be observed on/before Dec. 31, 2012²

If any of these events occurred within the stated time limit, the contracts paid out \$10; if the events did not occur, then the contracts paid nothing.

In some markets, whether the event has occurred or not is clear. For example, Argo clearly won best picture at the 85th annual Academy Awards.³ Other contracts require more specificity about what constitutes the event occurring. For example, the contract for the market on whether any country would leave the euro specified the following rules:

The market will be settled using official statements from the EU and Euro-member states, as reported in three independent and reliable media sources.

The market will be settled when an announcement is made—the Euro does not actually have to be dropped as a national currency by the date specified in the contract. For example, if there is an announcement on December 1st 2013 that the Euro will be dropped in June 2014 the market will be settled at \$10.00 on the date of the announcement (December 1st 2013) and not the date the Euro will no longer be used (June 2014).⁴

The contract rules also state that if a country is kicked out of the eurozone, the contract holder receives the payout. The level of detail required in the contract rules depends on the potential for disagreement about what outcome has occurred. As the euro example shows, the details of the contract rule can also significantly affect the information that contract prices reveal. If the rules specified that the euro would have to be dropped by the end of the contract date, or if a country being kicked out of the eurozone did not count, then the information gleaned from this market would be substantially different.

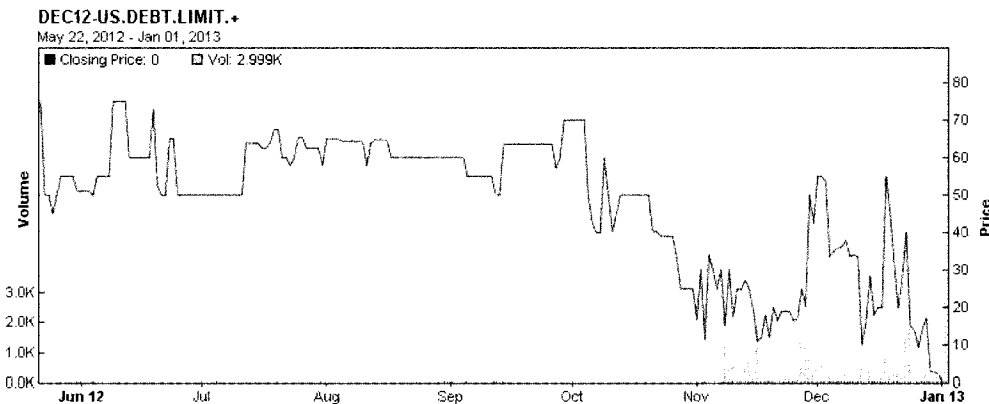
² Each example is an actual expired contract from Intrade.

³ Even for this contract, there is a small chance of uncertainty due to the possibility of a tie, which has occurred six times in the history of the Academy Awards.

⁴ See Intrade, “Any country currently using the Euro to announce intention to drop it before midnight ET 31 Dec 2012,” <http://www.intrade.com/v4/markets/contract/?contractId=713737>.

The main informational value of a prediction market comes from examining its prices. For winner-take-all contracts, given some basic assumptions about the markets,⁵ the price equals the market’s expectation of the probability of the outcome occurring. For a contract paying \$10 if an event occurs, if the current price is \$9, then the market believes the probability of the event occurring is 90 percent. By watching how these prices change over time, participants and observers can see how the market’s aggregate expectation of an event’s probability changes. For example, figure 1 shows the daily closing price for the contract on whether the US debt limit would be raised by the end of 2012. The numbers suggest that the probability the government would raise the debt limit appeared strong from June 2012 until early October, when prices began to decline, likely due to speculation starting in early October that the debt ceiling would not be reached until January 2013.⁶

Figure 1. Daily Closing Price of Intrade Contract: “The US debt limit to be raised before midnight ET 31 Dec 2012”



Source: www.intrade.com.

⁵ The required assumptions are that markets are efficient and that the market performs as a risk-neutral representative trader. While these assumptions may be strong, the observed divergences are likely to be small enough that the conclusions are approximately true. Furthermore, the predictions made under these assumptions perform well. See Snowberg, Wolfers, and Zitzewitz (2012).

⁶ See, for example, Damian Paletta, “U.S. Appears Set to Hit Debt Ceiling in January,” *Washington Wire*, October 15, 2012, <http://blogs.wsj.com/washwire/2012/10/15/u-s-appears-set-hit-debt-ceiling-in-january/>.

In addition to the mean, one can utilize winner-take-all prices to estimate a complete forecast distribution of a variable. For instance, one could have a contract that pays off if the official unemployment rate is between 5.00 percent and 5.25 percent by a certain date, another contract that pays off if the rate is between 5.25 percent and 5.5 percent, another for 5.75 percent to 6.00 percent, and so on. By looking at the prices of each contract, the participants in the prediction market estimate the probability that the value will fall within a particular range, and with enough contracts, we can estimate the full probability distribution of an outcome variable (Wolfers and Zitzewitz 2004).

1.2. Alternative Contract Structures

Other types of prediction market structures include index and spread contracts (Wolfers and Zitzewitz 2004). For index contracts, the amount paid is a function of the level of some outcome variable. For example, the Iowa Electronic Markets are prediction markets that offer vote share contracts that pay out based on a political party's share of the popular vote in the presidential election. If Democrats win 45 percent of the popular vote, then the contract pays out 45 cents to whoever holds contracts for the Democratic share. These prices reveal the market's belief of the variable's expected value, or mean.

Index contracts can also be structured to reveal other market beliefs about the distribution of the measure at hand. For example, an index contract could pay out based on the squared value of the Democratic vote share. This would reveal $E[d^2]$ where d is the Democrats' share of the popular vote. Combining this estimate with a basic index for this variable would allow the estimation of the variance using $Var(d) = E[d^2] - E[d]^2$. Traders may be interested in such markets if, for example, they have beliefs about the market's volatility. These types of markets

would be useful, for example, to firms looking to understand the uncertainty of forecast revenue. If market designers prefer a particular structure like this for informational purposes, but traders have insufficient demand for these types of contracts, then participation subsidies can be used to generate trading.

A third type of contract is a spread, in which the payout and cost are fixed, as say \$2 and \$1. The going price of the contract specifies the minimum value that the outcome must take in order to receive the payout, and varies until there are an equal number of buyers and sellers. This type of bet is common, and it includes point spreads in sports gambling. These contracts allow the discovery of market beliefs of percentiles. For instance, if the payout is \$2 and the cost is \$1, then the prevailing market price will be the median. If the payout is \$4 and the cost is \$3, then the market price will be in the 75th percentile (Wolfers and Zitzewitz 2004).

Other more complex market structures can also be used that allow the recovery of the full joint probability distribution over many variables, meaning that one could measure how the probabilities of two events are related. For example, one might be interested in how the odds of the following two outcomes are related: (1) whether a particular candidate will be elected president and (2) whether GDP will grow by 4 percent or more that year. Measuring the joint probability would tell you the probability of (1) occurring, contingent on particular probabilities of (2), and vice versa. For example, if the candidate is expected to enact economic policies that lead to the specified economic growth rate, and the probability of the candidate being elected is 80 percent, the joint probability might tell you that there is a 60 percent chance that GDP will grow by at least 4 percent, while if the odds of the candidate being elected are 10 percent, the probability of this fast economic growth might be more like 25 percent. These markets work by allowing participants to specify combinations of outcomes and use scoring functions to determine payout (Hanson 2003).

Many other modifications and types of prediction market designs exist. For example, various prediction market modifications have been proposed that would allow interested parties to subsidize participation, and others have been designed to work with “play money” and prizes (Abramowicz 2008). Alternative index structures are useful to consider both because traders may desire different betting structures and because prediction market designers may wish to extract different information.

2. The Benefits of Prediction Markets

2.1. The Informational Value of Prediction Markets

In most cases, the beneficiaries of speculative markets are those seeking to trade in them: firms that wish to sell stock to raise capital, bond traders who wish to buy and sell bonds for profit. For futures and options markets, the closest financial instruments to prediction markets, their hedging value to traders is commonly cited as the primary economic benefit. For example, farmers use futures markets in their crops to hedge against the possibility of lower crop prices in the future, and airlines use futures markets for oil to hedge against the risk of higher fuel prices. While speculative markets have the added benefit of inducing people to gather information and aggregating it into prices, until recently this benefit has not been a primary justification for those markets. For prediction markets, in contrast, the informational value of prices can be the primary benefit rather than the utility to the market participants (Hanson 2008).

Furthermore, even in cases when hedging or speculation is the primary reason that prediction markets exist, the value of the information these markets generate can be substantial. To see how prediction markets can generate positive benefits beyond those accruing to traders, consider the example of historical presidential betting markets.

Markets to bet on the outcomes of future events have existed for a long time, and elections in particular have a long history as the subject of betting markets. As Rhode and Strumpf's (2004) analysis of historical presidential betting markets shows, public and open political betting dates back to George Washington's election, and organized election-betting markets have existed since the 1860s.⁷ These markets became so popular that by the 1900s the amount of money bet in them was at times larger than amount invested in stocks and bonds. In 1916, the \$165 million exchanged in election-betting markets was more than double what was spent on election campaigns that year.

The popularity of these markets meant the current odds reflected the aggregation of a wide and diverse pool of knowledge and information. An added benefit of their popularity was that the current odds were made widely available. From 1896 to 1924, the *New York Times*, *Sun*, and *World* provided price quotes almost daily, giving newspaper readers up-to-date information that was otherwise largely unavailable in an age when polling was scarce and unscientific. With these odds, those interested in the election could catch up quickly on its status using the aggregated beliefs of dispersed market participants to see who had the lead and by how much.

We can see this wider utility of prices in Andrew Carnegie's comments at a press conference after returning from a trip to Scotland in 1904: "From what I see of the betting . . . I do not think that Mr. Roosevelt will need my vote. I am sure of his election."

A similar indication of the high confidence people placed in the market odds as representing accurate forecasts comes from the *New York Times*, which reported that "the Wall Street odds represent the consensus of a large body of extremely impartial opinion that talks with money and approaches Coolidge and Davis as dispassionately as it pronounces judgment on Anaconda and Bethlehem Steel."

⁷ The historical facts and quotes in this section come from Rhode and Strumpf (2004).

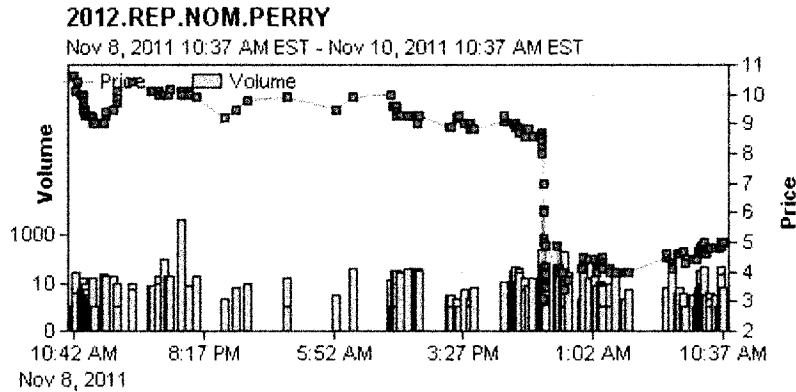
The confidence was well placed: historical presidential betting markets almost always predicted the correct winner, and well in advance of the election, despite the lack of scientific polling to inform the betting (Rhode and Strumpf 2004). In fact, Erikson and Wlezien (2009) find that these markets predicted better in the era before scientific polling (election years 1880–1932) than in the era with scientific polling (1936–2008), and that these early markets performed at least as well as later polling would.⁸

History thus shows that prediction markets are capable of producing valuable information and, as a result, are capable of being closely watched indicators. However, their usefulness is not only a historical artifact. Starting in the early 2000s, political and other prediction markets once again became a popular source of information. Their resurgence in popularity reflects both their good forecasting record and their ability to produce fine-grained data that polls, expert surveys, or other methods of aggregating beliefs cannot replicate.

Consider, for example, a story appearing on the website of the *New York Times* about a gaffe by presidential candidate Rick Perry during the 2012 GOP primary debate. The article showed how the prices on an Intrade contract that paid off if Governor Perry won the GOP nomination changed in the minutes and hours following his gaffe. The results, shown in figure 2, implied that his odds of receiving the nomination fell by around half. The ability to produce objective, up-to-the-minute assessments like this is unique to prediction markets, and thus part of why they are valuable sources of information.

⁸ This result is paradoxical given that scientific polling should have provided betting markets with more information and thus increased their accuracy. However, part of the explanation may be that in the earlier era, betting markets were much thicker. Rhode and Strumpf (2004) report that the peak betting volume in the earlier era was 200 times what is wagered on today's Iowa Electronic Markets.

Figure 2. Change in Price of Intrade Contract for Gov. Rick Perry’s Possible GOP Nomination



Source: www.intrade.com.

The resurgent popularity of prediction markets as informational sources has not been limited to elections. Stories in the *New York Times* in the last few years have cited Intrade prices on a wide range of topics, including whether the Higgs boson particle would be discovered;⁹ whether the Patient Protection and Affordable Care Act (Obamacare) would pass¹⁰—and then whether the Supreme Court would strike down its individual mandate;¹¹ whether LeBron James would sign to play for the New York Knicks;¹² whether Ben Bernanke would be reconfirmed as Fed chair;¹³ whether Treasury Secretary Geithner was going to be fired;¹⁴ and whether Sonia Sotomayor would be confirmed to the Supreme Court.¹⁵ In each of these examples, the author found prediction markets to be the best available source of information for summarizing the odds of the event occurring. The objectivity of prediction markets compared to an individual expert’s subjective, and perhaps politically partisan or

⁹ Dennis Overby, “New Data on Elusive Particle Is Shrouded in Secrecy,” *New York Times*, June 19, 2012.

¹⁰ Paul Krugman, “Health Care Resurrection,” *New York Times*, March 9, 2010.

¹¹ Eduardo Porter, “Self-Interest Meets Mandate,” *New York Times*, June 19, 2012.

¹² J. David Goodman, “King James and Other Small Things,” *New York Times*, July 8, 2010.

¹³ Catherine Rampell, “The Betting on Bernanke,” *New York Times*, January 22, 2010.

¹⁴ Dealbook, “Betting on Geithner’s Exit,” *New York Times*, March 18, 2009.

¹⁵ Kate Phillips, “Grassley to Vote against Sotomayor,” *New York Times*, July 27, 2009.

otherwise biased, assessment makes prediction markets particularly valuable to journalists , for whom the appearance of objectivity is essential.

As Perry’s gaffe showed, the real-time, constantly updating nature of prediction markets means they provide a highly refined measure that polls, expert surveys, and other methods of aggregating beliefs cannot easily replicate. However, this information is not just useful to individuals who want up-to-date information, but also to academics and other researchers. The following examples of academic studies using prediction-market data show the variety of questions these markets can address:

- how Democrat versus Republican presidential victories affect the stock market (Snowberg, Wolfers, and Zitzewitz 2007)
- how a cap-and-trade bill would affect various industries (Meng 2013)
- the impact of health care reform (before such legislation had been enacted) on health care industry stocks (Al-Ississ and Miller 2010)
- whether star actors increase revenue for movies (Elberse 2007)
- how the Iraq War was expected to affect oil prices and the stock market (Wolfers and Zitzewitz 2009)

We can see the optimism for the potential value of prediction -market data to researchers in the paper “How Prediction Markets Can Save Event Studies ,” wherein Snowberg, Wolfers, and Zitzewitz (2012) argue that “by augmenting event studies with prediction markets , other scholars will no doubt come up with creative ways to address many other unanswered questions. ”

Overall, the historical record and modern usage by the media and academics show the usefulness of prediction markets as a source of information. In many instances, individuals

choose prediction markets' probabilities over their next-best informational option, which illustrates that they are economically valuable to nontraders.

2.2. Prediction Markets' Successful Record of Forecasting

An important reason that political prediction markets are useful is that despite the availability of scientific polling, poll aggregators, and a wide variety of forecasts and expert opinions, prediction markets have a track record of successfully forecasting election outcomes. Since 1988, the Iowa Electronic Markets have provided a platform for prediction markets for elections. In addition, in elections from 2006 through 2012, prediction markets on Intrade remained closely watched and much discussed. Again, the focus on these markets' prices as forecasts is well placed: compared to polls, prediction markets are more accurate and have half the forecast error (Snowberg, Wolfers, and Zitzowitz 2012).

While prediction markets undoubtedly outperform individual polls, a variety of sophisticated poll aggregators are now available that remove known biases in polls and therefore raise the question of whether prediction markets add anything to these results. However, in competitions between debiased polls and debiased prediction markets, prediction markets forecast better. Rothschild (2009) compares the forecasting ability of Nate Silver's FiveThirtyEight forecast based on debiased polls to the political prediction markets on Intrade for the 2008 election. While FiveThirtyEight forecast slightly better than raw prediction markets within 30 days of the election and forecast worse before that point, prediction markets corrected for the known long-shot bias forecast better than either at any time period.

Perhaps more important than the head-to-head forecasting ability of prediction markets versus polls or fundamentals is whether the prediction markets provide different information than

the alternatives. If prediction markets are merely aggregating and debiasing polls, then their value is limited given the availability of other poll aggregators. However, forecasts that combine aggregated polls, prediction markets, and fundamental-based forecasts together outperform all three individually (Rothschild 2013). This finding indicates that there is unique information in political prediction markets that improves election forecasts beyond what polling and fundamentals can do.

The forecasting success of political prediction markets is perhaps the most well-known example, but the broad utility of markets as information sources goes far beyond forecasting elections, and the ability of markets to forecast better than alternatives can be found in a variety of places. For example, researchers have shown that orange juice futures markets improve on US National Weather Service forecasts (Roll 1984) and that horse race betting markets outperform professional handicappers (Figlewski 1979).

Prediction markets designed for information revelation in particular, have been successfully utilized to improve forecasts. Prediction markets forecast Google's IPO price better than Google did with its auction mechanisms (Berg, Neuman, and Reitz 2009). In the health field, such markets have provided forecasts of seasonal influenza activity two to four weeks in advance that performed better than historically based forecasts (Polgreen, Nelson, and Neumann 2007) and have accurately forecast the number of dengue fever outbreaks (Franco et al. 2010). Prediction markets tied to macroeconomic indicator data releases also outperformed a survey of professional forecasters. These markets were better able to forecast payrolls, unemployment claims, retail sales, business confidence, and other measures of macroeconomic performance, reducing forecast error by 5 percent on average (Gurkaynak and Wolfers 2006).

We can see the information-revelation benefits of these markets in the examples of firms that have successfully used internal prediction markets for forecasting. Hewlett-Packard used

internal prediction markets to forecast sales of printers and found that the markets outperformed the company's official forecasts (Chen and Plott 2002). HP also reported that prediction markets for the price of computer memory three and six months ahead were 70 percent more accurate than the firm's traditional forecasts.¹⁶ Siemens used an internal prediction market to correctly forecast that a product would not be delivered on time despite the firm's traditional planning tools suggesting otherwise (Ortner 1998). Best Buy has used prediction markets for a wide variety of purposes, including the demand for digital set-top boxes, store opening dates, and whether new services will be introduced on time.¹⁷

While many prediction markets are likely run without public knowledge, known examples of companies that have used prediction markets include Abbott Labs, Arcelor Mittal, Best Buy, Chrysler, Corning, Electronic Arts, Eli Lilly, Frito Lay, General Electric, GE Healthcare, General Mills, Intel, InterContinental Hotels, Masterfoods, Microsoft, Motorola, Nokia, Pfizer, Qualcomm, Swisscomm, and TNT (Cowgill et al. 2009).¹⁸ The extent of these private markets is a good indicator that the information they reveal is valuable.

2.3. The Advantages of Prediction Markets

Prediction markets have a variety of characteristics that give them advantages over other forms of forecasts: (1) they efficiently aggregate a variety of information and beliefs, (2) they create financial incentives for truthful revelations, (3) they provide incentives for gathering relevant information, (4) they incorporate new information quickly, and (5) they are difficult to manipulate.

¹⁶ Steve Lohr, "Betting to Improve the Odds," *New York Times*, April 9, 2008.

¹⁷ *Ibid.*

¹⁸ *Ibid.*

The problem that prediction markets address is that individuals have different sets of information and different beliefs, and therefore arrive at different expectations of the probabilities of uncertain future outcomes. Given this disagreement, what is the best way to aggregate probability beliefs to forecast outcomes? One alternative is to give everyone's beliefs equal weight. Another is to create some rule that provides weights based on past prediction performance. What prediction markets provide is a market-based aggregation of beliefs.

In essence, the prediction market method of aggregation assumes that more weight should be placed on the opinions of individuals who are willing to bet more money on their beliefs. One advantage of this weighting is that individuals are more likely to be truthful about what they believe, and how strongly they believe it, when they have an economic incentive to do so. Experimental evidence has shown that when you ask individuals political questions with factual answers, like whether inflation went up, down, or was unchanged while George W. Bush was president, there is an obvious partisan bias in their answers. However, when individuals are paid for getting the answer correct, this bias diminishes (Bullock et al. 2013). This incentive for truthful revelation is an immediate positive effect of the economic incentives prediction markets provide.

Prediction markets also lead to a positive participant-selection mechanism. Because false beliefs must be paid for in the long run, individuals who continually lose money by making bad predictions will be incentivized to stop participating in the market. Those who make good predictions, in contrast, will be rewarded and have the incentive to continue participating. In essence, the market selects for good predictors rather than presuming that anyone who wishes to make a prediction is equally capable, or designing a centralized system for selecting the best predictors.

In addition, when prediction markets are open to the public and their contracts are widely traded, individuals who may have useful information have an incentive to come forward to trade on that information, thereby revealing it to the market. Rather than requiring an a priori selection of who has the most relevant information, as with polling a panel of experts based on criteria used by the person doing the selecting, prediction markets create an incentive for those with information to come forward and participate. This process is similar to the selection of unbiased predictors, but it brings new information to the market rather than just getting better predictions from existing information.

Prediction markets not only bring new information to markets, they tend to incorporate this information quickly. Snowberg, Wolfers, and Zitzewitz (2012) provide an illustrative example in the death of Osama bin Laden. On May 1, 2011, at 10:25 p.m. ET, Donald Rumsfeld's former chief of staff Keith Urbahn announced the following on Twitter: "So I'm told by a reputable person they have killed Osama Bin Laden. Hot Damn." Intraday prediction markets on bin Laden's death quickly rose, going from 7 percent to 99 percent within 25 minutes. In contrast, the media did not announce the story until 33 minutes after Urbahn's announcement. The point here is not to suggest that prediction markets can or should supplant breaking news services, but that market prices incorporate new information rapidly. For many forecasts, like the probability of outbreaks of deadly disease, the speed at which new information is incorporated is critical.

Finally, prediction markets are useful aggregators because they are difficult to manipulate. There have been some attempts to manipulate these markets, most notably by individuals wishing to generate media attention by suggesting that the chance of a particular candidate winning an election is higher than it is (Snowberg, Wolfers, and Zitzewitz 2012). However, when multiple prediction markets exist, it creates an arbitrage opportunity when

divergences based on manipulation occur. If one market says a candidate's odds are 5 percent and another says they are 10 percent, then this leaves free money on the table for traders. Manipulation attempts will generate profit for other traders and help make markets more accurate (Hanson and Oprea 2009). Indeed, most evidence suggests that attempts at manipulation are unsuccessful and generate little media attention (Snowberg, Wolfers, and Zitzewitz 2012).

Given the success of markets and prices for making use of the “dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess” (Hayek 1945), it is not surprising that they would prove useful in directly aggregating dispersed information, as the empirical evidence presented in this section has shown.

2.4. Criticisms and Opponents of Prediction Markets

Despite the evidence of prediction markets' success, there are several common criticisms that are worth addressing. First is the criticism that prediction markets merely reflect conventional wisdom and that traders do not have any new information. While in many cases it is true that the markets are unlikely to reflect information that is not already widely dispersed, this criticism ignores the value in the objective aggregation of conventional wisdom. The history of the Policy Analysis Market (PAM) provides a particularly important example of how such criticism is misplaced. The United States' Defense Advanced Research Projects Agency (DARPA) created this prediction market, which was to debut in 2003, but it was shut down before it began due to widespread criticism. Nobel Prize winner Joseph Stiglitz brought the “no new information” critique of PAM:

But what was [DARPA's John M. Poindexter] thinking? Did he believe there is widespread information about terrorist activity not currently being either captured or

appropriately analyzed by the “experts” in the FBI and the CIA? Did he believe that the 1,000 people “selected” for the new futures program would have this information? If so, shouldn’t these people be investigated rather than rewarded?¹⁹

However, as Abramowicz (2008) argues, PAM’s goal was not to bring forth private information about terrorism that traders held, but to create an objective aggregation of assessments. As PAM architect Robin Hanson (2007) noted, “Successful intelligence requires not only the collection and interpretation of pieces of information, but also that the information be combined into consensus forecasts and passed up the chain of command.” This kind of consensus forecast may be especially useful in government and business bureaucracies, where group decisions and disagreements might otherwise be adjudicated by deliberation. In contrast to prediction markets, deliberation can be hampered by social sanction for disagreement which can lead to group biases that exaggerate rather than ameliorate individual cognitive biases (Sunstein 2007).

In other contexts, however, the benefit of bringing forth new, relevant information may fail to occur. Moreover, some markets may not generate enough interest to draw a significant pool of traders so that even the belief-aggregation mechanism fails. As Hanson argues, such criticisms are not identifying a market failure, but instead point to an efficient market outcome:

When you offer to pay a certain price for info, an efficient info exchange mechanism will typically induce some supply of that info, but only up to the point where the marginal cost of supplying info reaches the price you have offered to pay. It is no failure of an exchange mechanism when buyers cannot always buy everything they want at as low a price as they want.²⁰

Nevertheless, regardless of whether one calls this a “failure” of prediction markets or an efficient outcome, it remains true that in some contexts prediction markets will not function without subsidies to traders.

¹⁹ Joseph Stiglitz, “Terrorism: There’s No Futures in It,” *Los Angeles Times*, July 31, 2003.

²⁰ Robin Hanson, “Prediction Markets ‘Fail’ to Moo ch,” *Overcoming Bias*, July 19, 2012, <http://www.overcomingbias.com/2012/07/prediction-markets-fail-to-mooch.html>.

A related criticism is that prediction-market forecasts are often incorrect. However, few prediction-market proponents would claim that prediction markets are infallible. Events that prediction markets target are inherently uncertain, and the best that any forecast can do is make the most of the available information. Therefore, when a market does not predict the outcome, this result can reflect a failure of reality to be predictable rather than a failure of the market to optimally aggregate information. Furthermore, this criticism misunderstands the nature of probability: even events that have a 95 percent chance of occurring will not occur 5 percent of the time. While it is true that prediction markets cannot forecast with certainty the necessarily uncertain, it would be unreasonable to expect this outcome of any means of forecasting.

Another criticism points to divergences that can emerge between different prediction markets and to cases where individuals have been alleged to manipulate markets as evidence of market inefficiency. While there is some evidence that differences in market prices can arise due to single participants attempting to manipulate the market (Rothschild and Sethi 2013), the ability of these individuals to do so is partly a function of the number of traders willing to bet against them. Overall, there is no reason to believe that prediction markets are inherently any more manipulable or subject to arbitrage limits than the stock market. As prediction market skeptic Barry Ritholz has argued, the difference between the bond market and existing futures markets “is in the size, scale, and liquidity.”²¹ What’s more, as section 2.3 of this paper argues, these attempts at manipulation create profit opportunities for other traders, and as a result should become more difficult in the long run as more trades occur. As a result, to the extent that market inefficiencies have occurred in modern prediction markets, it is difficult to disentangle these

²¹ Barry Ritholz, “A Few Words on Prediction Markets,” *The Big Picture*, May 26, 2005, <http://www.ritholtz.com/blog/2005/05/a-few-words-on-prediction-markets/>.

outcomes from the limitations on these markets created by the restrictive legal environment they have operated in.

For example, since 2005, Intrade has been required to only allow US participants with verified assets of at least \$5 million. It seems likely that even if Intrade ignored this regulation, the threat of legal action reduced participation even when Intrade was at its most popular. In addition to explicit regulation, uncertainty about regulation in the industry creates a chilling effect that has likely further reduced trader participation even at these markets' peak liquidity.

A final criticism questions why prediction markets have failed to be adopted more frequently as a social institution. PAM's failure shows two important drivers of prediction market resistance: misunderstanding and moral objections. We can see clearly the importance of misunderstanding in the comments of Stiglitz, who despite a Nobel Prize for informational economics fails to understand the value of assessment aggregation. Moving beyond anecdotal misunderstanding, econometric analysis of over 500 media articles about PAM showed that the less informed the author was about the issue, the less favorable he or she was toward PAM (Hanson 2005).

The words critics use in moral objections to prediction markets include "repugnant," "shocking," "sick," "turn the stomach," "absurd," "bizarre," and "lunacy" (Hanson 2007). While moral arguments are outside the scope of economics, it can at least be noted that this charge may be inconsistent given the variety of explicit and implicit betting on life and death that occurs in other fully legal and nonstigmatized contexts. Life insurance, for example, bets where beneficiaries on the margin will explicitly realize an economic profit from death.²² In fact, in the

²² Graeme Wood, "Death at the Summit," *Pacific Standard*, November 4, 2013, <http://www.psmag.com/business-economics/death-summit-67326/>.

past, life insurance was seen as immoral because it was “gambling on human life.”²³ As Hanson has pointed out, “Nearly all financial instruments we use today were at one point or another considered illegal and immoral.”²⁴ Just as the social stigma against life insurance eventually dissipated in the face of the product’s economic benefits, it seems plausible that the same could happen for prediction markets. Similarly, the government intelligence agents who are skilled at predicting terrorist attacks outside prediction markets benefit economically from doing so in the form of promotions. In any case, most people would not find it repugnant to learn that an intelligence agent was promoted for predicting a terrorist attack, nor that said agent acted knowing that a promotion would follow.

In addition to moral objections to contracts that specifically appear repugnant, prediction markets also suffer social stigma related to their similarities with gambling. Sidestepping the debate over whether gambling is desirable, there are significant differences between gambling and prediction markets.

Three elements typically delineate an activity as gambling under US law: prize, chance, and consideration. Prediction markets for real money contain the element of prizes in the payoffs for winning predictions. However, US law designates chance as occurring “*only if skill offers no edge in determining who comes out ahead in an exchange*” (Bell 2011). Given the litany of forecasters, pundits, and consultants that are regularly hired to make predictions about the events that prediction markets are commonly the subject of, it seems unlikely that skill offers no advantage in generating predictions. Unlike picking lottery numbers, there is a large market for those making political, socioeconomic, and even entertainment predictions for for-profit

²³ Ibid.

²⁴ Ibid.

entities.²⁵ If individuals and firms can sell their abilities to formulate predictions in a competitive market, then it strongly suggests that skill provides an economically substantial advantage.

Another distinction is that while the primary, and in some cases only, purpose of gambling is for the entertainment of those placing the bets, one of the main purposes of prediction markets is to create prices that are useful to a wide variety of parties. In fact, it is easy to argue that this generation of prices has been the primary purpose for most prediction markets. Most media coverage of Intrade markets, for example, has not been to inform readers of a place where they can bet on uncertain events, but to report on the information contained in the prices.

Regardless of the coherence of the moral arguments against prediction markets, the legalization of Internet gambling in New Jersey, Nevada, and Delaware, and the interest in legalization from other states, suggests that public opinion, or at least the median voter, may be turning in favor of online gambling. In New Jersey, opposition to legalizing online gambling fell from 67 percent to 46 percent from 2011 to 2013.²⁶ By extension, the prediction markets that are accused of being a form of online gambling should benefit from reduced stigma as well.

Overall, it is undeniable that prediction markets will not always correctly forecast the future, and that in some instances they may fail to bring new information or even traders. However, popular opposition to these markets can be driven more by misunderstanding than by concerns that the markets are being utilized ineffectively or for negative results. In addition, even when specific failures of prediction markets are identified, it is difficult to argue that these failures reflect an inherent problem with the mechanism rather than a result of the limitations

²⁵ For example, consider the firm MPG, which charges up to \$20,000 to predict for movie studios whether a script will be successful. See Brooks Barnes, "Solving Equation of a Hit Film Script, With Data," *New York Times*, May 5, 2013, <http://www.nytimes.com/2013/05/06/business/media/solving-equation-of-a-hit-film-script-with-data.html>.

²⁶ Associated Press, "Opposition to Internet Gambling Lessening in N. J.," *Daily Finance*, March 20, 2013, <http://www.dailyfinance.com/2013/03/20/internet-gambling-opposition-lessening-nj-christie/>.

resulting from the regulatory climate. If prediction markets were allowed to grow and flourish as an industry, it is likely that their performance would increase and inefficiencies would diminish.

3. The Regulation of Prediction Markets

3.1. The Past and Current Regulatory Environment of Public Prediction Markets

Prediction markets have long operated under a restrictive legal environment as a result of both explicit regulation and legal uncertainty. To understand this legal context, a natural first question is: why do these markets raise any legal issues to begin with? In fact, as long as there is no cash or prize offered, a prediction market would likely raise no legal issues. As a noncommercial means of reporting on opinions, it would likely be protected by the First Amendment as free expression rather than free enterprise (Bell 2011). The regulation of real-money prediction markets, on the other hand, is complicated because they resemble, but are not equivalent to, two other highly regulated goods: commodity futures and gambling. As a result, prediction markets have historically been affected by laws and regulatory bodies targeted at these industries.

As the primary regulator of commodity futures and options, the Commodity Futures Trading Commission (CFTC) has broadly defined what constitutes a commodity under its regulatory purview as “all commodities, goods, articles, services, rights, and interests which are or may be the subject of futures contracts” (CFTC 2010). In short, nearly anything that could possibly be the subject of a futures market is a commodity potentially within the CFTC’s jurisdiction.

One of the earliest CFTC decisions regarding prediction markets was the issuance of two nonaction statements in the early 1990s for the Iowa Electronic Markets (IEM), a well-known and currently operating academic prediction market run by the University of Iowa’s Tippie College of Business. The market’s stated purpose is for research and educational purposes but participants

are engaging in real money bets. In two nonaction statements, the CFTC declined to establish jurisdiction over the markets. However, those letters still place restrictions on the IEM. First, while anyone may purchase contracts in IEM’s political prediction markets, nonpolitical markets are only open to “academic traders.” In addition, individuals are limited to a maximum investment of \$500 dollars, and submarkets are limited to 1,000–2,000 traders. Finally, the CFTC premised its nonaction on the IEM’s academic purpose and nonprofit operation (Bell 2011).

With the exception of IEM, the rest of the early prediction-market industry operated under a cloud of regulatory uncertainty owing largely to gambling laws. As section 2 noted, the presence of skill in prediction markets would appear to differentiate them from gambling under US law. However, US laws targeting gambling have had important impacts on the functioning of prediction markets.

One important source of uncertainty for prediction markets has been the Wire Act of 1961, which prohibited the transmission of bets over telecommunications systems. Despite a 2002 Fifth Circuit Court of Appeals interpretation as only applying to sports betting, the Department of Justice early in the first decade of the 21st century held that the act applied to all forms of gambling. The result was the prediction market industry operating in a “gray zone” of legality (Chiang 2007). At that time, even legal scholars who believed some prediction markets would be legal saw the chilling effect of the uncertainty, where the possibility of “even ill-considered and ultimately futile claims” could mean judicial exoneration came only after “a bruising legal battle” (Bell 2006).

The uncertain application of gambling law and the CFTC’s nonaction letter on IEM was the primary legal context for prediction markets from the founding of IEM in 1989 until the middle of the first decade of the 21st century. Then in October 2005, the CFTC filed charges

against Intrade for allowing US citizens to trade in options for the following commodities that fell under its purview:

- gold futures
- daily crude oil
- light sweet crude oil futures
- the intraday euro versus US dollar rate
- the US dollar versus yen exchange rate

Intrade agreed to pay a fine and comply with several conditions going forward, including warning US customers via website pop-ups about contracts they were banned from trading. Then in November 2005, the CFTC granted Intrade the status of an exempt board of trade. While this status allowed Intrade to operate legally, it could only allow “eligible contract participants” with assets of more than \$5 million to \$10 million (Bell 2005).²⁷ Complying with this rule would have significantly reduced the liquidity of Intrade markets at a time when US residents represented as much as 40 percent of its customer base (CFTC 2005).

Another large regulatory setback for prediction markets came shortly after in 2006, when President Bush signed the Unlawful Internet Gambling Enforcement Act (UIGEA). Among other things, this law empowered the Treasury Department to create rules preventing US banks and credit card companies from engaging in financial transactions with “gambling” sites abroad. Specifically, the act targets “unlawful Internet gambling,” which it defines as any bets that violate federal or state law. The “gray zone” uncertainty created by the Wire Act was not clarified, but instead magnified (Chiang 2007).

²⁷ Tom W. Bell, “TEN’s Plans for a Legal U.S. Prediction Market,” *Agoraphilia*, December 7, 2005, <http://agoraphilia.blogspot.com/2005/12/tens-plans-for-legal-us-prediction.html>. Individuals with \$5 million in assets were eligible if they entered the “transaction to manage the risk associated with an asset owned or a liability incurred, or reasonably likely to be owned or incurred.” Otherwise assets were required to be over \$10 million.

Despite the continuing legal uncertainty, the UIGEA effectively disrupted prediction markets. Even before the Treasury Department could write the rules, some banks began refusing to transfer money. Intrade users received the following notice:

Most US-based members will find it difficult to fund their accounts by credit card. It is very likely that any attempted credit card transfer will not be authorised by your bank. Please note that this is the policy of the bank and not that of the Exchange.

By the time the regulations were written, Intrade was not accepting credit cards, only check and wire payments (Goldberg 2010, n. 29).

Despite the 2006 passage of the UIGEA and a general environment of regulatory uncertainty, there was a growing interest in prediction markets leading up to the 2008 election. As a result of the heightened interest, the CFTC announced it was reviewing the applicability of the Commodity Exchange Act (CEA) to event contracts and released a request for comments.²⁸ While it did not issue a comprehensive response to the comments, in 2010 the CFTC allowed the operation of two prediction markets for box-office futures. The commission found that movie revenues constituted “a non-price-based measure of an economic activity, commercial activity or environmental event” that was similar to other commodities for which the CFTC has approved futures or options contracts (CFTC 2010). The commission’s statement clarified its stance on prediction markets by explicitly arguing that “event contracts” were potentially commodities within the CFTC’s jurisdiction:

The term “event” contract has no meaning under the Act. More than 500 contracts have already been submitted to the Commission that are based on some type of event or activity with economic consequences. The statutory definition of “commodity” does not suggest that an “event” cannot underlie a futures or options contract. Thus, that a contract is based on an event does not preclude it from being a commodity under section 1(a)(4). (CFTC 2010)

²⁸ From the CFTC request for public comments: “Since 2005 , the Commission’s staff has received a substantial number of requests for guidance on the propriety of offering and trading financial agreements that may primarily function as information aggregation vehicles.”

The commission also offered support for the economic value of box-office prediction markets. Until 2000, the CEA required an “economic purpose test,” which specified that a futures or option contract had to have utility as a hedging or price-basing tool (CFTC 2010). While the Commodity Futures Modernization Act of 2000 repealed this requirement, the commission’s statement on box-office futures made clear it believed box-office futures markets passed the economic purpose test and could serve both hedging and price-discovery purposes.

The exemption for box-office futures markets was short lived, as the Dodd-Frank Act modified the CEA to explicitly define box-office revenues as not a commodity, and thereby effectively banned box-office futures (Anderson 2011). In addition, Dodd-Frank provided explicit rules requiring the CFTC to prevent the listing or trading of “event contracts” if they are determined to be “contrary to the public interest,” which is defined as involving

1. activity that is unlawful under any federal or state law,
2. terrorism,
3. assassination,
4. war,
5. gaming, or
6. other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest (Stawick 2012).

The sixth criterion in particular potentially grants a large degree of discretion to regulators. What constitutes “contrary to the public interest” and the CFTC’s general view of prediction markets post–Dodd-Frank can be seen in a 2012 ruling against the North American Derivatives Exchange (NADEX) political futures market. To determine whether a contract was contrary to the public interest, the CFTC argued it should utilize the same “economic purpose

test” that was part of the CEA until 2000 and required hedging or pricing utility. In the ruling against NADEX, the CFTC argued that political futures had no hedging or pricing purpose due to “the unpredictability of the specific economic consequences of an election” (Stawick 2012).

The commission also has discretion to consider other factors in addition to the “economic purpose test” in determining public interest. In the NADEX ruling, it argued that political prediction markets were against the public interest because they “can potentially be used in ways that would have an adverse effect on the integrity of elections, for example by creating monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter’s political views of such candidates” (Stawick 2012).

An additional move to limit prediction markets came in November 2012 when the CFTC sued Intrade for violating the conditions of the 2005 order it had consented to and the terms required of it as an exempt board of trade. Intrade had allowed US customers to trade prohibited contracts. In particular, the CFTC alleged that Intrade was offering binary options in the following markets:

- gold: “February 2011 gold futures to close on or above 1,000 on 30 Dec 2011”
- currencies: “euro/US dollar to close on or above 1.0000 on 30 Dec 2011”
- US economic numbers: “United States will go into recession during 2011”
- banking: “75 or more US banks to fail during 2011”
- war: “United States to conduct overt military action against North Korea before midnight ET on 31 Dec 2011” (Banar and Slovick 2012)

In addition, the CFTC alleged that Intrade failed to warn US customers via website pop-ups that they were not allowed to trade these options, and it alleged that Intrade was not verifying that US customers were “eligible contract participants” with assets exceeding \$5 million to \$10 million.

The suit asked a federal judge to file an injunction against Intrade and fine it for violating federal commodity law.²⁹ As a result of the CFTC complaint, Intrade ceased allowing US customers to trade and instructed them to empty their accounts.³⁰ Volume on Intrade collapsed, and the following March, all trading was shut down, with the company citing “financial irregularities.”³¹

The modern regulatory history of prediction markets has generally been a move from uncertainty and legal gray areas to gradually more restrictive laws and enforcement. The legal space carved out for the Iowa Electronic Markets has proved to be an exception.

Traders in private markets face greater liability under insider trading laws than those in public markets. These laws forbid insiders from trading a company’s securities “on the basis of material, nonpublic information.” Normally, these laws apply to executives and not to average employees or independent contractors. However, if they participate in private prediction markets that give them material nonpublic information, these low-level employees or contractors can become “remote temporary insiders” for whom insider trading laws apply. Even if the corporation takes the necessary precautions and sees a minimal chance of insider trading occurring, the added risks can discourage prediction markets simply because “no corporation would welcome the heavy evidentiary burdens imposed by investigations into illegal trading of its shares” (Bell 2008).

3.3. Regulatory Reforms

Lawmakers and regulators could take a variety of steps to foster the existence of prediction markets. This section will propose actions that the executive, legislative, and judicial branches

²⁹ David Ingram, “Commodities Regulator Sues Intrade over Trading in U.S.,” *Reuters*, November 26, 2012, <http://www.reuters.com/article/2012/11/26/us-cftc-intrade-idUSBRE8AP0P220121126>.

³⁰ Matt Egan, “Intrade Tells U.S. Customers to Empty Accounts after CFTC Suit,” *Fox Business*, November 26, 2012, <http://www.foxbusiness.com/industries/2012/11/26/intrade-tells-us-customers-to-empty-accounts-after-cftc-suit/>.

³¹ Joc Weisenthal, “Betting Site InTrade Is Completely Shutting Down Trading,” *Business Insider*, March 10, 2013, <http://www.businessinsider.com/intrade-shutting-down-2013-3#ixzz2vf0vQjwB>.

could take. While it is unclear what the optimal regulation of these markets is, the extant research does not support the current restrictive regulatory environment.

A key question is whether these markets should remain under the CFTC's purview. An important benefit of CFTC jurisdiction is the preemption of state laws, including state-level antigambling laws (Bell 2008). While Bell has argued that antigambling laws would not likely apply to many prediction markets,³² the chilling effects could still be substantial.

If prediction markets remain under CFTC regulation, a key change that lawmakers should make is to remove the provision of the Dodd-Frank Act that banned box-office futures. The aforementioned CFTC approval of these markets as passing the "economic purpose test" indicates a lack of economic justification for this ban. In addition, legislation should undo Dodd-Frank's alteration of the CEA that banned prediction markets on terrorism and war, which, as section 2 argued, provide valuable information.

With or without these suggested legislative changes, an important regulatory improvement would be for the CFTC to act within its existing authority to approve prediction markets. One rationale for such approval is the CFTC's "economic purpose test," which requires that prediction markets have a hedging or price-setting purpose. While the primary benefit of prediction markets lies in the informational value they generate, if the regulatory environment allowed prediction markets to grow and evolve, they could become liquid enough to support hedging. The CFTC recognized this value in its statement approving Media Derivatives, Inc. (MDEX), the box-office futures market:

The Commission found that the contracts can perform hedging and price discovery purposes. Industry profit and losses have a clear and direct relationship to box office revenues. A contract based on those revenues could be used to hedge related risks. . . .

³² Bell (2006) argues that "real-money prediction market in claims about science and technology should run little risk of violating the various prohibitions that U.S. law imposes on unlicensed gambling transactions."

Information provided through staff discussions with industry sources, as well as through written comments and statements by several participants at the May 19, 2010, hearing, revealed that there are various risks associated with film production that could be hedged with risk management tools. (CFTC 2010)

The potential for economically beneficial hedging is not limited to box-office futures. As 19 of the leading academics studying prediction markets argued in a joint statement to the CFTC, even political prediction markets have a potential to serve a hedging function (Zitzewitz et al. 2012).³³ The potential for prediction markets to evolve into highly liquid markets with the possibility for hedging and the participation of institutional investors suggests the CFTC could use its current authority to approve prediction markets to operate under the basis of the “economic purpose test.” With the removal of the Dodd-Frank changes to the CEA, the CFTC’s scope for approval would be even greater.

In addition, the CFTC should recognize that a major economic benefit of prediction markets lies in the value of the information they generate. If a large percentage of the value of prediction markets is in a long thick tail of topics where interest would be among a smaller number of individuals, then the regulatory barriers should be as low as possible. The CFTC could accommodate such markets by carving out a space to allow information-motivated prediction markets to function with low barriers in contrast to the costly regulations applied to risk-hedging-motivated markets (Hanson 2008). One solution would be for the CFTC to create an “exit option” for prediction markets that see the CFTC’s regulation as overly burdensome. This option could be accomplished by clearly defining a limit to the CFTC’s jurisdiction. Bell et al. (2008) give three examples of limiting principles: (1) the prediction market only offers trading to members of a particular firm, (2) the market offers no significant hedging benefits, or

³³ Evidence for possible hedging motivations can be seen in, for example, Snowberg, Wolfers, and Zitzewitz (2007), which shows that Republican presidential wins are associated with higher equity valuations and bond yields.

(3) the market only offers spot trading in negotiable conditional notes.³⁴ These criteria would provide some legal protection for private prediction markets.

Another way to allow a low regulatory bar would be for the CFTC to return to the approach taken with IEM and issue nonaction letters (Bell 2008). However, in recognition of the benefits of allowing these markets flourish, the restrictions placed on “no action” markets should be more flexible than the limits on participation in IEM. For example, participation should not be limited to academics, and total contribution limits should be more than \$500. The letter to the CFTC from 19 prediction-market academics advised that a higher limit of \$5,000 would effectively prevent hedging (Zitzewitz et al. 2012).

There are also actions the judicial system could take to improve the regulatory environment for prediction markets. Legal scholars Cherry and Rogers (2008) have argued that the First Amendment should protect prediction markets as free speech. They state that such markets constitute expression by individual participants, and that “the market itself may be a speaker.” In addition, prediction markets further truth-seeking and should be protected similarly to how courts have protected computer code. By protecting prediction markets under the First Amendment, the courts could effectively remove CFTC jurisdiction over them.

Another important step would be for legislative or executive action to remove the chilling effect of the UIGEA on prediction markets by specifying that prediction-market sites do not constitute gambling so that banks are free to allow their customers to transmit money to these sites. While a 2011 Justice Department decision clarified that the Wire Act only made online sports betting illegal, and thus subject to the UIGEA, the historical uncertainty of online

³⁴ The third exit option defines the trades as notes rather than futures contracts. The difference is that futures contracts offer future delivery of unconditional rights (e.g., “1 oz. of gold will be delivered on January 1, 2015”) versus current delivery of conditional rights (e.g., “this note can be redeemed for \$X if Y comes true”).

gambling laws has likely created a chilling effect that will stifle innovation in this market without proactive legislation that clarifies the rules. We can see evidence of this chilling effect in banks' unwillingness to process payments for online gambling transactions even in the states where it has been legalized. Reflecting this unwillingness, the vice president of compliance for the American Bankers Association has stated, "There's still the uncertainty over Internet gambling and the liability that could fall on a bank."³⁵ Without specific federal legislation or regulation clarifying the legality of prediction markets with respect to the UIGEA, this and other chilling effects would likely be a problem for this industry as well.

An additional and more exhaustive legislative step would be to pass a law specifically protecting prediction markets. Bell (2006) offers a draft of legislation aimed at protecting prediction markets for scientific claims; however, this legislation could be expanded to protect all prediction markets. The legislation's goal would be to prevent the application of any state or federal laws to prediction markets except those laws that regulate general commerce. Such legislation would preempt state gambling, bucket-shop, insurance, and similar laws. It would remove prediction markets from the CFTC's purview while still offering protection from state-by-state litigation. As with the proposed regulatory approaches, this law could distinguish between prediction markets that are designed for significant hedging and those that are not, and leave the former under CFTC purview. It would not remove all legal authority from these markets, but would leave their regulation to state contract, tort, and property law. In addition, the law could be designed to allow laws that apply to general commercial transactions, such as the FTC's unfair trade practices laws.

³⁵ Christopher Palmeri and Elizabeth Dexheimer, "Online Casinos Hobbled as Credit -Card Issuers Reject Bets," *Bloomberg Businessweek*, November 15, 2013, <http://www.businessweek.com/news/2013-11-15/web-gaming-curbed-as-paypal-to-bank-of-america-refuse-bets-tech#p1>.

Overall, there remains room for executive, judicial, and legislative action to provide a better regulatory environment for prediction markets. While it is unclear which regulatory approach is optimal, the significant benefits and economic value of prediction markets are at odds with the current highly restrictive regulatory environment.

4. Conclusion

Prediction markets are important information-aggregation tools for researchers, businesses, individuals, and governments. Even given the restricted regulatory environment they have functioned in, prediction markets have shown promising applications in fields from demand forecasting to public health. Regulators should allow these markets to grow and evolve.

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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: Review of KalshiEx LLC's proposed Congressional Control Contracts pursuant to Commodity Futures Trading Commission Regulation 40.11(c).

Dear Chairman and Commissioners:

My name is Max Raskin and I am an adjunct professor of law at New York University and a fellow at the school's Institute of Judicial Administration. I also teach at the Stern School of Business. Two of my areas of legal research are financial law and cryptocurrency. I have written about prediction markets previously in the *Wall Street Journal*. Kalshi's proposed contracts are valuable hedging tool and would be a benefit to the American economy — they should be permitted to be listed for trading in the United States.

Political uncertainty is a fact of life that exposes millions of Americans to changing financial realities based on changing federal policy. Examples include energy firms that contend with changes in subsidies or construction firms that contend with changes in infrastructure spending.

The CFTC asks whether policy outcomes stemming from elections are sufficiently predictable to be used for hedging. The answer is yes, for three reasons. First congressional leaders make genuine attempts to enact the agendas they lobby for. In 2020, for instance, Democratic Senate leaders ran on \$2,000 stimulus checks and a large COVID-19 bailout for states. Soon after the Democrats gained a majority in the Senate, they passed a bill that granted the final \$1,400 to fulfill their promises and gave hundreds of billions of dollars to state governments. Second, people do not need absolute certainty to hedge. Consider

a bread company worried about an increase in the price of wheat. They also have issued a large quantity of bonds to finance the purchase of a new distribution plant. It is possible that a spike in the price of wheat—if it is exclusively caused by broad-based inflation—might not harm the company on net, because that will also decrease the real value of the bonds they have issued. There remains uncertainty. But insofar as an increase in the price of wheat increases the risk the company faces, it is totally normal and common to purchase a large number of financial instruments that hedge against that risk. Again, they purchase those instruments despite not having 100% certainty that the event, i.e., the increase in the price of wheat, will actually manifest in net harm for the company. An election is the same way. It is totally legitimate for a small business or family to purchase a hedge against an election outcome even though they do not have 100% certainty that the event (the election outcome) will actually manifest in net harm for them. But the increase in risk is sufficient.

Third, there are already more than two dozen comments in the CFTC portal from small businesses and individuals attesting to their desire to use the contract for hedging. In a free, liberal society, adults should be allowed to make these determinations for themselves.

The CFTC has an independent line of questioning regarding election integrity. As I wrote in a *Wall Street Journal* op-ed,

“As a historical and comparative matter, the U.S. allowed such markets for many years and the U.K. still does. No one questions the legitimacy of Margaret Thatcher or Tony Blair because people bet money on the outcome.”

The fact is that switching one’s vote does not make sense given the odds of being the deciding vote. Attempting to get enough others to switch their votes would be prohibitively expensive and campaigns already spend billions attempting to do so (with far larger incentives than \$25,000). Indeed, the 2020 cycle saw \$14.1 billion in total spending. It is implausible that anyone with a \$25,000 incentive could somehow then flip an election through concerted effort. After all, people already have vast financial stakes in election outcomes that are far greater than \$25,000 (sometimes by several orders of magnitude), and the combination of US norms, laws and enforcement regimes are more than sufficient to prevent these harms from coming to fruition.

I urge the Commission to approve Kalshi’s product. This is an exciting time for innovation in financial markets. New technology has made it possible for people to bring more certainty to an uncertain world. It

is my firm belief that in a free country, barring any extremely compelling reason, adults should be allowed to arrange their economic affairs as they see fit.

★ Studio

Dear CFTC,

My name is Valentin Perez, and I am the co-founder of Studio. Studio.com is an online platform to help democratize access to creativity, by giving regular people access to the step-by-step creative processes of some of the brightest minds in their field. I am writing to petition the CFTC to permit election event contracts to be allowed to trade in the United States.

Like any business owner, I am deeply impacted by a wide variety of public policies. For example, a sudden hike in the tax rate might cost me or my company tens of thousands of dollars. Changes in immigration policy might impact my ability to attract and hire the top talent in the world. From a balance sheet perspective, these risks look like any other we might face. As a result, it would be beneficial to be able to purchase a financial product that would allow me to hedge and manage my risk, so that my financial well-being is more stable and less sensitive to changes in the winds of political fortune.

The structure of these contracts are well-suited to the interests of startups, small businesses and families. The position limits are well-within reason for hedging (I don't have any need to hedge a \$10 million risk), and the binary structure seems well-tailored for the nature of the risk (namely, a Democrat or a Republican taking power is a binary event, so a binary structure makes sense).

In addition, these contracts help business owners like myself make the best decision possible. The price of the contract maps directly to a probability of the Democrats retaining control of Congress, a split Congress, or the Republicans taking control. As a result, business decisions that rely in part on what federal policy will look like in a few years can now rely on hard data, instead of rough guesswork about what it will look like. Those small edges in business intelligence can yield great benefits years down the line.

Business owners are not the only people who benefit from the information encoded in the contract's pricing. An employee joining a startup, for instance, could use the embedded probabilities to decide whether or not to take more of their compensation in the form of equity or salary, since one party or another might have different intentions regarding the appropriate level of taxation on capital gains versus labor income.

These contracts would benefit me personally, and the country as a whole. I would thus humbly request that the CFTC allow them to trade in the United States.

Thank you,



Valentin Perez
Co-Founder, Studio

From: Matanya Horowitz
Organization(s): AMP Robotics

Comment No: 69724
Date: 9/21/2022

Comment Text:

To Whom It May Concern at the CFTC:

I am Matanya Horowitz, founder and CEO of AMP Robotics, a company dedicated to transforming the economics of recycling. We use artificial intelligence and automation to identify and sort recyclable material at scale to help ensure that it is recycled and its value fully captured, instead of being lost to incineration or landfill.

As the CEO of AMP Robotics, I have seen first-hand the effects of federal policy on my business. The EPA has its own National Recycling Strategy that influences corporate demand for recycling, and thus indirectly our business, as do various Congressional bills to support recycling infrastructure, federal regulations that encourage the use of recyclable materials and more. There are a number of state initiatives ongoing as well. Naturally, the probability that these bills or regulations pass is directly downstream of which legislators are elected and party control of Congress. To hedge this risk, I would be able to better plan for the business if I were able to hedge for the possibility of positive or negative legislation related to promoting recycling infrastructure. For instance, a significant piece of recycling legislation and a more aggressive National Recycling Strategy may allow AMP to expand in the future. But if such legislation fails to pass, a hedged contract may allow AMP to adapt to a less favorable policy environment. This is only one example among many of how congressional directional can impact our business. At a higher level, impact on the environment affects all businesses and families in America, and changes in Congressional control substantially impact the probability of meaningful federal regulatory or legislative action being taken.

Notably, individual event contracts to hedge individual policy changes are not necessarily a viable alternative to a market on Congressional control. Many of these policy changes are relatively niche—while they affect a vast number of people, they are unlikely to attract sufficient volume to be able to provide enough liquidity for those most affected to hedge. Moreover, a specific policy event contract requires knowing precise details in advance, which may not be true several years out. But most importantly, what affects our business is less any one individual policy, but the sum of the dozens of different policies (or, more succinctly, the totality of the policy agenda) that the respective parties enact. We're thus supportive of a contract for "the totality of the policy agenda" and a contract on Congressional control. We believe this would be a good signal for how legislation will affect our business.

Risks are born in large measures and small measures. We do not see any reason to consider smaller risks as less important than larger risks. It is particularly encouraging to have a product that is tailored explicitly for small and medium-sized businesses. The low position limits of \$25,000 are perfect to allow for even smaller businesses to hedge. While there may be some businesses with even larger hedging needs, this provides a meaningful tool for us to stabilize and protect our business, and we believe a useful starting point for a new business tool.

Congressional control is an important factor in determining the profitability of my business and the businesses of millions of others. While many participants may join this market because they love politics or love forecasting (and thereby add liquidity for those of us who wish to hedge), they are far from the only people, and we don't believe this should be an impediment to us accessing financial markets to hedge our risks.

Thank you for providing the opportunity to comment.

Matanya Horowitz

ROA0001533

To the Honorable Commissioners of the Commodity Futures Trading Commission,

My name is Dustin Moskovitz. I am a co-founder of the work management platform Asana, as well as a co-founder of Facebook. I've also founded several nonprofits including Good Ventures in 2011 and Open Philanthropy in 2014, which was founded as a partnership between Good Ventures and GiveWell. In 2021, OpenPhil gave over \$400 million in grants, with over \$300 million allocated to public health efforts in the developing world. I am writing in support of Kalshi's submission to the CFTC to be allowed to offer a prediction market on Congressional control and to express my general belief that prediction markets (including from other providers such as PredictIt) can provide important benefits to society.

A core tenet of Open Philanthropy is our belief in the importance of improving our judgment. All private action—from business decisions to nonprofit grant allocation—requires making forecasts about the future. A business deciding whether to expand into a new market is implicitly making a forecast about the tax and regulatory environment in the future. A nonprofit deciding which cause areas are most tractable need to make forecasts about what the political environment will soon look like. Consider a grantmaking body trying to decide which groups to give money to. That grantmaking body will consider several factors, such as how important the cause they are considering is as well as the expected effectiveness of the potential recipient of the money at furthering that cause. But efficacy is often downstream of political control. A group trying to lobby Congress to change criminal justice laws, for instance, needs to adopt very different strategies if Republicans are in power or Democrats. In many cases, a grant may simply not be worth it if one party or another gains power, as the probability of reform in a given area may just be too remote.

As such, it is highly important to have *precise and accurate information* about the probability of different parties controlling Congress. We know from the academic literature on forecasting (such as the work from Philip Tetlock) that the sayings of pundits and experts are not the most accurate at estimating event probabilities. Liquid prediction markets can do much better, by not just aggregating the opinions of the masses but giving them a profit incentive to do as much research as possible to get the answer correct. By giving forecasters skin in the game, the price on the market would represent the most accurate election probabilities available. While many other commenters have spoken about the ways these markets could be used for hedging, or the way it could be used to price other financial instruments, I wanted to use this comment to explain how—in my own experience as both a corporate CEO and a major participant in the world of charity—accurate forecasting is critical to making good judgments. In this sense, prediction markets on Congressional control are indubitably in the public interest.

I know there are a number of prediction markets seeking CFTC recognition - Kalshi, PredictIt, Polymarket - and more that would if there were a clear path to operation. I support a simple and

open path to regulation, that protects consumers whilst providing the public access to this valuable and unbiased source of information.

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. Moreover, the relatively low position limits make it such that no one would have the financial incentive (let alone the means) to attempt to manipulate elections in order to receive a payout. Elections are multi-billion dollar affairs with millions of interested parties attempting to influence people's vote—the resources necessary to make a dent far outstrip the \$25,000 by several degrees of magnitude. These contracts will enhance the integrity of our elections by providing the news media with an accurate estimate about the state of the race. Rather than listen to pundits with a less-than-ideal track record and perceived partisan biases, the broader public can be informed by the unbiased market. That can help to enhance public understanding of how our elections work, and enhance voter trust in the overall process.

Thank you for your consideration.

Scott Supak
PO Box 395
Cherry Valley, NY 13320

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

Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

I am a retired union stagehand who consistently lost money in the stock market. I had to give up sports betting because I consistently lost at that too. Both of those attempts to supplement my small, fixed retirement income wound up being drains on my income and my family. And then I discovered prediction markets. I found that my knowledge of politics and probabilities were actual assets that I could use to make money. I found that my critical thinking skills and the ability to learn quickly were even more valuable than I had ever dreamed. I found that when I was able to keep my bias in check, I could profit from those who could not. I found that when I didn't understand something, I could learn about it, and be rewarded for that learning!

Unlike sports betting, casino gambling, or even investing in the stock market, I felt as if I was providing a public service by predicting election outcomes, and polling averages, even climate change, and economic indicators. Prediction markets have been proven to aggregate large swaths of data and make accurate predictions that are much more useful to the economy, and the world, than predicting who will, for example, win the Super Bowl.

I was a "Superforecaster" at the Good Judgement Project where our predictions regularly wound up on the desks of the President, Senators, and many other members of the US government who found our predictions to be a valuable tool. I was a forecaster at Intrade where we accurately predicted several elections and even managed to keep predictions accurate when millions of dollars were coming in on what would prove to be the losing side. Those markets worked well despite the attempts by some very wealthy people to paint a narrative by manipulating those markets. Those of us who saw that one side was attempting to influence prices to influence the media narrative (and thereby the election outcome) knew exactly what was happening and profited from it. We were the poster children of efficient market theory!

I have been predicting elections and polling averages at Predictit since its founding and have become an expert on making those markets more efficient using "linked margin" in what Kalshi refers to as "mutually exclusive groups." I've appeared on multiple podcasts to help people understand these methods of creating liquidity and efficiency in these markets. My years of work in this area have proven quite profitable and helped me in retirement by providing regular income for my efforts.

I work with a team of people who have all become amazingly good at what we do. The efficiency and accuracy of the markets at Predictit are a testament to the good work we (and many others) have done, and it's a shame that all that hard work could be meaningless now in a world where anyone with a phone can bet on a football game, but those of us who actually invest in futures (that help scientists, economists, and politicians create a better world more accurately based on facts and implied probabilities) will be left with no place to use our talents and skills.

Since Kalshi has moved into the prediction market arena, I've discovered that I can use their site to hedge economic risks to me, such as inflation, interest rates, and even recessions. Even better: I've discovered that the large institutions to whom I likely lost money when I was investing in stocks and bonds are hedging on these economic indicators like inflation, and they often distort prices away from what is the likely reality, offering me excellent expected values that have proven quite profitable.

The same reasoning behind having prediction markets that allow Wall Street to hedge against risk in economic indicators such as inflation, GDP, and interest rates apply even more to elections! Because much of what happens economically is directly related to political power, prediction markets on who will have that power provide two extremely beneficial effects: hedging against the risk of political change and accurately predicting future events that have an outsized impact on economics.

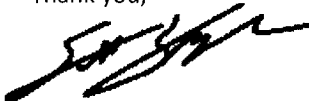
I'm especially interested in predicting climate change, something with the potential to greatly upset economic markets all over the world. I would relish the chance to invest in more markets that predict the long-term impacts of climate change, from polar ice caps melting to global temperatures, from sea-level rise to freshwater reservoir demise. By investing in a future where climate change impacts are much worse than they are now, I can create wealth to help my family deal with those impacts. And since what we Americans do about climate change is highly dependent on electoral outcomes, I would relish the ability to minimize the risks my family might face in this climate emergency future by investing in the political futures I see coming.

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).

But even in markets where I am not hedging risk, I am still providing a valuable service by making the markets more liquid, and more predictive. I've learned valuable skills in market-making, and liquidity-providing that provide me with a regular income while I'm making the markets more efficient and predictive. In many cases, especially with "linked markets" or "mutually exclusive groups" as I mentioned above, I've been able to make money with little, or even no risk, to myself. These kinds of arbitrage opportunities just aren't realistically possible for small investors in big markets like the stock market, and they don't exist at all in the gaming world of sports and casino gambling.

I hope for all our sakes, and especially for the sake of my granddaughter, that the CFTC embraces this innovative and beneficial possibility for Kalshi to provide election markets so that we can live in a world where facts, logic, and reason are still valuable commodities that one can use to create value.

Thank you,



Scott Supak

September 16, 2022

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: Review of KalshiEx LLC's proposed Congressional Control Contracts pursuant to Commodity Futures Trading Commission Regulation 40.11(c).

I'm a founder and angel investor from the Bay Area. SVAngel, my investment firm, has had the privilege of working with several hundred companies over the last 30 years, across dozens of different industries. These partners include firms like Google, Facebook, Coinbase, and Stripe. I'm also an advocate for more government action surrounding gun control, served as Vice Chairman of UCSF Medical Foundation, and have sat on the development committees of institutions like UCLA, Packard Children's Hospital, and the Tiger Woods Foundation, which aims to promote children's health and education.

I appreciate the CFTC requesting the public's input into these contracts so that I and others have the opportunity to weigh in on their value. The CFTC's products underlie the global financial system by providing risk management policies for many different sectors. Consequently, I pay close attention to the space. Kalshi's contracts would meet a demand from the market for both hedging and pricing purposes, and provide an invaluable public service to compete with polling and other forecasts. I strongly encourage the Commission to approve Kalshi's contract for listing by October 28th in time for the midterm elections.

Hedging and price basing (economic) utility

Kalshi's contract would provide meaningful risk mitigation for small businesses and households. In my experience as an investor and advisor to so many companies and small, growing businesses, I've seen first hand people struggling with these risks. The product proposed by Kalshi would go a long way towards managing these risks.

More specifically, the CFTC has solicited public comment regarding whether the outcomes of elections are "predictable" in order to serve as effective hedging tools. They are. The evidence is extensive and hard to ignore.

This is not a secret. Investment banks hire whole divisions to estimate the impact elections will have on their clients. This data is also published publicly on occasion, or discussed by the financial press (Slate: “Wall Street Says You Should Short Mexico to Prepare for Trump”).¹ While some headlines refer to presidential outcomes, plenty detail very specific Congressional outcomes, like when, in 2020, Bank of America provided roadmaps for each type of partisan outcome (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.²

Academics consistently discuss the link between changes in partisan control of Congress, and changes in polling, with consistent effects on financial markets, suggesting significant hedging and repricing by the market to manage risks arising from upcoming shifts in control of Congress.

CEOs also frequently flag electoral risk as it relates to their bottom line in earnings calls. According to Factset, more than a third of earnings calls in Q3 2020 mentioned the word “election”.³ I encourage Commissioners and staff to see these discussions. Concerns about a particular Congressional outcome are particularly relevant for energy, health care, and financial firms. Comments by several businesses and individuals have also testified to the importance of hedging elections in their lives and businesses.

If the market is engaging in significant extant hedging activity, then it is not deniable that an election event contract contains significant hedging utility and it is reasonably likely that the contract will be used for hedging. The hedging use of this contract is so obvious that it would satisfy even the CFTC’s proposed test of “market demand exists.”

I also note that concerns along the lines of whether elected officials actually successfully implement their goals and policies are incorrect. As discussed above, markets and businesses react to risks of political control, so clearly political control risks have impacts, and these risks can be managed. Further, this is not different from many other existing CFTC products. Basis risk is normal in many derivative products, like hurricane or housing price index futures. There’s no guarantee that a drop in the Case-Shiller housing price index (whose futures are listed on the Chicago Mercantile Exchange) will actually reduce asset value or cash flows for an investor or homeowner. Nonetheless, the CFTC permitted these valuable market innovations to be listed.

¹ [Banks suggest shorting peso to hedge against a Trump win. \(slate.com\)](#)

² 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.

³ [More Than One Third of S&P 500 Companies Are Discussing the Election on Q3 Earnings Calls \(factset.com\)](#)

I also note that a commenter saying “I could not or would not use this contract to hedge” should have little consequence. There is certainly no requirement that everyone be able to use the contract to hedge, only that it can reasonably be used for hedging. All of the comments demonstrating how the contract can be used for hedging directly address the question and demonstrate that the contract can and will be used for hedging.

Question seven asks whether the risks that elections portend can be hedged using other products. I am not aware of another circumstance where this logic was used to potentially deny a product with legitimate hedging purposes. Though I can imagine many such instances (such as hedging the risk of government benefits being taken away), the contract itself would still be valuable to isolate risk (rather than be subject to the risks of other assets) and produce significant price basing benefits uniquely.

Public interest

In addition to furthering the public interest by introducing an important hedging tool, the markets will further the public interest by providing an important data point that will help researchers and policy makers. PredictIt has been cited by many prominent scholars and government officials. Its markets are frequently referred to by the political media and leading thinkers to get a non-partisan view of the likelihood of an election’s outcome. Examples include 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.⁴⁵⁶⁷ 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; 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*.⁸⁹¹⁰ The fact that PredictIt has such power in the political press, despite its position and trader limits, is indicative of the incredible interest and social value in providing event contracts on elections to the public.

Academic researchers have used PredictIt’s data (a good in and of itself), finding that it has a variety of public issues. Hundreds of papers on economics, finance, and political science use PredictIt’s data to study prediction markets and their connection to political outcomes and traditional asset and currency markets. Examples include:

⁴ La Monica. “Joe Biden’s Fed conundrum: Stick with Jerome Powell or let him go?” 2021. CNN Business.

⁵ Heath. “These gamblers are putting money on the outcome of the impeachment inquiry.” 2019. Washington Post.

⁶ Contrera. “Here’s how to legally gamble on the 2016 race.” 2016. Washington Post.

⁷ <https://www.nytimes.com/search?query=PredictIt>

⁸ <https://twitter.com/NateSilver538/status/1242845027014971394>

⁹ <https://twitter.com/jasonfurman/status/1460404350975680514>

¹⁰ <https://twitter.com/paulkrugman/status/1177602108763316227?lang=en>

- Berg and Chambers (2016) found that using prediction markets, including PredictIt, increased user interest in civics and user news consumption.¹¹
- Miller (2021) found that PredictIt is better at election forecasting than traditional methods of forecasting.¹²
- French (2020) created an election prediction model using PredictIt that outperforms many traditional methods of forecasting.¹³

Finally, the CFTC asked if this situation is any different than in 2012, when it previously ruled on similar contracts. Event contracts were extremely limited in practice in 2012. In 2008, when it sought public comment on event contract regulation, the Commission acknowledged its extremely limited experience with event contracts. In fact, it admitted its only experience was with Iowa Electronic Markets, for which it had given two no-action letters in the 1990s. Between then and the Nadex order, the only event contracts that were certified with the Commission were a small number of economic indicators from Nadex itself and motion picture box office contracts, which were swiftly banned by Congress. That being said, the concept of election event contracts was so natural to the Commission such that even at that time, the Commission used the example of a presidential election binary to explain event contracts to the public!¹⁴ Event contracts were so limited in 2012 that regulation 40.11—which was the justification for rejecting Nadex’s contracts—was only published the day before the Nadex order. Kalshi’s proposal provides a prime opportunity for the Commission to make a decision more in line with the public’s interest and law.

Innovation

The fact that these contracts are innovative is not a reason to prohibit the contract. Many innovative products have become staples of the markets and have encouraged significant economic growth. In the past, for example, basic agricultural futures and index-settled products were once considered to be devoid of hedging utility and be pure gaming products. Today, those products are cornerstones of the global financial system. It is critical for government agencies to rely on evidence and testimony from potential hedgers and others rather than speculation or knee-jerk skepticism to novel products like Kalshi’s. This means considering their testimony, looking at the experiences of other nations, and the large value that election markets have had for academics and the public.

¹¹ Berg & Chambers. *Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement*. 2018. Journal of Political Science Education.

¹² Miller. *Predicting the 2020 Presidential Election*. 2020. Data Science Quarterly.

¹³ Franch. *Political preferences nowcasting with factor analysis and internet data: The 2012 and 2016 US presidential elections*. 2021. Technological Forecasting and Social Change.

¹⁴ [Federal Register :: Concept Release on the Appropriate Regulatory Treatment of Event Contracts](#)

As discussed above, Kalshi's contract submission does already have significant market hedging activity. However, I'm concerned that it could stifle innovation to require this of proposals, especially as outlined in questions eight and nine. Question eight specifically requests whether the Commission should consider requiring applicants to provide 'demonstrated need' of hedging and then asking if some percent of market participants must be legitimately hedging. Both of these standards would be very damaging towards responsible innovators. A 'demonstrated need' standard could make it more difficult for participants to bring products to market that potentially disrupt and compete with existing products, or which serve a niche that has yet to, but will, be filled. In addition, there is no way for a registrant to prove in advance of listing (nor does there exist a mechanism by which the Commission could reasonably guess) what percent of its participants would be hedging as opposed to speculating. It seems perverse to prevent would-be hedgers from using a product that would benefit them on the basis that too many others would use it for speculation. It would be disappointing to see these novel standards applied to Kalshi's contract as precedent for future submissions.

Question nine then goes on to ask whether and how the Commission should consider the contract's availability towards retail investors should affect their analysis. The Commission should not punish the contract for being more accessible, not less, to investors. Although retail investors are smaller, they are affected just as much by macro-political level events as large businesses. Retail investors can hedge all the same, and are no more likely to engage in speculation as large-dollar institutions (many of whom specialize in such behavior).

Kalshi's contract is a potentially powerful tool for the market. I look forward to the Commission's decision.



HARVARD UNIVERSITY

DEPARTMENT OF ECONOMICS
LITTAUER CENTER, CAMBRIDGE, MASSACHUSETTS 02138-3001

September 18, 2022

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

Dear Chairman and Commissioners of the Commodity Futures Trading Commission:

I am writing in support of the Commodity Futures Trading Commission approving Kalshi's proposal for electoral prediction markets.

My name is Jason Furman, and I am jointly the Aetna Professor of the Practice of Economic Policy Harvard's Kennedy School and a Professor the Practice of Economic Policy in the Economics Department at Harvard University where I conduct a wide range of research on policy-related issues. I served as Chairman of the Council of Economic Advisers under President Obama from 2013 to 2017, serving as his Chief Economist and a member of his Cabinet. Prior to that I served as Deputy Director of the National Economic Council from 2009 to 2013. In those capacities, I was deeply involved in the Administration's response to the Great Recession and at the forefront of some of the largest economic and policy debates of the time, including the American Recovery and Reinvestment Act, the Affordable Care Act, and the debates over the debt limit and fiscal cliff in 2011 and 2012.

My own use of prediction markets, including electoral prediction markets

I have personally encountered and extensively used prediction markets, including electoral prediction markets, extensively in three different settings:

The first is 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.

The second is in economic research. While I have not done any research on prediction markets I have frequently read and referred to this research to understand not just elections but the way that elections affect financial markets and the economy more broadly. In fact, some research on financial markets and the economy would be impossible without these prediction markets.

The third is in teaching. I co-teach Harvard's introductory economics class, called Ec10, and we introduce our students to prediction markets, show that, on average, they have historically been very accurate, and then show them political prediction markets. I believe that understanding probability, the difference between people's actions when money is at stake and when it just cheap talk, and the role of markets in aggregating information is helpful to students generally and specifically in the case of electoral prediction markets.

The reason why political prediction markets are superior to other tools for all of the above purposes is that they incorporate a wide range of information quickly and efficiently. A statistical model such as FiveThirtyEight's can only reflect the impact of an event on the political race once it starts appearing in polls. In contrast, a prediction market can react immediately. This near real-time probability calibration can be highly useful for researchers, whose event studies rely on a quick turnaround between the event occurring and the change in the data, in order to isolate the effects of the event from anything else occurring in that period. For instance, a researcher trying to learn the effects of a Supreme Court decision, an economic data release, or a candidate debate on electoral outcomes cannot wait weeks for enough polls to arrive to form a competent polling average, as too many different events may have occurred in the interregnum to be able to draw conclusions about any one in particular.

Prediction markets as a price discovery tool

The benefits of electoral prediction markets go well beyond the ways in which I have used them in my career. Elections can have profound affects for businesses. It is important for businesses to be able to make better predictions about elections (discussed in this section) and also hedge against the consequences of them (discussed in the next section).

Specifically, election prediction market can facilitate more accurate price discovery in other markets. Even those who are not actively participating in the market for election contracts, then, can benefit from the data that it provides.

For instance, suppose an energy firm is attempting to assess a fair market value for fuel to be delivered two years hence. To do so, the energy firm must estimate how supply and demand are likely to evolve over that period. Perhaps they use meteorological data and expect the winter to be unusually cold, and thus demand might rise. Or they survey earnings calls from key manufacturers to anticipate that supply chain bottlenecks from overseas natural gas producers might ease up, lowering the price. But another key factor they will consider is political risk. Legislative changes in environmental policy might increase or decrease the cost of producing natural gas.

While there is plenty of satellite data for a trader to use to estimate the weather impact on demand, there is little hard data to use to estimate political risk, which is a large part of the pricing puzzle. Enter election prediction markets. Traders know that their risk of beneficial or adverse policy changes depend on which party is in power and that change in risk is exactly what is necessary to price those commodity futures more accurately. A liquid, well-regulated

prediction market offering an accurate probability estimate of who is likely to control Congress would thus be highly valuable to price discovery.

There is ample academic evidence to suggest that prediction markets are highly efficient at aggregating information to produce an accurate forecast when compared to alternatives (especially farther out from an election). For example, economists Erik Snowberg, Justin Wolfers, and Eric Zitzewitz used data from the Iowa Electronic Markets to find clear linkages between prediction market prices and equity valuations.¹

Benefits of electoral prediction markets for small businesses needing to hedge

Election markets can also allow businesses and others to participate directly and hedge against the consequences of elections. Absent prediction markets businesses have no simple and transparent way to hedge against these risks.

Millions of businesses are affected by changes in Congressional control, facing both positive and negative risks. Congressional control impacts legislation, policy, and the business environment in ways that have direct economic consequence to businesses and workers. This risk is conceptually identical to climate risk, business interruption risk, and other similar risks that can and should be managed using the financial markets.

Many businesses have a regulated component to them, either directly because the business is a regulated activity, or as an integral component to the business. Energy, healthcare, and education are some of the many industries that are directly affected by the Federal government. Even industries that are not directly regulated operate in an environment that is directly impacted by the Federal government whether it is due to tax policy, labor regulations, financial regulations, or other myriad policies the government sets.

Political control can also impact the overall business environment, including macroeconomic developments like the likelihood of legislation that will raise or lower overall economic activity—and thus business sales—and also specific changes that could affect a businesses' ability to raise capital, hire workers, and expand.

Businesses should recalibrate and manage risk before elections occur. Businesses are forward-looking and should anticipate changes in policy and government attitudes. For example, businesses hire, contract, and build in anticipation of future demand. Investment decisions, partnerships, acquisitions, and more are made in anticipation of future growth and performance. Partnerships, loans, and equity deals are similarly forward-looking and similarly are affected by political control. Accordingly, risk management must begin beforehand as well. Equities and commodity futures reprice to account for potential changes in political control.

Election markets also provide an efficient tool for managing these dynamic and interrelated risks. A person that faces risks from multiple legislative changes and the changes to the business

¹ Snowberg, Erik, Justin Wolfers and Eric Zitzewitz, 2013, "Prediction Markets for Economic Forecasting," in the Handbook of Economic Forecasting Volume 2, Elsevier Press, pp.657-687.

environment that come with political control can effectively manage the risk through this contract, but cannot easily do so using contracts for individual policies alone.

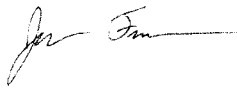
It is this hedging utility that distinguishes the market from the “gaming” contracts that the CFTC may be worried about. Whereas gaming contracts (such as a contract on the number of touchdowns a player scores in a football game) cannot reasonably be used for risk reduction purposes, an event contract on Congressional control clearly relates to an event of great economic importance.

The fact that many participants are not themselves using the contract for hedging does not refute this argument. If anything, non-hedgers serve a valuable purpose by providing greater liquidity and superior price discovery for the hedgers themselves—just as they do in a wide range of financial markets. Only if a market is exclusively used by speculators because the underlying event does not create sufficient risk that can be hedged would a contract be gaming. In contrast, not only can these markets be used for hedging, the great economic importance of the underlying event, and the significance of the risk, make them highly likely to be used as such.

The benefits of approving electoral prediction markets overwhelmingly outweigh the costs

Elections are not games, and the outcome of political control of Congress has enormous public interest ramifications. Election-focused prediction markets combine the economic significance of a powerful risk reduction tool for small businesses with the social significance of a powerful forecasting tool for researchers and policy-makers. A regulated election market will further the public interest by providing a valuable risk management tool, and providing data that will be valuable to businesses, economic researchers and policymakers alike. This is the exact kind of innovation that the CFTC should be embracing. I encourage the Commission to approve Kalshi’s contract for electoral markets.

Sincerely,



Jason Furman
Professor of the Practice, Department of Economics, Harvard University
Professor of the Practice of Economic Policy, Harvard Kennedy School

Comment No. 72484

Christopher Greenwood, N/A

2023 Contract

From: Victor Jacobsson
Organization(s): Rosfelt, Klarna

Comment No: 69707
Date: 9/18/2022

Comment Text:

My name is Victor Jacobsson, and I am a co-founder of Klarna, the world's largest buy-now pay-later company, with over \$80 billion in online sales in 2021. Today, I work as an independent advisor to a variety of startups and investors all around the world. In my experience—as an entrepreneur, advisor, and investor—political control has a vast impact on American businesses, and American business owners and workers deserve the opportunity to hedge the risk that political control might change in a way that adversely affects them.

The CFTC has asked the public to answer whether the effects of elections are predictable enough for them to be hedge-able events. While no one would claim to have a crystal ball and know exactly what bills Congress might pass, or exactly who they might confirm to important regulatory positions, risks indisputably rise when certain Congresses come into power, and hedging instruments are needed to mitigate that risk. The modern investor and business owner needs to take a comprehensive look at the risks (and opportunities) a business faces. Consider two risks, one of which has a 10% chance of occurring and will cause a \$250,000 loss if it happens. Another has a 25% chance of happening but will cause a \$100,000 loss. That first risk might be a hurricane, or a wildfire, or a particularly vicious hailstorm. The second might be an adverse change in Congress, with its concomitant changes in regulations, taxes, and beyond. It is considered negligent to not get insurance against the first risk. But in the United States, not only is it not obligatory to directly hedge yourself against the second, direct hedging products are strictly prohibited! From a business perspective, elections risk and other risks are very similar. Regulators should recognize that fact, and give business owners the tools they need to protect themselves in a similar manner.

The CFTC has also asked about whether these contracts can be used to price other services, including financial assets or commodities. As an investor and advisor, I receive a lot of pitches and proposals from entrepreneurs. A core part of any good pitch is an understanding of the legal, regulatory, and political environment. Shifts in any one of these key factors can impact a deal. There are any number of ways this can happen. An election might mean the end to a subsidy program the businesses rely on, or a tightening of regulation that increases their compliance cost, or a change to the way their customer base does business so that the expected future earnings of that company are lower. It is absolutely valuable then to know the probability of a new Congress entering government, as that affects the price that an investor is willing to pay per share of that company, and this is information that industry takes into account all the time. There is no doubt that businesses will start incorporating the data from the contract market into their assessments.

In conclusion, these contracts serve a valuable hedging function and price-basing function. My years of experience building, advising and investing in businesses strengthens the conviction I have in this fact. The CFTC should permit Kalshi to offer this valuable risk reduction tool to small business owners and the broader public.

ROA0001553

From: Michael Gibbs

Organization(s):

University of Chicago

Comment No: 69704

Date: 9/16/2022

Comment Text:

I am an economics professor at the University of Chicago. In my opinion, the Commission should approve this contract. Political elections are a major source of economic risk. There are good reasons to expect that election prediction markets will be a beneficial tool for improving hedging and efficiency of economic decision making that is contingent on such risks. Existing evidence suggests that such contracts have performed well in the past. It is worthwhile to experiment with this contract, and to expand the use of such contracts in the event that this experiment has a positive outcome.

Important insights into these issues are provided in a special symposium of the Journal of Economic Perspectives (Spring 2004): "Prediction Markets" (Justin Wolfers and Eric Zitzewitz, pp. 107-126); "Historical Presidential Betting Markets" (Paul Rhode and Koleman Strumpf, pp. 127-142). Both papers provide many additional relevant citations.

– 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 regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?

It is not appropriate to view any election contract as gaming. "Gaming" involves betting on outcomes that are intrinsically enjoyable but have no economic effect, such as sporting events. Elections have far-reaching economic effects. A better analogy is trading on futures contracts for interest rates or commodities prices.

– Do the contracts serve a hedging function? 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.

These types of contracts can be extremely valuable for hedging. The economic effects of election outcomes are enormous – even with respect to local elections, but certainly for national elections. This implies large economic uncertainties and risks associated with elections. Election prediction markets can be a valuable tool to help many types of economic agents to hedge their risks.

Even if the market or transaction size is too small for direct hedging of risks, prediction markets hedge risks more deeply, because they can provide more accurate, real-time predictions of the likelihood of various outcomes. That provides better information which can be used to improve the quality of decision-making, investments, etc. For example, consider a firm contemplating a large capital investment, with value contingent on the outcome of an election. Better quality predictions about the election can improve the timing, type, and magnitude of investment, increasing economic efficiency.

– 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 economic risks of election outcomes can be imperfectly hedged via other means currently available. However, prediction markets on these enormously significant events can greatly improve the ability to hedge (directly, and via improved economic decision making, as described above).

Moreover, evidence from academic research suggests that these types of contracts are a very promising tool. They tend to outperform other methods (e.g., polling). Moreover, there is little evidence that attempts to manipulate such markets succeed. These points are discussed in Wolfers & Zitzewitz; Rhode & Strumpf.

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

Binary contracts are useful, and have the virtue of simplicity in design and execution. However, the Commission should consider future applications with non-binary contracts. That includes markets with multiple possible outcomes

(e.g., a set of competing Presidential candidates), but also index and spread contracts (see Wolfers & Zitzewitz, Table 1).

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September 16, 2022

U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581

Re: Public Comment on Kalshi Proposed “Will <party> be in control of the <chamber of Congress>?” Contracts Pursuant to Commission Regulation 40.11(c)

Dear Commissioners:

I am writing to strongly support the approval of Congressional Control Contracts by Kalshi EX, LLC. As Lecturer in the Mathematics Department at the Massachusetts Institute of Technology, I teach financial mathematics and statistics courses. The contribution of the Kalshi exchange’s trading in event contracts is highly significant in providing the public and financial markets with explicit wisdom of crowds. Participants choosing to trade contracts based on their price is the scientific way to communicate their beliefs concerning the likelihood of the associated events. In addition to providing direct value to traders in the contracts, the public and financial markets benefit from the information conveyed by the dynamics of trading and prices in the contracts. Such activity supports efficiency in financial markets with the enhanced information flow of trading on a regulated exchange.

I have been registered with the CFTC for many years (as Commodity Pool Operator and now as a Commodity Trading Adviser). The importance of regulated exchanges to ensure the integrity and fairness of trading in financial markets is highly significant. I have been a long-term advocate for Kalshi in their pursuit of registering the exchange with the CFTC. In that capacity, I am an outside/independent director on the company’s risk oversight committee. Based on my experience and perspective, I offer below comments on several of the Public Questions posted in support of Congressional Control Contracts.

Yours truly,

A handwritten signature in cursive script that reads "Peter J. Kempthorne".

Dr. Peter J. Kempthorne

Comments on selected Public Questions posted concerning the Congressional Control Contracts.

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 regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?

Comment: The underlying activity of the contracts is political control. This activity is not one of the excluded activities in regulation 40.11(a)(1) – “terrorism, assassination, war, or gaming or an activity that is unlawful under any State or Federal law.” While such contracts involve betting on an event outcome, the outcomes of such bets are not purely random as in casino games or akin to sports betting for which the

public interest could be challenged. Instead, the Congressional Control Contracts provide a way for the public to communicate and share their expectations about congressional control. Such contract trading would have no direct impact on the outcome, but indirectly the wisdom of crowds would serve the public interest by helping to anticipate congressional composition and prepare for the impact of alternate outcomes.

2. 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?

Comment: While traditional gaming venues such as casinos or sports books might allow similar offerings, these do not serve the public interest. Allowing Congressional Control Contracts on the Kashi Exchange would serve the public interest by providing a completely equitable, transparent market for such contracts. Moreover, providing such contracts on a central exchange where the public can know and research the trading activity would support increasing the liquidity of such contracts, enabling the public with contract positions to adjust or close their contract positions efficiently in both time and cost. Such public-interest features are not available at casinos or sports books.

6. Do the contracts serve a hedging function? 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.

Comment: These contracts definitely serve a hedging function for individuals and investors. Their employment circumstance and opportunities can depend significantly on the political side with congressional control. Providing the ability to hedge alternate outcomes could have significant value to affected individuals. Also, the investment prospects of stocks or bonds in companies can depend significantly on congressional control (e.g., renewable vs fossil fuel energy companies; electronic vehicle and battery manufacturers). The Congressional Control Contracts would provide additional investment options to individuals which could diversify and lower their exposures to identifiable financial risks.

7. 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?

Comment: The traditional derivative products focus on the risks of existing underlying assets of the derivatives. The impact of congressional control is more broad-based. With a congressional control contract, such risks would be directly tradable, making the amorphous impact direct and tradable.

8. What standard should the Commission use in reviewing the contract's 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?

Comment: The hedging function of Congressional Control Contracts can only be determined through their use as actively traded contracts. The proof of demonstrated need by likely hedgers would likely not come until the active and liquid market for such contracts is available to the general public. While premature, an interesting question is whether the position limits for such contracts could be raised for participants self-designating themselves as hedgers. Such market activity would be feasible when trading in such a contract reaches maturity with sufficient liquidity.

11. 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?

Comment: As noted in Question 6, the investment potential of stocks and bonds of companies can be significantly affected by the outcome of the Congressional Control Contract. The risks of which political party is in congressional control could have an important impact on pricing commercial transactions in such assets or of related commodities. In addition to the direct payoffs of such contracts, their information value in terms of market insight/sentiment/wisdom would contribute to pricing and trading in these other assets.

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

Comment: The Congressional Control Contracts are definitely in the public interest. They provide two key contributions: 1) the ability to trade contracts on event outcomes for individuals directly affected by the event; and 2) the information content of informed, active traders about the likelihood of the contract event for use and consumption by the general public.

16. Should campaign committees, political action committees, candidates for the House and Senate, and other entities involved in political fundraising and expenditures or likely to hold non-public information, or subject to Federal Election Commission oversight, be prohibited from participating in the contracts? Would such a prohibition help address federal campaign law or manipulation and surveillance concerns? How would such restrictions impact the Commission's determination of whether the contracts are contrary to the public interest?

Comment: These possible prohibitions could be important in maintaining the integrity of the market in such contracts. I would support such prohibitions as supporting the public interest objectives of the Commission.

To whom it may concern,

My name is Sam Altman. I am the CEO of OpenAI, the world's leading artificial intelligence research laboratory and corporation, perhaps best known for the large language model GPT-3 and the image generation model DALL-E. Before OpenAI, I was president of the startup accelerator Y Combinator, the company that helped launch thousands of companies, including Airbnb, Dropbox, Doordash, Reddit, Stripe and Twitch. While president of Y Combinator, I helped launch the YC Continuity fund, a \$700 million fund to invest in YC portfolio companies. I am submitting this public comment to support Kalshi's proposed contract on Congressional control.

As a long-time investor in hundreds of early-stage startups, I know from personal experience that Congressional control has significant, direct, and predictable impacts on the risk exposures of small businesses, startups, and their founders and employees. Here is an example of how political control can directly and predictably affect the risks that a biotech startup faces. First, the biotech company has risk from FDA appointments and priorities which can mean the difference between rapid approval of a new treatment, or a yearslong delay that can cost the company's resources, and in extreme cases force the company into bankruptcy or a firesale. The company also faces risk regarding federal funding for research. Additionally, a Congress passing a mammoth new bill may force small businesses to spend small fortunes trying to navigate the regulatory uncertainty as the rulemaking process plays out. The risks of these events is directly, and predictably, tied to Congressional control and elections in general, and the risk management tools for this will be also. Nearly every business we fund faces risk from Congressional action in multiple ways..

Needless to say, then, these contracts have legitimate hedging use to manage risks and are not gaming. Congressional control is an economically significant event that impacts risk and many companies and founders and employees genuinely need to hedge against. The contract could be used by these companies, founders and employees to manage their risk very effectively. In my experience, many individuals and small businesses have the sophistication and foresight to hedge their risks quite effectively, and if the CFTC approves these contracts, based on my experience it is reasonable to assume that the contract will be used to hedge and manage risk.

I would not be writing this letter if I was not confident that this contract would not be contrary to the public interest. These contracts are obviously not the only economic exposure that small businesses and individuals have to elections. As I just illustrated, there are already significant exposures to elections. These contracts would actually help manage their existing risk. As an added advantage, the price of the contract represents the best "wisdom of the crowd" estimate of the probability of a given party winning the election. This data can be highly valuable to small businesses trying to make plans about the future and wondering about the expected

future path of federal policy, but also to researchers who are trying to estimate the effects of one party's agenda on various financial and economic variables.

It thus seems to me that the risks are minimal and largely speculative, whereas the benefits are real and large. The CFTC would be remiss to miss this opportunity to bring this socially valuable activity to American soil.

Stanford Law School

Joseph A. Grundfest
W. A. Franke Professor of Law
and Business, Emeritus
Senior Faculty, Rock Center for
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September 14, 2022

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: Review of KalshiEx LLC's proposed Congressional Control Contracts pursuant to Commodity Futures Trading Commission Regulation 40.11(c).

Dear Chairman and Commissioners:

This comment urges approval of KalshiEx, LLC's ("KalshiEX" or "Kalshi") proposed Congressional Control Contracts pursuant to Commodity Futures Trading Commission Regulation 40.11(c).

I am a former Commissioner of the United States Securities and Exchange Commission (1985-1990).¹ I am currently the W.A. Franke Professor of Law and Business (Emeritus) at Stanford University where I have served since leaving the SEC in 1990, and am also Senior Faculty of the Rock Center on Corporate Governance. My scholarship has been published in the Harvard, Yale, and Stanford law reviews, and my areas of specialization include financial market regulation, fraud, corporate governance, and venture capital.

When considering the public policy implications of the proposed contract, it is constructive for the Commission to recognize the robust information environment in which the contract proposes to trade. In particular, there is no shortage of commentary and prediction relating to the outcome of federal elections in general, or the prospects for control of either house of Congress in particular. The proposed contract will thus not be introduced in an information vacuum. The contract's implications for the public interest are therefore most accurately appreciated by considering the marginal effects that its introduction would have over and above the robust information sources already present in the market, and that will continue to be vigorously exercised if the contract is approved.

Significantly, dozens of polls seek to measure and predict the outcome of Congressional elections by district and in the aggregate. These polls include Quinnipiac,² ABC/Washington Post³,

¹ The views expressed in this comment are my own and do not reflect, nor should they be ascribed to, the views or positions of any other organization with which I may be affiliated.

² Quinnipiac University, "Poll Results", <https://poll.qu.edu/poll-results>

³ Washington Post-ABC News Poll, https://www.washingtonpost.com/wp-srv/politics/polls/postabcpoll_031012.html

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New York Times/Siena,⁴ Ipsos,⁵ and Emerson College.⁶ For example, a recent Emerson College poll found Senator Raphael Warnock trailing his challenger Herschel Walker for the Georgia Senate seat by two points.⁷ Other Senate races, such as the one in Pennsylvania, have been similarly well-polled with Emerson College⁸ polling joining similarly reputable Susquehanna Polling & Research and giving Lieutenant Governor John Fetterman a modest margin over his challenger, Mehmet Oz.⁹

Many commentators and consultants also predict Congressional campaign outcomes, again on a district-by-district basis, as well as for Congress as a whole. These commentators include the Cook Political Report,¹⁰ Data for Progress,¹¹ Politico¹² and Frank Luntz.¹³ Steve Shepard of Politico, as an example, rates the Senate as a “toss up” but projects that Republicans are “likely” to take control of the House.¹⁴ Meanwhile, the Cook Political Report rates nine of the thirty-five Senate seats up for re-election as Safe Democrat, three as lean Democrat, four as lean Republican, and fifteen as Safe Republican.¹⁵

Some analysts construct statistical models that rely on polling data to aggregate this information and to generate quantitative predictions of likely electoral outcomes. The most famous of these models is, perhaps, operated by FiveThirtyEight,¹⁶ but there are many prominent alternatives, including models generated by the Economist¹⁷ and the New York Times.¹⁸ FiveThirtyEight, as of September 11, 2022, projected a 74% probability that Republicans would take control of the House, and a 69% probability that Democrats would control the Senate.¹⁹ The Economist also projects a 74%

⁴ The New York Times/Siena College Research Institute July 5 -7 2022.

<https://int.nyt.com/data/documenttools/us0722crosstabs-nyt071122/33ffa85627ee4648/full.pdf>

⁵ Ipsos. “Political and Public Opinion Polling”, <https://www.ipsos.com/en/political-and-public-opinion-polling>

⁶ Emerson College Polling. <https://emersoncollegcpolling.com/>

⁷ See <https://emersoncollegcpolling.com/georgia2022-walker-holds-two-point-lead-over-warnock-in-tight-senate-race-kemp-leads-abrams-by-four/>

⁸ See <https://emersoncollegcpolling.com/pennsylvania2022-fetterman-holds-four-point-lead-over-oz-for-us-senate-shapiro-leads-mastriano-by-three/>

⁹ See <https://www.politicspa.com/susquehanna-poll-fetterman-holds-five-point-lead-on-oz-49-44/111648/>

¹⁰ Cook Political Report, <https://www.cookpolitical.com/>

¹¹ Data for Progress, “Elections”, <https://www.dataforprogress.org/elections>

¹² Politico. “2022 Election Forecast”, <https://www.politico.com/2022-election/race-forecasts-ratings-and-predictions/>

¹³ Frank Luntz, “What Happened When 7 Trump Voters and 6 Biden Voters Tried to Find Common Ground”. NEW YORK TIMES (Jul. 28, 2022), <https://www.nytimes.com/interactive/2022/07/28/opinion/focusgroup-political-division.html>

¹⁴ See, Politico Forecast, September 11, 2022, available at <https://www.politico.com/2022election/race-forecasts-ratings-and-predictions/>

¹⁵ See <https://www.cookpolitical.com/ratings/senaterace-ratings>

¹⁶ FiveThirtyEight, “2022 election forecast”, <https://projects.fivethirtyeight.com/2022-election-forecast/senate/?cid=rrpromo>

¹⁷ The Economist, “How The Economist presidential forecast works”, THE ECONOMIST (2020), <https://projects.economist.com/us2020-forecast/president/how-this-works>

¹⁸ See <https://www.nytimes.com/live/2020/presidential-polls-trump-biden>

¹⁹ See <https://projects.fivethirtyeight.com/2022-election-forecast/house/>; and <https://projects.fivethirtyeight.com/2022-election-forecast/senate/>

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probability that Republicans will control the House, but generates a higher 78% probability that Democrats will control the Senate.²⁰

Other analysts build models that rely on economic or other macro criteria to predict the outcome of federal elections, including presidential and congressional campaigns. For instance, Yale Professor Ray Fair,²¹ Google's Patrick Hummel and Microsoft Research's David Rothschild²² all have developed models along these lines. London School of Economics' Torun Dewan and Harvard's Kenneth Shapsle reviewed the vast literature surrounding these fundamentals models (including political science game theoretic models of elections) and found dozens of models, which encompass a wide variety of modeling choices.²³ For example, as of July 28, Fair's model projected that Democrats will receive 47% of the two-way House vote in the 2022 midterm election.²⁴

Prediction markets based on federal elections are active abroad and easily accessed by US persons. At Britain's BetFair, more than \$250 million was traded on the US election as of the Wednesday before election day, with another \$150 million expected over the following few days.²⁵ Several other sites, including Ireland's Paddy Power (now owned by BetFair) and UK's LadBrokes saw millions in trading as well.²⁶ Polymarket's 2020 presidential election market supported more than \$10 million in trading.²⁷ Many US residents access these markets using a variety of affordable VPNs, and the predictive probabilities implied by trading in these markets are obvious to all. Recent prices on Betfair imply a 68% probability that Democrats retain control of the Senate and a 74% probability that Republicans take control of the House, with roughly \$400,000 wagered on the outcome of Senate races and \$300,000 wagered on House races.²⁸ At Ladbrokes, prices imply a 56% probability that Democrats retain control of the Senate and a 75% probability that Republicans take control of the House.²⁹

There is no shortage of press commentary that reviews and aggregates these different perspectives into a single overarching theme. The New York Times recently published a roundup of

²⁰ Split Decision, *The Economist*, Sept. 10, 2022, at 25.

²¹ Ray C. Fair, "Predicting Presidential Elections and Other Things", 2002.
<https://fairmodel.econ.yale.edu/rayfair/pdf/vote.pdf>

²² Patrick Hummel and David Rothschild, "Fundamental models for forecasting elections at the state level", *ELECTORAL STUDIES* (2014), <https://www.sciencedirect.com/science/article/abs/pii/S0261379414000602#>

²³ Torun Dewan and Kenneth Shepsle, "Political Economy Models of Elections", *ANNUAL REVIEW OF POLITICAL SCIENCE* (2011), <https://www.annualreviews.org/doi/10.1146/annurev.polisci.12.042507.094704>

²⁴ See <https://fairmodel.econ.yale.edu/vote2020/indexnel.htm>

²⁵ Chris Isidore, "\$284 million has already been wagered by British bettors on the US election outcome". *CNN* (October 30, 2020), <https://www.cnn.com/2020/10/30/business/us-presidential-election-wagering-record/index.html>

²⁶ "Betting sites see record wagering on US presidential election", *CNBC* (Nov. 7, 2016), <https://www.cnbc.com/2016/11/07/betting-sites-see-record-wagering-on-us-presidential-election.html>

²⁷ Polymarket, "Will Trump win the 2020 US presidential election" <https://polymarket.com/market/willtrump-win-the-2020-us-presidential-election>

²⁸ See <https://www.betfair.com/exchange/plus/politics/market/1.179673535>

²⁹ See <https://sports.ladbrokes.com/event/politics/international/uselections/2022-house-elections/234135146/all-markets>

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the prognostications of election “soothsayers.”³⁰ Such coverage is common at leading media sources, including the Washington Post,³¹ Politico,³² and the Wall Street Journal.³³

Finally, overt and entirely legitimate efforts by millions of people seek legally and powerfully to influence the outcome of federal elections. Editorial boards, columnists, and armies of influencers, endorsers, and campaign contributors all strive to tilt election outcomes. Presidential candidates in 2020 spent north of \$4 billion,³⁴ and Congressional candidates spent a further \$4 billion,³⁵ all raised from more than four million donors.³⁶

The public interest benefits of introducing Kalshi’s contract in this environment are palpable and easily enumerated.

First, Kalshi’s proposed contract will identify all market participants and subject them to know-your-customer and anti-money laundering requirements. The contract will generate audit trails and all transactions will be transparent to regulators. In contrast, alternative data sources operate with varying degrees of transparency and disclosure, and many are not subject to direct federal regulatory oversight. Federal authorities, for example, neither know the identities or incentives of persons who respond to polls, nor can audit or validate the numerous statistical models that operate in this space. Indeed, First Amendment considerations properly limit the government’s ability to monitor and control alternative predictive information sources. In contrast, Kalshi’s contract will have a level of transparency and regulatory compliance unequalled by any of these other predictive sources. The processes by which Kalshi generates its predictive information will also be fully transparent to regulators and market participants alike, and will be subject to careful scrutiny. Kalshi will thus add a differentiated and regulated voice to predictive public information flows.

Second, numerous observers have commented on the possibility that polling data are becoming less reliable either because respondents are unwilling to respond truthfully to pollsters or

³⁰ Blake Hounshell, “Why the Soothsayers Are So Puzzled by This Year’s Midterms”, NEW YORK TIMES (Aug. 8, 2022), <https://www.nytimes.com/2022/08/08/us/politics/midterm-election-democrats-republicans-predictions.html>

³¹ Annie Linskey and Michael Scherer, “Democrats see the once unthinkable: A narrow path to keeping the House”, WASHINGTON POST (Aug. 27, 2022), <https://www.washingtonpost.com/politics/2022/08/27/democrats-republicans-house-midterms/>

³² Myah Ward, “Election forecasters rethink their ratings”, POLITICO (Aug. 25, 2022), <https://www.politico.com/newsletters/politico-nightly/2022/08/25/election-forecasters-rethink-their-ratings-00053839>

³³ John McCormick, “Independent Voters Now Tilting Toward Democrats in Midterm Elections, WSJ Poll Finds”, WALL STREET JOURNAL (Sep. 1, 2022), <https://www.wsj.com/articles/democratic-midterm-prospects-improve-as-races-heat-up-wsj-poll-finds-11662024601>

³⁴ Federal Election Commission, “Statistical Summary of 24 Month Campaign Activity of the 2019-2020 Election Cycle”, <https://www.fec.gov/updates/statistical-summary-24-month-campaign-activity-2019-2020-election-cycle/#:~:text=Presidential%20candidates%20raised%20and%20spent,209%20through%20December%2031%2C%202020>.

³⁵ *Id.*

³⁶ OpenSecrets, “Donor Demographics”, <https://www.opensecrets.org/elections/overview/donor-demographics?cycle=2020&display=G>

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because the evolution of internet and cellphone communications introduces bias into polling practices.³⁷ Kalshi's market is not as vulnerable to these concerns because Kalshi market participants have powerful incentives to accurately predict election outcomes. Expressing any other incentive would be financially costly and adverse to the trader's financial interests. From that perspective, knowledgeable observers interested in adjusting for biases that might be influencing polling practices have incentives to express their adjustment factors by participating in the Kalshi contract, and thereby informing the rest of the market of these adjustment factors.

Third, by operating a differentiated market in which knowledgeable observers can express predictive judgments in an incentive compatible manner, free of biases that can influence other predictive methodologies, Kalshi's contract will add to the competitiveness, accuracy, and transparency of all predictive forms of expression in the marketplace.

Fourth, concerns that a contract like Kalshi's might be used for manipulative purposes are easily exaggerated. Persons interested in manipulating markets have little incentive to identify themselves to federal authorities who can quickly respond with civil or criminal sanctions. Persons interested in manipulating federal elections will find it far more rational to launch social media disinformation campaigns or other forms of deception than to participate in a contract market where they must identify themselves and know that their every move is monitored by regulatory authorities. Further, because of the ambiguous relationship between turnout and perceived position in a campaign, it is far from clear how persons interested in manipulating an election would participate in the Kalshi market. Would a person favoring Candidate X want to inflate the probability that Opponent Y will prevail, and thereby attempt to stimulate more X supporters to show up at the polls? Or, would the person favoring Candidate X want to deflate the probability that Opponent Y will prevail in order to dishearten Candidate Y's supporters and suppress opponent turnout? And, if market participants seek, for partisan reasons, to tilt the market one way or another, they will be entirely unable to prevent counterparties from entering the market to offset their non-market-based efforts to influence Kalshi's predictive estimates. Indeed, they would be creating profitable trading strategies for their opponents – hardly an outcome they would welcome. The optimal strategy for a potential manipulator is thus far from clear, and this ambiguity very substantially diminishes concern that the Kalshi market will be used for manipulative purposes. Indeed, given the ambiguous electoral consequences of efforts to influence pricing of the Kalshi contract, a person interested in promoting one candidate over another would likely find it far more rational simply to contribute to the favored candidate's campaign where the effect of the contribution is far less ambiguous.

³⁷Joseph P. Williams, "The Problem with Polls", US NEWS(Sep. 28, 2015), <https://www.usnews.com/news/the-report/articles/2015/09/28/why-public-opinion-polls-are-increasingly-inaccurate>; Jemima McEvoy, "2020 Election Polls Were the Least Accurate In Decades—Mostly For Underestimating Trump, Report Finds". FORBES (Jul. 19, 2021), <https://www.forbes.com/sites/jemimamcevoy/2021/07/19/2020election-polls-were-the-least-accurate-in-decades-mostly-for-underestimating-trump-report-finds/?sh=4cf10fc56318> Nate Cohn, "Yes, the Polling Warning Signs are Flashing Again", NEW YORK TIMES (Sep. 12, 2022), https://www.nytimes.com/2022/09/12/upshot/pollingmidterms-warning.html?campaign_id=9&emc=edit_nn_20220912&instance_id=71706&nl=the-morning®i_id=159018825&segment_id=106056&te=1&user_id=399100d1a84e7cf6c6483ccc4f676104 David Leonhardt, "Are the Polls Wrong Again?", NEW YORK TIMES (Sep.12, 2022), <https://www.nytimes.com/2022/09/12/briefing/polling-midterms-republicans-democrats.html>


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Fifth, the electorate's view of the likely outcome of an election will not be determined exclusively by the pricing of the Kalshi contract. Voters retain access to multiple sources of predictive information, as described above, and will discount Kalshi's predictive information, to the extent appropriate, in light of all other predictive information sources that are active in the market.

Sixth, the extent to which the public is willing to rely on the predictive information generated by the Kalshi contract will be codetermined by the level of confidence the Kalshi contract generates in its integrity. The greater the public's confidence in the integrity of the information generated by the contract, the greater the reliance the public will place on the contract, and the more valuable the contract to society and to its sponsors. The contract's sponsors thus have intrinsic incentives to operate the market without bias or favor to any side of any contract, and to assure that the contract's predictive results are as unbiased and accurate as possible. It is unclear that every other voice in the market for predictive information has equivalently neutral incentives.

I trust that these observations are helpful to the Commission in its deliberations and would be happy to respond to any inquiries that the agency might wish to pose as part of its deliberative process.

With best regards,



Joseph A. Grundfest
The William A. Franke Professor of
Law and Business, Emeritus

To whom it may concern,

I wish to write in favor of Kalshi's proposed contracts regarding the midterm elections. I'm a lifelong philanthropist and activist focusing on promoting women's rights and LGBTQ+ rights. I'm on the board of Vital Voices, a nonprofit organization originally founded by Hillary Clinton to advance women's rights and economic empowerment. I'm an art dealer by trade, and I run an art gallery that specializes in centering women, LGBTQ+ and minority art voices. One of my core driving missions is to promote the integrity of the US electoral system and safeguard it from threats to discredit and undermine it.

All of my work is rooted in my and my family's long history of promoting rights for women and LGBTQ+ communities everywhere in the world. I draw a lot of inspiration for my work from my ancestor Rajkumari Amrit Kaur, who was honoured in the TIME 100 Women list for her activism around women's rights to vote and her work alongside Mahatma Gandhi (some of which has inspired Martin Luther King Jr.'s incredible impact in this country).

Financial markets provide many a path to achieve financial independence and weather the tides of political change. I've seen first hand how elections can have enormous societal impact, and the ability to financially safeguard oneself from those changes is paramount.

Whether it be social spending, labor regulation, or the promotion of human dignity and respect, elections impact people's everyday lives. People deserve the ability to hedge themselves against those risks. Traditional financial tools—like derivatives and options—may protect someone with traditional financial assets at stake, but for most people who are imperiled by elections in a way wholly unique from anyone else, these tools just won't cut it. A straightforward hedging contract—such as the proposed election contracts—is a better way to help individuals with what they need. If you are a woman whose right to female health services is under threat, election outcomes matter. If you work in retail or in food service, as millions of Americans do, macroeconomic policies have a strong and obvious effect on your ability to make ends meet: when the economy craters, your job is at risk. If you stay at home to care for a loved one—a child, an aging parent, a sick relative—different governments have different policy proposals towards supporting you and your needs. The ability to protect yourself against a government who will not support you and your needs a valuable public service.

As I said, elections matter and they immense impact on millions of people, if not all people. Another principal benefit of election markets is their forecasting value. Millions of Americans read the news each evening during election season to find out who's winning, who's falling behind, and more. But many of those news reports are, to be generous, of dubious quality. They base themselves off of who they feel has the "momentum" or other determinations of fuzzy, unscientific provenance. Misinformation is everywhere and is polarizing the country. Polls are getting less and less accurate and more and more biased over time. Prediction market values would be an invaluable addition to the media ecosystem but, to date, they have largely been eschewed in part due to prediction markets' small size and questionable legal status. A well-regulated, safe, and trustworthy prediction market could integrate into the news reports and provide useful information to millions of Americans, by giving them a source of more truthful forecasts of what's going to happen with the next electoral event.

In sum, these are all the reasons why I strongly support these markets and the public benefits they bring to the table.

Amar Singh

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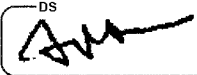
To the Commissioners of the CFTC,

My name is Jorge Paulo Lemann. I am a Swiss / Brazilian businessman who co-founded 3G Capital in the U.S., Banco Garantia in Brazil, and helped create Anheuser-Busch InBev, the world's largest brewery business. In the past and present I have been a board member of the Gillette Company, Kraft Heinz, Swiss Re, AB InBev, Lojas Americanas, and have participated in Advisory Councils of NYSE, Credit Suisse, DaimlerChrysler, J.P. Morgan, Harvard Business School, and Exor.

Several consumer-packaged goods (CPG) companies I built and have helped build are some of the largest participants in a variety of commodity futures and derivatives markets. As someone who deeply understands the fundamental purpose of futures markets and their crucial ability to transfer risk in the economy, I am writing in strong support of CFTC approval of Kalshi's proposal to list political event contracts.

In its questions to the public, the CFTC questions whether this contract possesses (a) hedging utility (question 6), and (b) price-basing utility (question 11). Previously, when deciding the Nadex case, the CFTC had determined that "the unpredictability of the specific economic consequences of an election means that the Political Event Contracts cannot reasonably be expected to be used for hedging purposes" and that "there is no situation in which the Political Event Contracts' prices could form the basis for the pricing of a commercial transaction involving a physical commodity, financial asset or service". These statements 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. Political parties have different platforms, different people, and different policy goals, and while the precise details of what the government ultimately enacts may not be known with certainty, elections have a direct impact on the risk of economically costly events occurring and economically beneficial events not occurring. Elections result in the appointment of different people to regulatory positions, the enactment of different regulatory policies, the passing of different farm bills, and more. These all directly impact pricing, investment outlooks, and many other economic decisions because they shape the landscape that businesses operate in. An investment may look very different if hypothetical legislative and regulatory events x, y and z occur than if they do not occur. If an election makes it materially more likely for the events to occur, that election poses significant risk to the parties in the deal. That risk can and should be hedged.

Additionally, the consequences of elections on risk mean that commodity markets will respond to elections as well. And because the financial markets are forward looking, they change in response to the likely outcomes of elections too. From my experience, the data from these markets will be useful in determining the pricing for commodities, investments and financial assets, and services. Thus, even companies for whom the position limits (\$25,000) are too small to be valuable would benefit from having this valuable data point available in the market.



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Moreover, in the seventh question that the CFTC posed to the public, they ask whether there exist “unique economic risks tied to the outcome of congressional control that cannot be hedged via [traditional] derivative products”. The answer is yet again a resounding yes. In an increasingly globalized world, the risks that businesses face cannot be merely reduced to price shocks in raw commodities. Of course, changes in the wheat market (to produce beer at AB InBev) affect the profits of my companies, and we use existing products to hedge accordingly. But those are hardly the only risks that we face. National policy from many countries, including the United States, have an impact, and constitute risk, as well. And these risks manifest in ways beyond just the raw commodity price mechanism (though elections do certainly affect commodity prices as well), and therefore cannot be fully hedged using only existing hedging products. For example, even in cases when appointments to certain regulatory positions do not affect commodity prices, they would still impact the input prices we must pay. One tax or regulatory change might not affect the price paid wholesale for wheat but might increase the cost it takes to process it. As a result, a hedge on the price of wheat would not capture the financial risks we face. While large companies like AB InBev can safely absorb increased compliance costs to accommodate new or different rules, many smaller farms, and companies—many of whom operate on razor-thin margins—cannot so easily do so. As a result, they are subject to the vicissitudes of federal policymakers with little ability to reduce their exposure in a way a larger company might be able to do so. The \$25,000 position limits may not be the perfect fit for a company with billions of dollars in annual revenue, they are perfect for small businesses and, should this market evolve over time, may be a great fit in the future for larger businesses.

Additionally, several questions can be seen to imply the possibility that an exchange, or the CFTC, should be determining how market participants should manage their risk. That would be a profound and unfortunate shift from the current regime that was created by Congress and has allowed for significant growth and development of healthy markets. It is up to market participants to determine whether there is risk, how to manage their risk, and what products and strategies to use to hedge their risk. Similarly, it is up to firms to determine what data points they will utilize in conducting their business.

The CFTC should act in a way consistent with its mandate and with the law: to allow legitimate economic contracts that can be used for hedging and for price-basing purposes by thousands of American businesses.

Sincerely yours,

DocuSigned by:

C4D7EFED78DD449...
Jorge Paulo Lemann

From: Sam Steyer
Organization(s): Greenwork

Comment No: 69677
Date: 9/11/2022

Comment Text:

To whom it may concern,

My name is Sam Steyer, and I'm writing on behalf of myself and Greenwork, where I'm co-founder and CEO. Greenwork is a software company that helps clean energy companies build their installation and construction capacity. We offer our customers tools to hire skilled tradespeople, build a network of local contractors, and ensure compliance with labor regulations. I'm writing in support of Kalshi's political control contracts, which would greatly help mitigate risk and provide accurate information for businesses like ours that engage in politically sensitive sectors.

Energy as a sector has always been deeply tied with policy and regulation. From the earliest days, electric utilities have operated under a government-granted monopoly and been subject to a regulated rate of return model. The US government has been deeply involved in ensuring access to oil at reasonable prices through the Strategic Petroleum Reserve and negotiation with foreign parties like OPEC. Most recently, we have been thrilled to watch the passage of the landmark Inflation Reduction Act, which invests \$369B in clean energy and climate work over 10 years and we view as foundational to bringing about a zero-carbon energy transition.

Greenwork has already experienced the importance of government policy very directly. Much of this experience has been very positive! We are members of the Department of Energy's Better Buildings Workforce Accelerator and have applied to both California and Federal Grants. Policies like the Investment Tax Credit and California's Net Metering rules are fundamental to the success of many of our customers in the solar industry.

One early potential Greenwork cofounder did not join the company, in part, out of concern that if an administration that was skeptical of clean energy was elected in 2020, it would undermine our customers and our business. To be clear: election risk was a major concern for a co-founder who would have greatly helped our business and will remain a clear and tangible risk that our business faces going forward. This is a great example of exactly the use case of Kalshi's contract, and the fears that market participants have. Not (just) that a particular policy will be enacted, but rather, that a government hostile to our interests could be elected, who could implement myriad such policies through regulation, subsidy, judicial nominations, taxation, departmental appointments, and more. Such an election would deter not just cofounders, but investors and partners as well. The election risk is the thing we wish to hedge uniquely.

In addition, decisions like those would be made with more confidence and certainty if Kalshi's contracts were permitted for approval. A market on election outcomes would be a better prediction tool than current polling and modeling by aggregating all information and having people put their personal wealth on the line. We'd gladly use this information in order to inform company decisions, as would others in the industry.

The 2022 midterms are no different. The Inflation Reduction Act of 2022 is the most important climate and clean energy legislation ever passed in the United States. The way that it is implemented over the coming months and years will have a very meaningful effect on our business. For example, if the prevailing wage and apprenticeship requirements in the bill are robustly supported, as we expect they will be under a pro-labor government, that will create demand for HR services like ours that help companies invest in worker training and well-being, paying more to provide a better worker experience and creating a market for Greenwork.

I believe that small businesses, such as ours, should have tools to hedge against political outcomes impacts on their businesses, in the same way that large companies, in practice, already do. To that end, I encourage the Commission to approve Kalshi's contracts before the October 28th stated deadline if at all possible.

From: Zvi Mowshowitz
Organization(s):

Comment No: 69673
Date: 9/9/2022

Comment Text:

Dear CFTC,

I am writing in support of Kalshi's submission to the CFTC regarding prediction markets on elections. I have previously been a quantitative trader with Jane Street Capital, and I have been a long-time supporter of and participant in prediction markets. I am currently writing at Don't Worry About the Vase where a major topic is forecasting events, in particular Covid-19. I am one of the world's leading experts in prediction market construction and design, and have consulted for multiple prediction market companies.

I believe that well-functioning markets on elections are crucial, and that they should be granted legal status.

Prediction markets are our best tool for understanding many aspects of our world. Unlike many financial markets, the market will resolve to a definite value within a limited time frame, so they reward being right about what will happen rather than trying to anticipate market trends. Losses are bounded, so you can stay solvent longer than the market can stay crazy. This rapid feedback and the potential to fully realize one's edge attracts smart money to correct mistakes.

This is how we live in a world where we can use prediction markets to get access to excellent probabilistic knowledge of which scientific papers will replicate, or the outcomes of sporting events, or the outcome of an election. All we need is a prediction market with broad participation.

In many prior elections, prediction markets were by far the best tool for knowing the current state of the race and the likelihood of different outcomes. This was for example greatly helpful to stock market investors in 2016, to separate out the impact of changes in the presidential race from other drivers of stock prices.

Not only do I reject the CFTC's suggestion that these markets might compromise election integrity, I would claim the exact opposite. Having prediction markets preserves election integrity. When prediction markets are greatly surprised by an outcome, or are predicting an outcome in a way that does not reflect what a free and fair outcome would look like, that is an alert that integrity is under threat.

In 2020, on election night, prediction markets acted as an important check against attempts to prematurely declare victory. As things progressed, they sent a strong signal that changes were not the result of fraudulent changes but rather predictable from the distribution of ballots and how and when they were counted. They also served, after the outcome was decided, as a canary in the coal mine that there would be continued challenges to the integrity of the election, giving us a warning that something like January 6 was possible.

They continue, today, to alert us to threats to election integrity. If someone wants to profit from manipulating an election, there already exist many ways to get indirect exposure to elections synthetically via other markets that would exceed the exposure plausibly available directly in election markets at any reasonable price.

Attempting to manipulate election markets to distort public perception would end in failure. Citadel LLC and others have expressed a clear willingness to take large positions if someone moves the market to an unnatural price. It would be exponentially expensive, likely costing billions, to cause a persistent and large jump in a regulated and legal prediction market on a major American election.

Also, to the extent this is a worry, Kalshi's proposal makes this a smaller worry because prediction markets already exist overseas, and Kalshi's market would be even more robust to this attack.

Prediction market information also protects the public from media bias and media attempts to distort the state of the race. The best media coverage of recent elections has fully integrated existing prediction market information, and is far better for it. Other news coverage ignored such predictions, both before and on election night, and ended up spreading misinformation.

Election markets not only do not harm the integrity of the political process, they are vital to the integrity of the political process. They should be embraced by US regulators.

To whom it may concern:

I am a lawyer, a policy analyst, and founder of the think tank People's Policy Project. Over the last five years, my organization has produced research and policy proposals on topics including the welfare state, climate change, housing, and social ownership of wealth. Before starting the People's Policy Project, I worked at the think tank Demos. My work has been cited or featured in almost every major media publication, including the *New York Times*, the *Washington Post*, and *The Wall Street Journal*.

I am writing this letter in support of allowing KalshiEx to offer binary contracts on which political party will be in control of the U.S. Congress and in support of allowing tightly-regulated entities to offer binary contracts on election outcomes generally (Filing 22-002).

I believe that these contracts serve two important purposes:

1. For the public, the trading of these contracts produces useful real-time information about the important question of who is likely to govern the country in the near future. This information is widely sought out already, which is why many major publications, including *The New York Times* and *FiveThirtyEight*, publish election forecasts based on polling data, and why hundreds of articles are produced each election cycle prognosticating about the election outcome. The implied probabilities produced by actual traders risking their own money gives a separate insight into the question that polling aggregation and punditry does not.
2. For individuals, these contracts allow hedging against certain policy outcomes that could be important to their personal finances. While it's true that the ultimate policy outcome of a given election outcome is not entirely certain, candidate promises and the general policy tendencies of the parties provide some guidance about the direction policy will shift based on who wins. More narrowly, there are hundreds of thousands of individuals who work in and around politics whose life circumstances are altered quite radically by political outcomes.

It's almost certainly true that most of the individuals who would participate in these futures markets are not hedging against any personal risk and just hoping to make money by picking the right side of a binary election outcome contract. These kinds of participants are not sympathetic and enabling this kind of behavior should not be the aim of public policy. But these participants are also necessary to produce the valuable informational and hedging functions of these contracts. So these considerations need to be balanced against one another and, in my view, the balance of considerations favors allowing the contracts.

Lastly, it is worth remembering that there are foreign betting markets, like Betfair in the UK, where gamblers, including Americans, already place wagers on the outcomes of US elections. Bringing election contracts onshore and regulating them domestically would reduce the risks involved in this market relative to the status quo.

Sincerely,

Matt Bruenig



United States Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear regulators at the CFTC,

I am writing as the founder and co-CEO of from Nabis, a wholesale technology platform supporting legal cannabis sales in California. As one can reasonably surmise from the nature of our business, political outcomes have a substantial impact on our bottom line. Different governments may have different policy preferences regarding the legality of our product. Legislation impacts our ability to safely access banking and the rest of the financial system. National policy impacts our ability to market, attract talent, and reach needed reforms. Few businesses in the nation are more directly downstream of who wins Congress.

To be perfectly blunt, policy risk is no different to us than a tree falling on the roof of our headquarters. We'll lose tens of thousands of dollars if a tree falls on us, cannabis-averse leaders gained control of either the House or the Senate and the odds of major policy progress collapse. Both are equal risks, but only one we can potentially purchase a hedging product for. While much larger companies may be able to go to a major investment bank and get an election hedge constructed for them out as an over-the-counter derivative, the overwhelming majority of businesses in America cannot. A simple, intuitive election hedge could thus help reduce the policy risk we have in our business, allowing us to focus on delivering the best product we can.

Thank you!

Jun S. Lee,
Founder and Co-CEO,
Nabis



From: Flip Pidot

Organization(s):

Sharp Square Capital

American Civics Exchange

Comment No: 69645

Date: 9/2/2022

Comment Text:

In my capacity as manager of a CPO/CTA fund organized to provide liquidity to and transact on KalshiEx, and in light of my experience curating and writing rules for the markets on PredictIt from 2014-2019, I write in support of Kalshi's proposed Congressional Control Contracts.

These contracts should be approved without hesitation, as they clearly conform to CEA provisions and CFTC regulations and core principles. The economic purpose to be served by such contracts is overwhelming and the objections commonly presented are unfounded.

The CFTC's rejection a decade ago of similar products proposed by Nadex involved a fairly egregious misinterpretation of Dodd-Frank's event contract proscriptions, an error that not only disqualifies it as precedent in this review, but deserves explicit correction as part of the Commission's approval.

The Commission poses the following 17 questions in its request for public comment (paraphrased for brevity):

1. Do the contracts involve gaming as described in Regulation 40.11 or section 5c(c)(5)(C) of the CEA?

These sections don't define gaming, of course, but simply prohibit event contracts that involve gaming, leaving the reader (or regulator) to figure out how to define it. In its 2012 order prohibiting Nadex's election contracts, the CFTC relied on the definition of "bet or wager" in USC § 5362, which includes staking value on the outcome of "a contest of others" (and the CFTC then judged that an electoral "contest" qualifies as such).

This aggressive interpretation of the phrase "a contest of others" plainly does not reflect the Commission's own criteria for application of Reg 40.11. If a political campaign, in which multiple candidates vie for the "prize" of election to public office, qualifies under this definition, surely contests such as the

Oscars, Emmys and Grammys (in which candidates vie for literal prizes) likewise qualify. Yet Kalshi has previously self-certified and listed numerous contracts tied to these contests without objection by the CFTC.

Furthermore, PredictIt (the market operating under no-action relief since 2014), while neither a DCM nor an SEF, has nonetheless been bound by the product proscriptions in Reg 40.11, being unable to list contracts tied to most military activities, outcomes closely associated with mortality of public officials, etc. Yet PredictIt has successfully and without issue listed many thousands of contracts tied to electoral outcomes. Notwithstanding the Commission's recent decision to revoke PredictIt's no-action letter for alleged non-compliance, its routine listing of electoral "contests" clearly did not run afoul of Reg 40.11's topical prohibitions.

2. Should the Commission consider whether election contracts are available in casinos or defined as gaming under state or federal law?

Federal law grants the CFTC exclusive and preemptive jurisdiction over futures transactions. The Commission should resist any temptation to cede its jurisdiction to state law or regulations.

As the Commission summarized in a brief to SDNY years ago:

CEA Section 2(a)(1)(A) grants the CFTC "exclusive jurisdiction" to regulate "transactions involving," inter alia, "contracts of sale of a commodity for future delivery." 7 U.S.C. § 2(a)(1)(A). This provision "preempts the application of state law." *Leist v. Simplot*, 638 F.2d 283, 322 (2d Cir. 1980) (Friendly, J.); see also *Stuber v. Hill*, 170 F. Supp. 2d 1146, 1150-51 (D. Kan. 2001). That plain meaning is confirmed by the statute's legislative history, which says that "regulations issued by the Commission . . . preempt the field insofar as futures regulation is concerned," and, if state law conflicts with the Commission's regulations, "Federal law w[ill] govern."

<https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/cftcbriefiso102612.pdf>

The issue of federal legislative definition of gaming is discussed in Question 1.

3. Do these contracts involve "an activity that is unlawful under any State or Federal law" as described in Reg 40.11 and section 5c(c)(5)(C) of the CEA?

They do not. Elections are not unlawful activities.

The lawfulness test plainly refers to the underlying activity/events (not the lawfulness of listing contracts tied to their outcomes), appearing as it does as the first in a list of proscribed event topics that includes assassination, terrorism, war, etc.

4. In determining whether these contracts involve unlawful activity, should the Commission be influenced by whether state laws permit betting on the outcome of elections or by federal prohibition of interstate betting?

No, because, as discussed in Question 3, this is simply irrelevant. The lawfulness test applies to the underlying activity (elections), not the listing of contracts tied to such activity.

5. Are the contracts substantively different from the contracts Nadex proposed in 2012 such that the Commission's analysis should be different?

They are not substantively different. The Commission's analysis should be different not because the contracts are different, but because the Commission's 2012 analysis was incorrect.

Since elections are neither unlawful activity, assassinations, acts of war, nor terrorism, Reg 40.11 offers the Commission only two even superficially plausible bases on which to prohibit election contracts: 1) that they constitute gaming (addressed above) or 2) that they fit into the final catch-all category of "other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest."

This catch-all, importantly, must not be misinterpreted as "anything else determined by the Commission to be contrary to the public interest." Congress enumerated several specific categories of undesirable activities, presumably because it feared the consequence of the potentially perverse incentives for market participants to bring about (or at least profit from) such outcomes.

Some of these activities, however, have notoriously slippery legal definitions. The United States hasn't declared war in 80 years, but it's safe to assume Congress meant to include plenty of military activities that fall outside such a narrow scope. Hence the catch-all.

Also note that the phrase "contrary to the public interest" here directly applies to the underlying activity, not to the listing of the contracts.

Just as they are not unlawful, elections are not contrary to the public interest.

6. Are the economic consequences of congressional control predictable enough to serve a hedging function? Provide tangible examples of commercial activity that can be hedged directly by the contracts.

According to FEC data compiled at OpenSecrets.org, the top 50 interest groups had by June of this year given nearly a billion dollars to Congressional candidates for this midterm cycle alone. Not only does every major business sector have a demonstrable financial interest in (and hedgeable exposure to) the Congressional balance of power, but that exposure is nicely asymmetric, making electoral outcomes especially well-suited to the risk reallocation function of futures markets.

Oil and gas, agriculture and automotive companies, for example, steer more than two thirds of their donations toward Republican candidates. Unions, law firms, tech and media companies on the other hand donate overwhelmingly to Democratic candidates.

7. Are there unique economic risks tied to the outcome of congressional control that cannot be hedged via derivative products on equities, debt, interest rates, etc.?

The economic consequences of various election outcomes do often affect the pricing of traditional financial instruments and their derivative products, but attempting to use such products to offset an electoral exposure carries enormous basis risk. The whole point of regulated event contracts is to enable market participants to offset their own unique economic exposure to discrete underlying outcomes, rather than attempt to construct sloppy proxy hedges from products whose price movements are affected by countless additional factors.

8. 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?

For any emerging product category, it's vital not to impose an unduly burdensome threshold that will prevent its maturation. Most prospective natural hedgers will either be unaware of the products' existence or be reticent to manage any significant degree of financial risk using such products, at least until they're able to observe a certain level of liquidity and price stability, a track record of stable exchange operation, and a lack of settlement surprises arising from insufficiently robust rules writing.

It should be sufficient that the contracts address significant, two-sided quantifiable economic exposure among natural hedgers, even if the related hedging demand in some cases may presently be largely theoretical. Surely the majority of contracts currently trading without controversy or special review on Kalshi would fail any meaningful hedging percentage test, but that doesn't and shouldn't disqualify those non-electoral event contracts from being listed.

9. Should the Commission consider contract and position sizes and the intended customer base to assess hedging use? Do small dollar contracts targeted at retail customers have hedging utility against macro level national political events? Does whether contracts are margined or fully collateralized affect this analysis?

The \$25,000 position limit is an artificial constraint that, while surely well-intended, unduly constrains maturation, liquidity and adoption of these contracts by natural hedgers, particularly institutional market participants.

However, targeting retail customers does not constitute a hedging mismatch. Retail customers include small business owners, homeowners, tax payers, energy consumers, medical patients, and investors in traditional financial markets, all capacities in which they experience meaningful economic exposure to federal electoral outcomes and other macro political events.

10. Should the Commission consider contract design and payout? Are binary contracts useful for hedging nonbinary economic events?

Binary contracts can be sub-optimal for inherently non-binary events, but the contracts at issue in this review involve distinctly binary outcomes (i.e. which of the two major parties will control each chamber of Congress).

As for non-binary economic events already traded on Kalshi, like target interest rates, GDP growth, forex rates, or the closing value of an equity index, the mismatch between the binary product structure and the scalar nature of the underlying is addressed to some extent by the listing of several binary brackets representing various numerical ranges. When those ranges are mutually exclusive, the application of margin linking contributes to better liquidity and aggregate pricing coherence across the several brackets.

11. 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?

Better visibility into the probability of a party's control of a legislative chamber serves a significant and plainly evident price-basing function. Prevailing tax rates, closure of tax loopholes, federal spending levels and priorities, sector-specific subsidies, energy policy, and health care policy are among the more glaring examples of Congressional agenda items that can be reliably expected to differ drastically depending on which party holds the gavels. Decisions as major as a multi-billion dollar M&A and project finance transactions and as minor as whether to purchase an electric vehicle or install solar panels on a home all incorporate a series of assumptions about future federal policy, the prospects of which are closely tied to the identity of the majority party..

Awareness of shifting odds of a particular favorable or adverse treatment that is anticipated to correlate strongly with the party in power will naturally enable more reliable pricing across a wide range of transactions.

12. Are the proposed contracts contrary to the public interest?

On the contrary. Just as every other category of regulated commodity futures enables the efficient reallocation of risk, so too do event contracts, so long as a wide array of prospective market participants are asymmetrically economically exposed to the underlying events.

Electoral outcomes clearly meet this test.

13. Could the trading of these or other political control or election-based contracts affect the integrity or the perception of integrity of elections?

A common argument against bringing electoral contracts on-exchange holds that the existence of such markets is somehow corrosive to election integrity, but this amounts to little more than a knee-jerk reaction to any novel intersection between money and politics.

Ironically, the wholly uncontroversial (to the point of being clichéd) idea that money is a corrosive force in politics is one of the strongest arguments in favor of listing electoral outcomes on regulated exchanges. So universal and overwhelming is the exposure of virtually every commercial concern (including small business and households) to electoral outcomes that countless commercial entities shovel as much money as legally permissible (at times, perhaps more) at the candidates and parties they feel pose less threat of enacting adverse policy changes.

What better way to reduce that pernicious imperative than to offer a more sanitized, transparent, duly regulated mechanism through which market participants can offset such unwanted exposure, with no attending influence over candidates and elected officials?

14. Could the contracts facilitate violations of campaign finance laws? For example, could the contracts make it easier to sidestep prohibitions governing coordination between candidate campaign committees and PACs?

Such coordination prohibitions are already trivially easy to sidestep and need no assistance from the futures markets. It's not clear that the existence of such markets offers any novel or more clandestine means by which to coordinate.

15. Do the contracts present special considerations with respect to susceptibility to manipulation or surveillance? Could candidate campaign committees or PACs manipulate the contracts by trading on internal, non-public polling data?

Yes. These contracts should, by exchange rule, forbid trading by certain enumerated parties, to include, at a minimum, federal policymakers (legislators, regulators and judges) and their staffs, candidates and their staffs, and registered campaign committees and PACs.

16. Should campaign committees, PACs, candidates, entities subjected to FEC oversight, and those likely to hold non-public information be prohibited

from participating?

Yes.

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

None.

Under Reg 40.11, the Commission is empowered to make such a determination only when the proposed event contracts reference “1) unlawful activity, 2) terrorism, 3) assassination, 4) war, 5) gaming, or 6) other similar activity determined [...] to be contrary to the public interest.”

Congress expressly limited the public interest catch-all to apply only to activities “similar” to crime, terrorism and warfare.

Even in 2022, elections don’t qualify.

ROCK

Family of Companies

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: KalshiEX LLC

Dear Members of the Commission:

I write on behalf of the Rock Family of Companies, the largest private employer in the City of Detroit and the largest investor in the city's revitalization. Since moving to Downtown Detroit some 12 years ago, the Rock Family of Companies has grown our presence in the city to nearly 15,000 team members and has committed more than \$5.6 billion to rebuilding and revitalizing the city.

As you know, the State of Michigan was one of the epicenters of unfounded challenges to the results of the 2020 election. In particular, the City of Detroit was singled out for unfounded allegations regarding the processing and counting of ballots. These allegations had unmistakable racial undertones and strove to cast Detroit in a light diametrically at odds with our efforts, and the efforts of so many, to build a more positive future for the city.

We are aware of a pending application by KalshiEx LLC for regulatory approval of a trading market regarding the outcome of elections for the United States Congress. In general, it is our view that such a platform offers another antidote to unfounded claims about election outcomes. The ability to say that the "market has spoken" in recognizing official election results offers yet another affirmation and bulwark against persistent efforts to challenge, or undermine, the results of our democratic elections.

We appreciate the Commission's consideration of the pending request, as well as this comment in favor of its approval.

Sincerely yours,



Jared Fleisher
Vice President for Government Affairs
Rock Family of Companies

To the Commissioners of the Commodity Futures Trading Commission,

We are a group of progressive legislators, policymakers, activists, journalists, pollsters and grassroots organizers. We are writing this letter in staunch opposition to the Commission's rumored action prohibiting election prediction markets. A prohibition is not customer protection and it is not market integrity preservation. The evidence is clear: **the potential decision to prohibit election markets actively undermines election integrity and shakes our confidence in the ability of the CFTC to effectively protect consumers in emerging markets.** Instead the Commission would be unfairly stifling valuable innovation.

Prohibiting prediction markets threatens election integrity.

In short, prohibiting these markets doesn't protect election integrity; it actively undermines it by furthering polarization, worsening the public's understanding of our democratic process and promoting unsafe, black market exchanges. To ban these markets is highly contrary to the public interest.

The Commission must look and evaluate the hard evidence. Real-world data repeatedly emphasizes the superior forecasting accuracy of prediction markets to polls and pundits. Because traders have financial skin in the game, their principal incentive is to predict accurately, instead of merely supporting a partisan line. In 2020, small-scale prediction markets were one of the few remaining places where people from different political walks of life interacted with each other regarding politics, and it helped to moderate right-wing extremist beliefs about the inevitability of Trump's re-election. Going forward, as the threat of right-wing radicalism only grows, it's more important than ever to have these mechanisms that combat extremism in place. Beyond participants, these markets benefit the public as well: these accurate forecasts help regular citizens understand elections far better than relying on the right-wing media ecosystem or a social media echo chamber. Banning these markets, moreover, will only push this activity onto offshore, unregulated platforms without customer protection and surveillance. Protecting customers and our elections means these markets need to be on regulated exchanges, not relegated to the shadows where the CFTC can pretend their hands are clean so it isn't their problem.

Accusations of heightened manipulation risk are unfounded.

There are mountains of data from other countries and in smaller-scale markets such as PredictIt that these prices are resilient to manipulation. Many features of the market—low position limits, bounded prices, the ultimate resolution of the contract to a 0 or 1—make these markets more resistant to market irrationalities or manipulation than metals futures, energy commodity futures, or even many equities. Protecting markets and election integrity means looking at evidence and the data, not idle speculation.

The risk of insider trading is minimal, especially in relative terms.

Unlike in energy commodities where a single EIA report could swing the outcome, there is little genuinely decisive and actionable material nonpublic information for the aggregated results of over 450 elections. Standard market procedures, including KYC, exchange rules, CFTC regulations, trader prohibitions and market surveillance, are more than sufficient to mitigate this risk.

The CFTC should not privilege speculative insider trading concerns over real-world data showing these markets can be offered safely. These concerns are no basis to block a market. How will the CFTC handle other markets' insider trading threat—will they prohibit all trading there as well? CFTC and exchange rules and protections exist for a reason: they work.

The CFTC has an opportunity.

The CFTC has an opportunity to allow these markets to foster with the appropriate safeguards. The CFTC must approve election markets.

Signatories:

Rep. Ritchie Torres (D-NY 15)
Sean McElwee (Founder, Data for Progress)
Drey Samuelson (Co-founder TakeltBack.org)
Dylan Matthews (Vox)
Joel Wertheimer (Civil rights lawyer)
Ethan Winter (progressive pollster)

About the Signatories

Ritchie Torres is the U.S. Representative for New York's 15th District, which is primarily located in the South Bronx. Torres is a lifelong progressive, and a member of the Congressional Progressive Caucus. He is also a co-chair of the Congressional LGBTQ+ Equality Caucus, and a member of the Congressional Black Caucus and the Congressional Hispanic Caucus. He is a supporter of protecting elections and voting rights, and was a supporter of the For the People Act.

Sean McElwee is the founder of Data for Progress, the leading progressive polling and political consultancy organization. Data for Progress is the industry leader in issue polling and specializes in helping progressives use data to optimize their advocacy efforts and political strategy. Sean's writing has been featured in the New York Times, the Washington Post and The Atlantic. Sean is an expert in election integrity, and is the founder of AVR NOW, an advocacy group dedicated to passing automatic voter registration in the state of New York. He recently testified in front of the New York State assembly on issues of election security and integrity.

Drey Samuelson is a former Chief of Staff for Senator Tim Johnson (D-SD), working for him from 1997 to 2015. He is the co-founder of TakeItBack.org, an organization dedicated to helping build grassroots organizations to support progressive candidates and causes, including promoting Medicaid expansion and voter turnout.

Dylan Matthews is a senior correspondent and lead writer at Vox and a founder of Vox's Future Perfect, a series focusing on "finding the best ways to do good". His writing focuses on economic policy, poverty reduction and global health. He previously wrote for the Washington Post.

Joel Wertheimer is a civil rights lawyer, political consultant and an advisor to New York State Senator Alessandra Biaggi. He also served as Assistant Staff Secretary to President Barack Obama and Staff Secretary to Governor Andrew Cuomo. His civil rights work focuses on many causes, including wrongful convictions and police misconduct.

Ethan Winter is a leading progressive pollster, having advised Super PACs, pro-choice ballot initiatives and democracy partners.

We are professors and academic researchers from a variety of disciplines—from economics to political science to law. We are writing in support of legalizing the use of prediction markets for electoral outcomes, not just for Kalshi but for all other Designated Contract Markets (DCM) under the supervision of the Commodity Futures Trading Commission (CFTC). We believe these markets are squarely in the public interest, and reject claims that they constitute gambling or may threaten the integrity of our democratic process.

- Election prediction markets are a powerful resource for researchers. Researchers have been using the data generated by existing markets such as the Iowa Election Market (IEM) and PredictIt for over fifteen years (see, for example, “Party Influence in Congress and the Economy,” from Erik Snowberg, Justin Wolfers and Eric Zitzewitz). Much of this research falls into two camps: first, some researchers use prediction market probabilities to estimate the effect of the election on various economic variables. Second, other researchers use prediction market probabilities to learn what events actually influence campaigns. A legalized market with greater liquidity and participation numbers should allow these efforts to expand even further. As such, these contracts serve the public interest.
- The CFTC solicited public comment on the price-basing utility of election contracts. In our experience observing the market, financial market participants routinely use the probability of various parties’ controlling Congress (and the Presidency) to accurately price various assets. An accurate valuation of many investments, assets, physical commodities, and the value of services requires an accurate assessment of the future trajectory of the political environment. The political environment has significant and predictable impacts on business, and it is a significant factor that affects valuations. A fully-approved market without the limitations on existing unregulated markets will provide even better data that not only can be used for pricing financial assets, physical commodities, and services, but no doubt will.
- Furthermore, election contracts have bona fide hedging utility. Companies already hedge electoral risk demonstrating that this demand is real and large. However, these hedges are often indirect, since there are no election-based event contracts, and their pricing is not as accurate as an event contract on the elections would be.
- Kalshi’s new submission’s larger position limits and order sizes make the contract more suitable for hedging, especially by institutions. These features will reduce the number of casual speculators using the contract and increase the number of market participants who will use the contract to mitigate risk. The CFTC should encourage these types of measures as they are indicative of responsible innovation.

- The CFTC also asked for comments on whether exchanges should have to prove an existing market demand for hedging before listing a new product. As made clear above, there is a demonstrated market for hedging this product. However, the CFTC should refrain from adopting any of the tests implied in these questions as they are overbroad and will have a negative impact on innovation: the line of questioning is the kind that is indicative of the type of government overreach that generally stifles innovation. If the CFTC would force an exchange to prove that there is an existing demand for hedging, the CFTC risks preventing innovation, and significantly stunting the growth and development of event contract markets and other futures and derivative markets. Additionally, the CFTC should not substitute its judgment for market participants' own assessment of their risks and how best to manage their risk.
- A common theme of the CFTC questions is in regard to whether election prediction markets constitute gaming. They do not. An election prediction market is no more gaming than traditional financial markets, including commodity, futures, and derivatives markets, due to the vast economic utility of the contracts. While it is true that a portion of market participants may speculate, this is fully consistent with normal market functioning. Many participants in energy or agricultural markets are speculators, yet their presence does not refute the economic utility of those contracts. If anything, these speculators serve an important role by providing liquidity and rapid price-discovery. Considering the vast hedging and price-basing value of these contracts, it would be a mistake to consider these “gaming”.
- In addition, these markets are resilient against manipulation. In academic studies of manipulation on existing prediction markets, price ‘pump’ attempts were short-lived and The combination of greater liquidity and number of participants makes such a phenomenon substantially less likely on a well-regulated market.¹² In addition, the relatively low position limit means any one participant, even maxing out their total position, is highly unlikely to be able to move the market in a meaningful way for any meaningful period of time as sophisticated traders enter on the other side of the market to profit off of the mispricing.
- Manipulation of the election itself seems even less likely. The argument would be that if someone now has a financial stake in the outcome of over 400 elections, they may either change their own vote or attempt to change the vote of others. This argument ignores the fact that people *already* have a *significant* amount at stake in elections. Additionally,

¹ For a historical analysis, see: Paul Rhode & Koleman Strumpf, 2006. "Manipulating political stock markets: A field experiment and a century of observational data," Natural Field Experiments 00325, The Field Experiments Website.

² For the theoretical argument, see: Robin Hanson, “A Manipulator Can Aid Prediction Market Accuracy”, 2007. <http://mason.gmu.edu/~rhanson/biashelp.pdf>

these fears are unfounded speculation, and ignore the empirical fact that direct election trading exists in many other countries, such as the U.K., without such documented ill effects. Moreover, the contract has been designed to prevent that from happening by imposing Know-Your-Customer authorization, CFTC oversight, and a modest position limit. Changing the outcome of any election by even an infinitesimal amount, let alone altering a national election or the totality of all the Congressional elections, would be far more costly than the proposed position limits. Kalshi's new submission also enumerated many actors prohibited from trading on the contract.

- If these markets have any impact on the electoral process at all, it would be a positive impact. Polling error has increased in recent years, polarization is at an all time high, fake news is rampant: a market-based mechanism for forecasting the outcome of the midterms would be a vastly superior alternative to polling and punditry, and would thus foster a healthier and more reasonable debate around the electoral process. Combating fake news and providing a better mechanism for truth makes the proposed contracts very much so in the public interest.

Ultimately, these are economically valuable markets (not gaming markets) that promote the public interest through superior forecasting. The Commission should embrace this valuable activity by bringing it under its regulatory umbrella.

Signed,

Justin Wolfers

Professor of Public Policy and Economics, University of Michigan
Senior Fellow, Brookings Institution
Senior Fellow, Peterson Institute

Michael Abramowicz

Jeffrey and Martha Kohn Senior Associate Dean for Academic Affairs
Oppenheim Professor of Law, The George Washington University

Joseph Grundfest

William A. Franke Professor of Law and Business, Emeritus, Stanford University
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Bartley J. Madden Chair in Economics, George Mason University
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Co-Author, *Marginal Revolution*

Michael Gibbs

Clinical Professor of Economics, The University of Chicago
Research Fellow, Center for the Study of Labor
Co-Author, *Personnel Economics in Practice*

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/opabchnam26>.

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/ptc082422kexdem001.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.”).

³⁸ 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 . . .”).

‘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.

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⁴⁴ 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.").

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

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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=krmct>.

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.efic.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 iPredict'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."^{102,103} 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.

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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>.

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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 can also 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.

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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 iPredict'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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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.¹¹⁶

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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.

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.¹³⁰ 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.

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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.cfte.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 Zitowitz (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 Zitowitz 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 F, 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 B, 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*



By Electronic Submission

July 24, 2023

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: KalshiEx, LLC's Self-Certified Proposed Political Event Contract

Dear Mr. Kirkpatrick:

Better Markets¹ appreciates the opportunity to comment on the Commission's review of KalshiEX, LLC's proposed congressional control contract under CFTC Regulation 40.11.²

BACKGROUND

On July 19, 2022, KalshiEX, LLC ("Kalshi") submitted a proposal ("Original Proposed Contract") to the CFTC seeking review and approval of a new binary event contract, which Kalshi titles "the 'Will <party> be in control of the <chamber of Congress>?' Contract." Kalshi's Original Proposed Contract was a binary (all-or-nothing) option contract whose payout was contingent on whether a particular political party will control Congress at a particular time.

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements, and more.

² 17 CFR § 40.11, *Review of event contracts based upon certain excluded commodities*; U.S. COMMODITIES FUTURES TRADING COMMISSION, *CFTC Announces Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11* (June 23, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8728-23>

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On May 16, 2023, after receiving public notice from several news outlets that the Commission was going to deny its Original Proposed Contract³, and after receiving public advice from Commissioner Pham that it should withdraw its proposal⁴, Kalshi withdrew its bid. Less than 30 days later, on June 12, 2023, Kalshi officially notified the Commission that it was self-certifying a political control event contract (“Self-Certified Contract”). Kalshi’s Self-Certified Contract is substantially similar to the Original Proposed Contract, albeit with certain discernible differences. In response to Kalshi’s notification, on June 23, 2023, the Commission announced that it has commenced a review of the Self-Certified Contract in accordance with CFTC Regulation 40.11(c).

The proposed Self-Certified Contract should not be approved based on several legal and policy grounds because it would (1) violate the statutory and regulatory framework applicable to event contracts; (2) constitute “gaming” under state and federal law; (3) undermine public faith in our markets and elections; and (4) fail to serve the primary purpose of the futures markets as a viable hedging and price discovery mechanism. Although the Commission has previously allowed several non-profit ventures to offer trading on similar political event contracts under specific and limited circumstances, Kalshi’s proposal constitutes a significant departure from previous precedent. Never before has the Commission allowed a for-profit venture to operate in this sensitive arena, fraught with the potential for abuse.

The proposal suffers from multiple fatal flaws. Kalshi’s scant publicly available submission lacks sufficient detail to enable a full and meaningful assessment of the proposed Self-Certified Contract. However, on the available record, meager though it is, the Commission must conclude that the contract would violate the law, pose a serious threat to investors, and fail to serve the legitimate hedging and price discovery functions of the markets it regulates. As a legal matter, Kalshi’s event contract involves, relates to, or at the very least is similar to “gaming” and an activity that is unlawful in numerous states across the country. That must bear heavily on the Commission’s decision and indeed prove dispositive. The CFTC must be mindful that the wrong decision by the CFTC here could de facto preempt innumerable state laws in ways that Congress

³ Lydia Beyoud, *CFTC Poised to Deny US Political Gambling Before November Polls*, Bloomberg (Oct. 28, 2022), <https://www.bloomberg.com/news/articles/2022-10-28/cftc-poised-to-deny-us-political-gambling-before-november-polls?sref=mQvUqJZj>. See also Nick Baker, *CFTC Staff Recommends Rejecting Kalshi's US Election Contracts*: Bloomberg, (October 28, 2022), <https://www.coindesk.com/policy/2022/10/28/cftc-staff-recommend-rejecting-kalshis-us-election-contracts-bloomberg/>

⁴ Declan Harty, *CFTC's Pham: Kalshi should withdraw election betting bid*, PoliticoPro (Nov. 08, 2022), <https://subscriber.politicopro.com/article/2022/11/cftc-commissioner-kalshi-should-withdraw-election-betting-bid-00065579>. See Better Markets Ethics Complaint Regarding CFTC Commissioner Caroline Pham’s Apparent Public Disclosure of Highly Confidential, Nonpublic, Internal, Factual and Legal Discussions Regarding the Pending Application of KalshiEx, LLC (Dec. 8, 2022), https://bettermarkets.org/wp-content/uploads/2022/12/Better_Markets_Letter_CFTC_Ethics_Complaint_Pham.pdf see also Better Markets Ethics Complaint Regarding CFTC Commissioner Caroline Pham’s Apparent Public Disclosure of Highly Confidential, Nonpublic, Internal, Factual and Legal Discussions Regarding the Pending Application of KalshiEx, LLC (Dec. 12, 2022), <https://bettermarkets.org/wp-content/uploads/2023/06/LTR-CFTC-Inspector-General-re-Pham-12-12-22-.pdf>.

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clearly did not intend. In addition, the contract is susceptible to manipulation, further endangering investors and the integrity of the markets.

This proposal would contribute to the deeply troubling trend toward the “gamification” and “retailization” of finance. In this increasingly common pattern, everyday consumers and investors are lured into new financial products and services by claims that the offerings represent beneficial “democratization” and “innovation.” Yet as we have seen with the “digital engagement practices” that fueled the meme stock frenzy,⁵ and even more so in the market for cryptocurrencies, the result is typically massive wealth accumulation for a few sponsors and issuers and massive losses suffered by the vast majority of investors.⁶

Democracy and elections are foundational principles for our country and are not appropriate subjects for gaming, gambling and betting. Given the use and abuse of social media in the gambling space⁷ and the A.I. in the political space⁸, 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. Even relatively small amounts of spending on negative attack ads can help swing a close race, local elections, and primaries with low turnout, especially if done in the last few days before an election when there is little if any time for a meaningful response.⁹ Imagine what damage an AI deepfake video, supercharged by viral social media, could do if a gambler wanted to try to increase the odds of winning his or her bet in the days before an election. The truth will not catch up to the lie before the votes - and die - are cast.

⁵ See generally Dennis M. Kelleher, Jason Grimes, and Andres Chovil, *Securities—Democratizing Equity Markets With And Without Exploitation: Robinhood, Gamestop, Hedge Funds, Gamification, High Frequency Trading, And More*, 44 W. NEW ENG. L. REV. 51 (2022).

⁶ There are numerous additional downsides that should be considered. See, e.g., Madison Darbyshire, *Traders phone up gambling helplines as game-like broker apps spread*, the Financial Times (Oct. 6, 2021) (“Helplines of gambling addiction recovery groups have been ringing with a new kind of caller: day traders. The rise of mobile brokerage applications outfitted with prompts, animations, rewards, and digital flourishes have brought the feel of investing platforms closer to online sports betting and gambling.”), available at <https://www.ft.com/content/8f9bbc77-06b1-4fbd-8b7e-6e381ba038a7>; Scott Chipolina and Oliver Barnes, *There needs to be a health warning: How crypto trading can lead to addiction*, the Financial Times (June 2, 2023) (“Debate over whether the sector should come under scope of financial services or be treated like gambling.”), available at <https://www.ft.com/content/0f879851-5c74-42ef-914b-154cd4c9a881>.

⁷ Jared Diamond, *A Reporter’s Tweet Moved NBA Draft Odds. He Also Works for a Gambling Company*, The Wall Street Journal, (June 24, 2023), https://www.wsj.com/sports/basketball/nba-draft-shams-charania-the-athletic-fanducl-84c9ccc4?mod=hp_featst_pos5

⁸ Emily Birnbaum and Laura Davison, *AI Is Making Politics Easier, Cheaper and More Dangerous*, (July 11, 2023), <https://www.bloomberg.com/news/features/202307-11/chatgpt-ai-boom-makes-political-dirty-tricks-easier-and-cheaper?srd=premium&srcf=mQvUqJzj>

⁹ While Kalshi’s proposed Self-Certified Contract is nominally limited to the change in partisan control of Congress, we would anticipate that, if allowed by the CFTC, Kalshi and others would quickly offer similar contracts on all sorts of elections from the local level to the Presidency.

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Given all these factors and the negative impact that the commodification of our electoral process would have on the integrity of our democracy, we urge the Commission to reject Kalshi's Self-Certified Contract.

Legal Context

The Commodity Exchange Act ("CEA") Section 5c(c)(5)(C) prohibits the listing of agreements, contracts, transactions, or swaps in an excluded commodity.¹⁰ Section 5c(c)(5)(C)(i) of the CEA prohibits event contracts that "involve, relate to, or reference" terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law.¹¹ The legislative history of CEA Section 5c(c)(5)(C) indicates that CFTC should consider whether the event contract as a whole involves activities listed under Section 5c(c)(5)(C)(i).

In 2011, the Commission promulgated Regulation 40.11 to implement Section 5c(C)(5)(C) of the CEA.¹² Regulation 40.11(a)(1) prohibits the listing of an agreement, contract, or transaction "that involves, relates to, or references" terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law.¹³ Because not all undesirable contracts may fall neatly within the specific categories listed in Regulation 40.11(a)(1), CFTC Regulation 40.11(a)(2) includes a provision that prohibits event contracts involving an activity that is "similar to" the activities enumerated in 40.11(a)(1), so long as the Commission determines the contract to be "contrary to the public interest."¹⁴

Regulation 40.11(c) provides for a 90-day review period for any such contract that the Commission determines may involve gaming or any of the other activities referenced in Regulation 40.11(a)(1).¹⁵

Prior Commission Approaches

Historically, the CFTC has permitted binary event contracts only under conditions more limited and tightly controlled than those of the Kalshi contract. In 1993, CFTC staff issued a no-action letter to the Iowa Electronic Markets ("IEM"), an academic prediction market run by the

¹⁰ 7 U.S.C. § 7a-2(c)(5)(C). The Commodities Exchange Act (CEA) is codified at 7 U.S.C. § 1 *et seq.*

¹¹ 7 U.S.C. § 7a-2(c)(5)(C)(i).

¹² Provisions Common to Registered Entities, 76 Fed. Reg. 44776, 44785 (July 27, 2011).

¹³ 17 C.F.R. 40.11(a)(1).

¹⁴ 17 C.F.R. 40.11(a)(2).

¹⁵ 17 C.F.R. 40.11(c).

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University of Iowa's Tippie College of Business in conjunction with several other universities.¹⁶ Among the event contracts available for trading on the IEM are political event contracts regarding partisan control of the United States Congress. The CFTC's staff no-action letter allowed the IEM to continue offering its political event contracts, but with several restrictions. First, the no-action was premised on the IEM's academic purpose and operation as a non-profit entity. Second, neither the IEM nor the University of Iowa charges any commissions or receives a return in connection with its operation, and IEM does not realize a financial profit or suffer loss as a result of the transactions.

In December 2011, the North American Derivatives Exchange ("NADEX") submitted a proposal to the CFTC seeking approval of five new political event contracts relating to the political control of the United States Congress and the Presidency.¹⁷ On April 2, 2012, the CFTC issued an order prohibiting NADEX from listing its proposed political event contracts.¹⁸ In its order, the CFTC found that the contracts, which would have paid out based upon the outcome of US federal elections, "involved[] gaming" and were contrary to the public interest under CEA Section 5c(c)(5)(C)(i). In its analysis, the CFTC determined, among other things:

- (1) "the unpredictability of the specific economic consequences of an election means that the Political Event Contracts cannot reasonably be expected to be used for hedging purposes;"
- (2) "there is no situation in which the Political Event Contracts' prices could 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;" and
- (3) "the Political Event Contracts can potentially be used in ways that would have an adverse effect on the integrity of elections, for example by creating monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter's political views of such candidates."¹⁹

¹⁶ CFTC No-Action Letter, CFTCLTR No. 93-66, 1993 WL 595741 (June 18, 1993), <https://www.cftc.gov/sites/default/files/idc/groups/public/@llettergeneral/documents/letter/93-66.pdf>.

¹⁷ U.S. COMMODITIES FUTURES COMMISSION, *CFTC Commences 90-day Review of NADEX's Proposed Political Event Derivatives Contracts* (Jan. 5, 2012), <https://www.cftc.gov/PressRoom/PressReleases/6163-12>.

¹⁸ U.S. COMMODITIES FUTURES COMMISSION, *Order Prohibiting the Listing or Trading of Political Event Contracts*, https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ndocs/nadexo_rder040212.pdf.

¹⁹ *Id.*

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In 2014, the CFTC staff issued a no-action letter to PredictIt, operated by researchers at the Victoria University of Wellington, allowing its political event contracts to operate in the United States provided that it met certain conditions. Among these conditions were that the market must:

- be small-scale and not-for-profit;
- be operated for academic and research purposes only;
- be overseen by faculty at the University, without receipt of separate compensation;
- be limited to 5,000 traders per contract, with an \$850 investment limit per participant in any contract;
- not offer brokerage services or charge commissions to participants;
- utilize a third-party service provider to perform know-your-customer (“KYC”) due diligence on its participants; and
- only charge those fees necessary to cover the costs of implementing the KYC process, regulatory compliance, and basic expenses necessary to operate the proposed event contract market.

In August 2022, however, the CFTC staff informed PredictIt that it had violated the no-action letter, that it was withdrawing the no-action letter, and instructed the company to wind down its operation of the political event contracts by February 2023.²⁰

The Kalshi Contract

Kalshi’s Original Proposed Contract provided that it was their intention to impose a position limit of \$25,000. However, in Kalshi’s new Self-Certified Contract, it is the exchange’s intention to increase the position limit as follows:

- (i) The Position Limit for Individuals shall be \$125,000 per Member; and \$250,000 for those with demonstrated established economic hedging need;
- (ii) The Position Limit for Entities shall be \$5,000,000 per Member; and \$10,000,000 for those with demonstrated established economic hedging need;
- (iii) The Position Limit for Eligible Contract Participants shall be \$50,000,000 per Member; and \$100,000,000 for those with demonstrated established economic hedging need.

Kalshi’s Self-Certified Contract provides that a claim for a purported need for economic hedging by an individual, entity, or eligible contract participant member may be demonstrated to Kalshi according to the means and methods established by Kalshi. Whether a member has demonstrated

²⁰ U.S. COMMODITIES FUTURES COMMISSION, *CFTC Staff Withdraws No-Action Letter to Victoria University of Wellington, New Zealand Regarding a Not-For-Profit Market for Certain Event Contracts* (Aug. 4, 2022), <https://www.cftc.gov/PressRoom/PressReleases/8567-22>.

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that it has a sufficiently established an economic hedging need is determined solely at Kalshi's discretion. Furthermore, the Self-Certified Contract provides little information on the fees and commissions Kalshi charges on its platform, stating only the following:

“Members will be charged fees in accordance with Rule 3.6 of the Rulebook. Fees are charged in such amounts as may be revised from time to time to be reflected on the Exchange's Website.”

As with its Original Proposed Contract, Kalshi does not include a copy of the Rulebook referenced in its submission, leaving readers and possibly the Commission itself without key information regarding the specifics of its fee structure or Kalshi's unilateral, subjective power to change any and all provisions. Finally, 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.

If approved, Kalshi's proposal would represent a significant departure from the fundamental and historical underpinnings of the futures markets. The fundamental purpose of the derivatives market is to provide a means of hedging risk and price discovery for commercial enterprises, not to enable mass speculative gambling among retail traders.²¹ While limited speculation is permitted to provide additional liquidity necessary to enable derivatives markets to perform their important historic functions, the markets overseen by the CFTC are not — and never were — intended as casinos or predominantly speculative vehicles.²² Nor were our elections intended to be commodified, commercialized, and gambled upon *en masse* with the mere click of a button.

The Commission has appropriately identified several areas of interest in the 24 questions it posed for public comment.²³ We hope our comments assist the Commission as it reviews this proposal.

¹³ See Timothy E. Lynch, *Derivatives: A Twenty-First Century Understanding*, 43 LOY. U. CHI. L. J. 1 (2011) (“[E]nabling hedging is the *raison d'être* for the existence of derivatives, and without this characteristic, it is doubtful that the modern derivatives industry would have developed.”); Lynn A. Stout, *Derivatives and the Legal Origin of the 2008 Credit Crisis*, 1 HARV. BUS. L. REV. 1 (2011); Miriam A. Cherry & Robert L. Rogers, *Prediction Markets and the First Amendment*, 2008 U. ILL. L. REV. 833, 838 (2008) (distinguishing the information-aggregating function of prediction markets from the price discovery function of other traditional markets); COMMODITIES FUTURES TRADING COMMISSION, *The Economic Purpose of Futures Markets and How They Work*, <https://www.cftc.gov/LearnAndProtect/AdvisoriesAndArticles/economicpurpose.html>

²² See generally Lynn A. Stout, *How Deregulating Derivatives Led to Disaster, and Why Re-Regulating Them Can Prevent Another*, 1 LOMBARD ST. 4 (July 2009).

²³ COMMODITIES FUTURES TRADING COMMISSION, *Questions on the KalshiEX, LLC “Will <party> be in control of the <chamber of Congress> for <term>?” Contracts for Public Comment*, <https://www.cftc.gov/media/8801/DMOKalshiQuestions062323/download>

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COMMENTS

I. The Submission fails to provide sufficient information to allow meaningful public comment or appropriate review by the Commission.

As a threshold matter, the Self-Certified Contract from Kalshi is grossly deficient and has to violate the Administrative Procedures Act (“APA”) that requires enabling meaningful public comment. It is largely opaque, providing remarkably scant detail about the material features of the contract. In short, it fails to supply enough information that might enable the Commission or interested members of the commenting public to fully evaluate the contract. Even if the Commission believes that it has sufficient information from Kalshi’s public and confidential submissions, that is inadequate because the Commission has deprived itself of the benefit of informed, meaningful public comment on the material aspects of the proposed Self-Certified Contract. This is a key reason that the APA requires agencies like the CFTC to seek, obtain, and take into account public comment.

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.²⁴ The Self-Certified Contract application also does not offer a description of how margin will be handled under the contract.

More significantly, 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. 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.²⁵

1. Kalshi failed to properly comply with the submission requirements provided in CFTC regulation 40.2(a)(3).

In its Self-Certified Contract submission, Kalshi used language that appears to certify that the event contract complies with the CEA and CFTC regulations. However, in the actual

²⁴ As noted above, even the minimal information that is publicly available is subject to our serious concerns surrounding Kalshi’s reservation of the right to alter the terms of the contract in the future.

²⁵ Kalshi’s ability to change the contract in the future is a major concern even if such future alterations are subject to Commission approval. Regardless of that approval process for later changes, the public (and the Commission itself) are now being asked to evaluate a contract with terms that may essentially be inaccurate, to the extent Kalshi already harbors the intention to change them in the future.

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certification document required under Regulation 40.2(a)(3)(iv), Kalshi did not certify that the event contracts comply with the CEA and CFTC regulations. In fact, Kalshi only included language in the certification document from regulation 40.2(a)(3)(vi) which certifies that Kalshi posted a notice of pending product certification with the CFTC and a copy of the submission on its Website.

In contrast, Kalshi's previous self-certified event contracts with different underlying subject matters all contained a statement certifying the compliance of their contracts with CEA and CFTC regulations along with a signature from a representative. However, Kalshi did not do the same in its Self-Certified Contract. With this apparent omission, this is a de facto admission by Kalshi that its Self-Certified Contract does not comply with the CEA and CFTC regulations. Regardless, Kalshi has failed to meet the necessary regulatory requirements for self-certifying its political control event contract. The CFTC should require Kalshi to remove its political control contracts due to its failure to comply with the regulatory requirements put in place to ensure legal compliance and protect market integrity.

II. The Commission should prohibit trading of the Self-Certified Contract because it conflicts with the intent of the Commodity Exchange Act, violates the letter of the Commission's rules against event contracts, and is contrary to the public interest.

The Commission should reject Kalshi's Self-Certified Contract because it conflicts with the letter and spirit of the Commodity Exchange Act, Commission Rule 40.11, and the public interest. Section 5c(c)(S)(C) of the Commodity Exchange Act provides, in pertinent part:

(C) SPECIAL RULE FOR REVIEW AND APPROVAL OF EVENT CONTRACTS AND SWAPS CONTRACTS.—

(i) **EVENT CONTRACTS.**—In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

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- ii. PROHIBITION.—No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

Following these Dodd-Frank amendments to the CEA, the Commission promulgated Rule 40.11,²⁶ pertaining to event contracts. In that rule, the Commission wisely chose to exercise the authority from Congress to impose an outright ban on gaming contracts or similar contracts that are contrary to the public interest. The rule provides as follows:

§ 40.11 Review of event contracts based upon certain excluded commodities.

(a) *Prohibition.* A registered entity shall not list for trading . . . any of the following:

- (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law; or
- (2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references an activity that is similar to an activity enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.

A. The proposed Self-Certified Contract involves, relates to, or is similar to, gaming, which is condemned under the CEA, prohibited under the Commission’s rules, and outlawed in several states.

Kalshi’s Self-Certified Contract is substantially similar in all material respects to the NADEX contracts, which the Commission appropriately denied because they were, involved, related to, or were similar to gaming and because they were illegal under state law.

1. The Kalshi contract involves gaming.

As the CFTC determined in its response to NADEX’s 2012 proposal for binary event contracts, political event contracts involve or are similar to “gaming.”²⁷ Here too, Kalshi’s virtually identical political event contract is gaming, involves gaming, relates to gaming, or is “similar to”

²⁶ 17 C.F.R. § 40.11.

²⁷ See U.S. COMMODITY FUTURES TRADING COMM’N, *Order Prohibiting the Listing or Trading of Political Event Contracts*, (Apr. 2, 2012), <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>

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gaming within the meaning of CEA § 5cI(5)(C)(i) and Commission Regulation 40.11(a)(1). It, therefore, falls squarely under the Commission’s regulatory prohibition, as authorized under the terms of the CEA.

Like NADEX’s proposal in 2012,²⁸ Kalshi now proposes to list a binary (all-or-nothing) event contract whose payoff is contingent upon the election of representatives to the United States Congress, such that one political party gains “control” — or a voting majority — of a chamber of Congress for a particular congressional term. Participants in such political prediction markets place a sum of money at risk, with the payout based on the market’s assessment of the probability of each outcome. If a participant “predicts” correctly, they are rewarded monetarily. Conversely, if they predict incorrectly, their position will lose monetary value.

The conclusion that the Kalshi Self-Certified Contract, and the NADEX contract before it, are, involve, relate to, or are similar to “gaming” follows from an analysis of both federal and state law.²⁹ 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 40.11.³⁰ 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.”³¹

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.*”³² Although neither the Unlawful Internet Gambling Enforcement Act nor the Commodity Exchange

²⁸ For a discussion of the Commission’s treatment of the NADEX contracts, see Dave Aron & Matt Jones, *States’ Big Gamble on Sports Betting*, 12 UNLV GAMING L. J. 53, 75–76 (2021).

²⁹ For a discussion of prior CFTC consideration and analysis of event contracts and “gaming,” *see id.*, at 71–86.

³⁰ U.S. COMMODITY FUTURES TRADING COMM’N, *Order Prohibiting the Listing or Trading of Political Event Contracts*, (Apr. 2, 2012), <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>; The Unlawful Internet Gambling Enforcement Act is codified at 31 U.S.C. § 5361 *et seq.*

³¹ 31 U.S.C. § 5362(1)(A) (emphasis added); *see also* Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling and the Speculation Paradox*, 86 B.U. L. REV. 371 (2006); Dave Aron & Matt Jones, *States’ Big Gamble on Sports Betting*, 12 UNLV GAMING L. J. 53, 67–86, 71 (2021) (discussing the CEA’s application to event contracts).

³² Relatedly, the traditional common law definition of “gaming” includes three elements: consideration, prize, and chance, all of which are present in prediction markets. *See* Tom W. Bell, *Gambling for the Good, Trading for the Future: The Legality of Markets in Science Claims*, 5. CHAP. L. REV. 159, 165-166 (2002).

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Act defines the term “contest,” the Cambridge English Dictionary provides the following definition:

“a competition to do better than other people, esp. to win a prize or achieve a position of leadership or power: **‘In the last election, he survived a close contest against a political newcomer.’**”³³

Moreover, as observed by the CFTC in its 2012 order against the NADEX proposal, numerous states’ gambling laws expressly link the terms “gaming” or “gambling” with betting or wagering upon the outcome of an election:

“[S]everal state statutes, on their face, link the terms gaming or gambling (which are used interchangeably in common usage, dictionary definitions and several state statutes) to betting on elections, and state gambling definitions of ‘wager’ and ‘bet’ are analogous to the act of taking a position in the Political Event Contracts.”³⁴

This is no less true now than it was in 2012, and there is no reason why the Commission should now find otherwise.

While some contend that political event contracts cannot be or involve “gaming” because prediction markets contain an element of skill as opposed to mere chance, the statutory definition of “bet or wager” above lists “a game subject to chance” in the disjunctive and but one of several examples, not a necessary element. That political prediction markets contain an element of skill — i.e., informational or predictive superiority — makes them no more distinct from gaming than does a professional poker player’s expertise make their profession distinct from gambling. Both at the blackjack table and in a prediction market, skill will aid the participants. But in both cases, significant elements of uncertainty and chance preside over the endeavor that are outside the control of the participants, rendering the activity one that is, involves, relates to — or is at least similar to — “gaming” for purposes of the CEA.³⁵

Proponents of Kalshi wrongfully claim that the language and structure of Section 5c(5)(C)(i) make clear that the scope of the Commission’s discretionary review is narrowly

³³ THE CAMBRIDGE ENGLISH DICTIONARY, *Contest* (emphasis added), <https://dictionary.cambridge.org/us/dictionary/english/contest>.

³⁴ U.S. COMMODITY FUTURES TRADING COMM’N, *Order Prohibiting the Listing or Trading of Political Event Contracts*, (Apr. 2, 2012), <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

³⁵ See Ryan P. McCarthy, *Information Markets as Games of Chance*, 155 U. PA. L. REV. 749, 770 (2007); Thomas Lee Hazen, *Disparate Regulatory Schemes for Parallel Activities: Securities Regulation, Derivatives Regulation, Gambling, and Insurance*, 24 ANN. REV. BANKING & FIN. L. 375, 401-12, 416-18 (2005) (comparing investing, hedging, insurance, and gambling as risk-taking activities).

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focused on the nature of the contract's underlying event, not on trading in the contract itself. Because elections do not fit within any of the enumerated activities, they claim that the Commission should not impede self-certification of the political control contract.³⁶ However, 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.³⁷ As mentioned previously, the Self-Certified Contract proposed by Kalshi should be rejected by the Commission since the whole contract can be categorized as a form of gaming. On Kalshi's exchange, customers will voluntarily bet money based on the outcome of a competitive political election.

2. The Kalshi contract involves an activity that is unlawful under state law.

As a separate matter, the Commission also rejected the NADEX contract because it plainly involved, related to, or referenced an activity that was unlawful under numerous states' laws. The same is true with respect to the Kalshi contract, a separate factor that is also dispositive under Rule 40.11(a)(1).³⁸ Placing a bet or wager on the outcome of an election is civilly or criminally unlawful in well over a dozen states nationwide.³⁹ For decades, states have long asserted their right to protect

³⁶ See Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts, <https://www.cftc.gov/sites/default/files/filings/ptc/23/06/ptc0612232837.pdf>

³⁷ See In the Matter of the Self-Certification by North American Derivatives Exchange, Inc., available at <https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>

³⁸ See, e.g., NV REV. STAT. § 293.830 (2014) ("Any person who makes, offers or accepts any bet or wager upon the result of any election, or upon the success or failure of any person or candidate . . . is guilty of a gross misdemeanor."); TN CODE § 2-19-129 (2014) ("A person commits a Class C misdemeanor if such person makes any bet or wager of money or other valuable thing upon any election."); 720 ILL. COMP. STAT. ANN. 5/28-1 (2011) ("A person commits gambling when he . . . [m]akes a wager upon the result of any game, contest, or any political nomination, appointment or election . . ."); NEB. REV. STAT. § 28-1101(4) (2011) ("A person engages in gambling if he or she bets something of value . . . upon the outcome of a game, contest, or election . . ."); N.M. STAT. ANN. § 44-5-10 (1978) ("Bets and wagers on an election authorized by the constitution and laws of the United States, or by the laws of this state, are gaming within the meaning of this chapter [on gambling debts and losses."); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011) ("'Gambling' means risking any money . . . upon . . . the happening or outcome of an event, including an election . . . over which the person taking the risk has no control."). See also GA. CODE ANN. § 16-12-21(a)(2) (West 2011) ("A person commits the offense of gambling when he . . . [m]akes a bet upon the result of any political nomination, appointment, or election . . ."); MISS. CODE ANN. § 97-33-1 (2011) ("If any person . . . shall wager or bet . . . upon the result of any election . . . he shall be fined in a sum not more than Five Hundred Dollars . . ."); S.C. CODE ANN. § 16-19-90 (2011) ("Any person who shall make any bet or wager of money . . . upon any election in this State shall be guilty of a misdemeanor . . ."); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011) ("A person commits an offense if he . . . makes a bet on the result of any political nomination, appointment, or election . . .").

³⁹ See NATIONAL CONFERENCE OF STATE LEGISLATURES, *Wagering on Elections? Not a Smart Bet* (Sept. 17, 2014), <https://www.ncsl.org/blog/2014/09/17/wagering-on-elections-not-a-smart-bet.aspx>.

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the integrity of their elections by prohibiting placing wagers on the outcome of an election.⁴⁰ In the absence of finding a public interest, the Commission should not preempt these states' longstanding, deeply rooted concerns by granting KalshiEx — a profit-driven venture — license to profit from speculation on the outcome of our elections.

B. The Contract is otherwise contrary to the public interest.

1. The proposed event contract is readily susceptible to manipulation.

Kalshi's political event contract runs afoul of the CFTC's Core Principles applicable to Designated Contract Markets — namely, Core Principle #3's requirement that a contract must not be “readily subject to manipulation.”⁴¹

Political prediction markets operate in a shrouded space that would readily lend itself to manipulation and other forms of abusive activity. It raises the specter of political insiders privy to non-public information — say, internal polling or campaign finance data — wielding their informational advantage to profit at the expense of others.⁴² And it would be susceptible to other classic forms of market manipulation. After all, “parties with an interest in the outcome have an incentive, whenever possible, to move the odds prices in their preferred direction.”⁴³

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, although scholars do not agree on how serious the problem is. Information market traders can gain from manipulations in two ways. 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. At least in the

⁴⁰ See generally Paul W. Rhode & Koleman S. Strumpf, *Historical Presidential Betting Markets*, 18 J. OF ECON. PERSP. 127 (2004) (outlining the history of election wagering in America).

⁴¹ See COMMODITIES FUTURES TRADING COMMISSION, *Designated Contract Markets (DCMs)*, <https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm>

⁴² See Alex Altman, *Political Betting Market Raises Questions About Insider Trading*, TIME (Oct. 6 2015), <https://time.com/4062628/fantasy-sports-predictit-political-forecasting/>.

⁴³ Paul W. Rhode & Koleman S. Strumpf, *Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data 2* (Jan. 2007) (unpublished manuscript, available at <https://economics.yale.edu/sites/default/files/files/Workshops-Seminars/Economic-History/rhode-051116.pdf>).

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short term, manipulators have succeeded in artificially inflating or deflating the prices of securities in information markets. In 2004, TradeSports's election prediction market fell victim to two 'sustained attempts' at manipulation, which resulted in 'large price changes that do not appear to have been based on any information.'⁴⁴

Similarly, in one study, titled "Affecting Policy by Manipulating Prediction Markets: Experimental Evidence," researchers found experimental evidence demonstrating how a highly motivated actor can manipulate prediction markets, thereby undermining their predictive reliability:

We find clear evidence that highly incentivized manipulators can destroy the predictive power of an information market. That is, we have identified a case where manipulators do cause human forecasters to make predictions that are no better than random guessing would generate showing that prediction markets can be manipulated. Further, our results show that the effects of introducing manipulators are due to more than just the large influx of liquidity in the market. This finding demonstrates that policy makers should not indiscriminately rely upon market predictions, but rather need to consider the incentives and wherewithal of potential manipulators. Our results are also suggestive that the possibility of such manipulators may also be sufficient to undermine the market aggregation of information.⁴⁵

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 number of gamblers.

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,⁴⁶ the Commission should not allow the adoption of political event contracts as Kalshi proposes.

⁴⁴ Rebecca Haw Allensworth, *Prediction Markets and Law: A Skeptical Account*, 122 HARV. L. REV. 1217 (2009).

⁴⁵ Deck, *infra* n. 46, at 61.

⁴⁶ See, e.g., Brad Plumer, *How to Swing the Prediction Markets and Boost Mitt Romney's Fortunes*, THE WASHINGTON POST (Oct. 23, 2012), <https://www.washingtonpost.com/news/wonk/wp/2012/10/23/how-to-manipulate-prediction-markets-and-boost-mitt-romneys-fortunes/>; Alex Klein, *InTrade And Jon Huntsman: Why the Media's Faith in the Internet Betting Ring Is Foolish*, THE NEW REPUBLIC (Jun. 21, 2011), <https://newrepublic.com/article/90371/intrade-and-jon-huntsman-president-odds-republican-nomination>. See generally Kloker, Simon and Kranz, Tobias T., *Manipulation In Prediction Markets – Chasing The Fraudsters*. In PROCEEDINGS OF THE 25TH EUROPEAN CONFERENCE ON INFORMATION SYSTEMS (ECIS), Guimarães, Portugal, June 5-10, (2017) (pp. 2980-2990), <http://aisel.aisnet.org/ecis2017trip/47>; Cary Deck, Shengle Lin, & David Porter, *Affecting Policy by Manipulating Prediction Markets: Experimental Evidence*,

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2. Kalshi’s proposed for profit contract would fail to provide the consumer protections and academic benefits provided by other non-profit prediction markets.

The fact that some other event contract platforms have been allowed to operate does not support the approval of the Kalshi submission. Those other platforms were readily distinguishable and were subject to multiple important limitations and conditions. Unlike the Iowa Electronic Markets⁴⁷ — and, until recently, PredictIt⁴⁸ — Kalshi is a for-profit entity established and motivated to maximize financial gain. Moreover, 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, as well as creating and offering a proliferation of other contracts, presumably enabling betting on virtually all other elections in the U.S. and elsewhere. Kalshi’s submission proposal provides little assurance that it will not do so, outlining no specific details regarding its fees, commission policies, or business plans.

In contrast, the conditions of the no-action letter granted to the Iowa Electronic Markets state that its prediction market is run on a not-for-profit basis, no commissions are charged to users, and its administrators do not receive a return in connection with the site. Moreover, traders are limited to position limits of well under \$1,000. Until recently, the political prediction market PredictIt — a non-profit project run by academics from the Victoria University of Wellington in New Zealand — likewise operated with similar restrictions protecting traders and guaranteeing researchers access to its data.⁴⁹ These contracts are a far cry from Kalshi’s proposed Self-Certified Contract. The Commission’s recent withdrawal of PredictIt’s no-action letter only intensifies concerns surrounding the appropriateness of allowing even non-profit research enterprises to operate event contract platforms, let alone the one advanced by Kalshi.

3. Kalshi’s proposed contract would redirect capital from productive uses into highly speculative markets and would undermine public trust in our elections.

85 J. ECON. BEHAV. & ORG. 48 (2013) (“[W]e present evidence from the lab indicating that single-minded, well-funded manipulators can in fact destroy a prediction market’s ability to aggregate informative prices and mislead those who are making forecasts based upon market predictions.”).

⁴⁷ See IOWA ELECTRONIC MARKETS, <https://iemweb.biz.uiowa.edu/>; CFTC No-Action Letter, CFTCLTR No. 93-66, 1993 WL 595741 (June 18, 1993), <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/93-66.pdf>.

⁴⁸ See Declan Harty, *No Future: Regulator Orders Political Prediction Market to Shut Down in U.S.*, POLITICO (Aug. 09, 2022), <https://www.politico.com/news/2022/08/09/nofuture-regulator-orders-political-betting-market-to-shut-down-in-u-s-00050238>.

⁴⁹ See Declan Harty, *Washington Weighs Plan to Let Americans Wager on Elections*, POLITICO (Sep. 5, 2022), <https://www.politico.com/news/2022/09/05/votersbetting-elections-trading-00054723>.

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Kalshi's contract would redirect capital that could otherwise be productively deployed in the public securities markets and elsewhere into a highly speculative and risky market that serves little if any economic purpose, just like traditional gambling.⁵⁰ Such markets prey on unwary traders and typically serve to enrich the few at the expense of the many.⁵¹ What is more, this speculative market runs contrary to the fundamental and historical purposes underlying the derivatives market — namely, to hedge commercial risks and assist in price discovery. Indeed, if anything, the so-called market that would be created by Kalshi's Self-Certified Contract would appear to increase risk rather than hedge or alleviate it.

And it does so at the steep cost of jeopardizing the integrity of and public faith in our elections. Whether through mere perception or through other means, there is little doubt that the mass commodification of our democratic process would raise widespread concerns about the integrity of our electoral process. Putting aside the significant issues of whether such markets could inspire vote-switching and other nefarious conduct, the mere impact on the public's perception of our democracy is cause enough to conclude that it is decidedly not in the public interest.

A. CFTC Regulation 40.11(a)(2) includes a very important catch-all provision.

Because not all contracts that would clearly be contrary to the public interest may fall neatly within the specific categories listed, CFTC adopted a regulation, 40.11(a)(2), that prohibits event contracts involving an activity that is “similar to” the activities enumerated in 40.11(a)(1), so long as the CFTC determines the contract to be “contrary to the public interest.”⁵² This provision serves as a clear recognition that there are simply some types of trading that society can and must consider off limits.⁵³

For example, 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. However, few would doubt that such betting should be prohibited because such a contract would “involve, relate to, or reference” assassination. But

⁵⁰ See Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling, and the Speculation Paradox*, 86 B.U. L. REV. 371, 373-74 (2006) (“[G]ambling is viewed as an enterprise of chance that encourages [participants] . . . to divert useful capital into a chaotic system whereby an undeserving few reap ill-gotten gains while the vast majority foolishly lose.”); Lynn A. Stout, *Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives*, 48 DUKE L.J. 701, 715 (1999) (“Common law courts regarded speculation as a type of wagering rather than a useful form of economic commerce.”); Thomas Lee Hazen, *Disparate Regulatory Schemes for Parallel Activities: Securities Regulation, Derivatives Regulation, Gambling, and Insurance*, 24 ANN. REV. BANKING & FIN. L. 375, 377 (“In contrast to investing, hedging and insurance, gambling is not generally viewed as a productive activity or one that provides any benefit to society beyond its entertainment value.”).

⁵¹ See Jon Kimball & David Rees, THE WASHINGTON POST, *We Made Thousands On This Website. But We're Still Happy It's Shutting Down* (Aug. 25, 2022), <https://www.washingtonpost.com/opinions/2022/08/25/predicting-gambling-political-prediction-markets/>.

⁵² 17 C.F.R. 40.11(a)(1).

⁵³ 17 C.F.R. 40.11(a)(2).

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it's not difficult to anticipate a lawyer's argument that a school shooting actually did not "involve, relate to, or reference" assassination, at least not in a narrow traditional sense. No one, however, could argue that such a contract would be "similar to" assassination and thereby properly prohibited as contrary to the public interest. 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.

B. Congress did not intend for the CFTC to police elections.

Widespread gambling on our elections through the simple click of a button is far removed from the purpose, function, and importance of the electoral processes. Such activities undermine the sanctity and democratic value of elections, turning them into speculative spectator sports. Better Markets agrees with the statements made by Chair Behnam regarding the new and entirely different role the CFTC would have to assume if political contracts were allowed.⁵⁴

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 situation presents not only legal implications but also broader policy considerations. It prompts questions regarding the suitability of this financial regulatory body being heavily involved in overseeing and policing gambling on the country's electoral processes. Therefore, it is important for the CFTC to carefully evaluate all these implications and potential consequences when it deliberates on whether to allow a political event contract in the derivatives marketplace.

III. The Submission cannot and will not serve a meaningful hedging or price discovery function.

The legislative history of CEA Section 5c(c)(5)(C) makes clear Congress's intent to restore the economic purpose test that was used by the CFTC to determine whether a contract was contrary to the public interest pursuant to CEA Section 5(g) prior to its deletion by the Commodity Futures Modernization Act of 2000. The restored economic purpose test calls for an evaluation of an event contract's utility for hedging and price discovery purposes. The unpredictability of the specific,

⁵⁴ Tracey Alloway and Joe Weisenthal, Transcript: CFTC Chair Rostin Behnam on the Fight to Regulate Crypto, A live Odd Lots interview from the ISDA annual meeting, (May 18, 2023), <https://www.bloomberg.com/news/articles/2023-05-18/transcript-cftc-chair-rostin-behnam-on-the-fight-to-regulate-crypto?sref=mQvUqJZj> stating, "Imagine a situation where we have alleged fraud or alleged manipulation of an election and someone coming to the CFTC and say, "You know, you have a contract listed on an election in, you know, X district in Y state, and we believe there was fraud, because of hardware, software, news, you name it." Right? "You need to police that fraud." So without being too indirect, what I'm trying to say is the CFTC could end up being an election cop, and I don't think that's what Congress meant or intended for us to do. And I think that raises for me personally, and I can't speak for the commission or my colleagues, a lot of legal questions and policy questions about whether or not you would want a financial regulator that's very interesting policing elections."

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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.

While the contract would pose significant threats to the public interest, as demonstrated above, Kalshi's proposed contracts would not perform any countervailing function that these markets were created for and intended to serve. Specifically, they cannot serve the futures markets' fundamental purpose as a meaningful hedging or price discovery mechanism. The proposal thus poses serious risks without benefits, a lose-lose proposition.

As the Commission itself observed in its previous review of NADEX's political event contracts,⁵⁵ the consequences of political control of Congress are too uncertain to provide a meaningful hedging function, for significant uncertainty still surrounds whether control of Congress will translate into any specific policy outcome or whether and to what extent such policy outcomes would influence commodity-related risks. For example, just because a party running on a tax reform platform gains control of Congress does not mean that this party can and will muster the support to pass their desired specific tax changes, much less whether or not a President would then sign such a law.⁵⁶ This calls into question the efficacy of a political event contract for purposes of hedging against tax risk. The same uncertainty applies to the impact of an election on any policy.

History is littered with innumerable examples of campaign promises, however genuine, being utterly meaningless once a person or party is elected or in control of one or both houses of Congress. As the old saying goes, "too many in this town mistake majority for control." Partisan majorities do not mean control and neither majorities nor control mean that some specific legislative item or agenda has any chance of passing or not, much less becoming law. The proponents of the Self-Certified Contract are ignoring these well-known, longstanding facts. The unsupported and unsupportable claims of a hedging purpose for the Self-Certified Contract are nothing but a smokescreen to get the CFTC to allow gaming and gambling on U.S. elections.

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.

⁵⁵ COMMODITIES FUTURES TRADING COMMISSION, *Order Prohibiting the Listing or Trading of Political Event Contracts* (Apr. 2, 2012) ("[T]he unpredictability of the specific economic consequences of an election means that the Political Event Contracts cannot reasonably be expected to be used for hedging purposes."), <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

⁵⁶ See, e.g., Marianna Sotomayor & Leigh Ann Caldwell, *House GOP Tries to Embark on a United Front as Expected Rifts Loom*, THE WASHINGTON POST (Sep. 23, 2022) ("Pleasing the factions will be a difficult job for anyone in leadership unless the possible majority margin is large enough to deter members from advancing their will — a tension often seen this term among Democrats who have only a four-vote margin."), <https://www.washingtonpost.com/politics/2022/09/23/house-gop-tries-embark-united-front-expected-rifts-loom/>.

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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.

IV. Legalizing gambling on elections will be a dramatic policy change with potentially grave national implications.

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.

Legalizing gambling on U.S. elections — de facto or otherwise — would be a dramatic policy change with potentially grave national implications. The consequences of gambling on elections are far-reaching and alarming. Given the use and abuse of social media in the gambling space⁵⁷ and artificial intelligence (AI) in the political space⁵⁸, 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. As noted above, when \$100,000,000 bets are allowed and billions of dollars are at stake, this is inevitable. It would also be reasonable to think that with this much money at stake that organized crime syndicates would get involved in what has historically been a lucrative activity for them, i.e., gambling.

Elected officials rely not only on free and fair elections to engender faith in the outcomes of elections, but elections are the foundation of American democracy. Gambling on elections would create very powerful incentives for bad actors, or even those just looking to make a quick buck, to interfere with our elections and try to sway voters outside of the democratic process. For example, it is easy to imagine how AI or social media might be manipulated to quickly circulate false and misleading information within hours or days of an election that could move enough votes to change the election's results.

⁵⁷ Jared Diamond, A Reporter's Tweet Moved NBA Draft Odds. He Also Works for a Gambling Company, (June 24, 2023), https://www.wsj.com/sports/basketball/nba-draft-shams-charania-the-athletic-fanduel-84c9ccc4?mod=hp_fcatst_pos5

⁵⁸ Tiffany Tsu and Steven Lee Myers, A.I.'s Use in Elections Sets Off a Scramble for Guardrails, Gaps in campaign rules allow politicians to spread images and messaging generated by increasingly powerful artificial intelligence technology, (June 25, 2023), <https://www.nytimes.com/2023/06/25/technology/ai-elections-disinformation-guardrails.html?smid=nytc0reios-share&referringSource=articleShare>

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As Bloomberg News reported on July 12, 2023, “AI is making politics easier, cheaper and more dangerous,” including:

“AI holds the potential to supercharge the dissemination of misinformation in political campaigns. The technology is capable of quickly creating ‘deepfakes,’ fake pictures and videos that some political operatives predict will soon be indistinguishable from real ones, enabling miscreants to literally put words in their opponents’ mouths. Deepfakes have plagued politics for years, but with AI, savvy editing skills are no longer required to create them.”⁵⁹

As a result, deepfake videos are already being deployed to impact voters, as Bloomberg pointed out:

“In March [2023], an anonymous Twitter user posted an altered video that went viral, purporting to show Biden verbally attacking transgender people. Another one, circulate widely by a right-wing US pundit, appeared to show Biden ordering a nuclear attack on Russia and sending troops to Ukraine.”⁶⁰

Allowing gambling on elections will make the dangers of AI and interference in elections much worse, more likely, and gravely consequential. Given the current environment where many Americans already question the integrity of U.S. elections, this would be adding fuel to the fire at the worst possible time.

As betting apps proliferate on mobile phones, widespread gambling on our elections through the simple click of a button is far removed from the purpose, function, and importance of the electoral processes. Such activities undermine the sanctity and democratic value of elections, turning them into speculative spectator sports. Moreover, the prospect of the CFTC assuming the role of an “election cop” raises very serious concerns about the misalignment of that new and unprecedented role with the CFTC’s historic mission and mandate as established by Congress. The CFTC is not designed, intended, set up, or funded to regulate gambling activities.

In short, Kalshi’s proposal would distort the fundamental and historical purposes of the futures markets — namely, to aid hedging and price discovery among commercial enterprises — while ushering in a flood of retail traders to enter a quintessentially speculative market with the prospect of suffering substantial losses.⁶¹ As noted at the outset of this letter, this proposed contract would further contribute to the trend toward the “gamification” and “retailization” of finance. In

⁵⁹ Emily Birnbaum and Laura Davison, AI Is Making Politics Easier, Cheaper and More Dangerous, Voters are already seeing AI-generated campaign materials — and likely don’t know it, (July 11, 2023), <https://www.bloomberg.com/news/features/2023-07-11/chatgpt-ai-boom-makes-political-dirty-tricks-easier-and-cheaper?srd=premium&sref=mQvUqJZj>

⁶⁰ *Id.*

⁶¹ *See supra* notes 21–22, 50 and accompanying text.

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this increasingly common pattern, everyday consumers and investors are lured into new financial products and services, justified by claims that the offerings represent beneficial “democratization” and “innovation.” Yet as we have seen again and again—with the “digital engagement practices” that fueled the meme stock frenzy, and even more so in the market for cryptocurrencies—the result is typically massive wealth accumulation for a few sponsors and issuers and massive losses suffered by the majority of investors.⁶²

The futures markets were not established as a new type of casino but to facilitate the provision of essential goods to Americans by enabling commercial entities to manage the price risk associated with their productive commercial activities.⁶³ There is no credible evidence that Kalshi’s proposed Self-Certified Contract will serve these critical functions, but little question that it will pose serious threats to investors, markets, and our democracy. Given what is at stake, we urge the Commission not to approve Kalshi’s contract.

CONCLUSION

We hope these comments are helpful as the Commission finalizes the proposal.

Sincerely,



Dennis M. Kelleher
Co-founder, President and CEO

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⁶² See generally Dennis M. Kelleher, Jason Grimes, and Andres Chovil, *Securities—Democratizing Equity Markets With And Without Exploitation: Robinhood, Gamestop, Hedge Funds, Gamification, High Frequency Trading, And More*, 44 W. NEW ENG. L. REV. 51 (2022).

⁶³ See generally Christine Hurt, *Regulating Public Morals and Private Markets: Online Securities Trading, Internet Gambling and the Speculation Paradox*, 86 B.U. L. REV. 371 (2006).



07/24/2023

VIA ELECTRONIC SUBMISSION

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington DC 20581

**Re: Commodity Futures Trading Commission Request for Information and Comment
for KalshiEX Congressional Control Contracts, Industry Filing 23-01**

Dear Mr. Kirkpatrick,

CME Group Inc. ("CME Group") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") request for information and comment regarding KalshiEX LLC's ("Kalshi") proposed congressional control contracts.

CME Group, a corporate holding company, owns and operates multiple futures exchanges. Our exchanges offer the widest range of global benchmark products across all major asset classes. These products are widely used by market participants for risk management and price discovery. Throughout our corporate history, our exchanges have been involved in most of the major developments that serve as the basis for today's futures industry. For example, we had a front row seat at the very birth of futures trading, the standardization of futures contracts, the formation of the clearing process, as well as the initial introduction of financial futures, cash-settled contracts, and electronic trading. Over our long history, we have demonstrated ongoing leadership with respect to developing new products that have legitimate economic purpose.

Kalshi has recently proposed to offer derivatives contracts based on the outcome of elections in the U.S. Congress. In short, we believe that contracts based on elections are contrary to the public interest and the Commission should prohibit an exchange from listing them, as it has in the past.

The Commission does not currently allow exchanges to list event contracts based on political elections. North American Derivatives Exchange (“Nadex”) proposed listing very similar contracts a little over a decade ago. At that time, the Commission reviewed and correctly exercised its statutory authority to reject the filing.¹ In our view, nothing has changed. The Commission may now hear technical arguments seeking to call its authority into question. While reasonable minds can almost always differ on some point of law, the Commission should ignore this legal nitpicking that is beside the point. Congress clearly gave the CFTC specific statutory authority in this area.² The Commission chose to use that authority in 2012 to prevent event contracts that were based on the outcome of political elections. The analytical reasoning underpinning the Commission’s prohibition had a sound legal basis.³ That legal basis remains completely intact today. Thus, from our perspective, the CFTC has already correctly made this decision and that decision should stand.

We are also persuaded by the logic of certain questions recently raised by Chairman Behnam. The Chairman has asked whether a derivative contract on a political election might compel the Commission to attempt to act as an “election cop”.⁴ The question is pertinent because the Commission is obligated by Section 6(c) of the Commodity Exchange Act to police for fraud and manipulation in connection with any commodity in interstate commerce. For the contracts in question here, the underlying “commodities” are the relevant political elections. Therefore, the Commission must consider and potentially address the unfortunate possibility that fraud occurs in a political election underlying a contract. Do any of us really believe that Congress intended for the CFTC to play this role in the electoral process? Is this result in the public’s interest? For our part, we do not think Congress intended or wants this result, and we do not think such a result would be in the public’s interest.

Finally, and importantly, the Commission’s prior decision to prevent widespread adoption of these types of political contracts relied on a very compelling public policy rationale, and that rationale has never been stronger. The Commission made a finding in the Nadex Order that these types of instruments could “potentially be used in ways that would have an adverse effect on the integrity of elections”.⁵ Although some may attempt to argue that allowing these

¹ CFTC Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts (April 2, 2012) (“Nadex Order”), available at <https://www.cftc.gov/PressRoom/PressReleases/6224-12>.

² In the Nadex Order, the Commission relied on its authority under section 5c(c)(5)(C)(i) of the CEA, which authorizes it to disapprove certain types of event contracts if it finds they are contrary to the public interest. The Commission has other statutory authority as well that may provide a separate basis for rejecting the contracts. For example, there is a legitimate question as to whether political election results are covered by the CEA’s “excluded commodity” definition or the event contract element of the “swap” definition, and if they are not, they cannot be the basis for a regulated contract offering by an exchange. The Commission also has plenary authority to regulate options under section 4c(b)-(e).

³ When the Commission rejected the Nadex filing in 2012 pursuant to section 5c(c)(5)(C)(i), it properly found that the contracts, considered as a whole, constituted gaming contracts and were contrary to the public interest. The Commission’s order further noted that several states had laws linking betting on election outcomes to gaming/gambling. To the extent any states prohibit or regulate betting on election outcomes, that further supports rejecting Kalshi’s proposal as contrary to the public interest. Allowing Kalshi to list the contracts would preempt state gaming laws by operation of section 12(e), doing an end-run around the states’ public policy determinations on gaming, for contracts that serve no meaningful economic purpose to justify receiving such a benefit.

⁴ See “CFTC Chair Rostin Behnam on the Fight to Regulate Crypto.” *Odd Lots* Podcast, published May 18, 2023, at 34:00. <https://podcasts.apple.com/us/podcast/odd-lots/id1056200096>

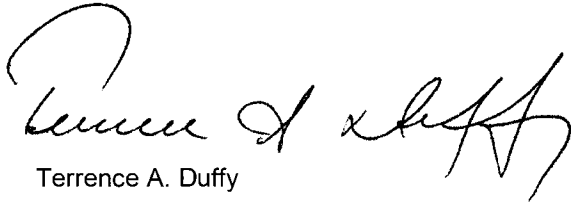
⁵ Nadex Order at p. 4.

contracts now is indeed in the public interest, based on our vantage point, and armed with the past ten years of experience, we would disagree.

In summary, we firmly believe the Commission should not change its mind on this topic now. And we are also quite sure that if it did entertain that possibility, and it conducted a credible review of the public interests involved, it would very quickly conclude that approving contracts like these was still obviously contrary to the public interest, just as it was 10 years ago. But we do not see any need to take this step. The Commission should be very comfortable relying on its past precedent here. Derivatives contracts on political elections have not been allowed and should not be allowed, for good reason.

CME Group appreciates the opportunity to comment on this matter and we would be happy to discuss any of our views with the Commission.

Sincerely,



Terrence A. Duffy

C A M P A I G N F O R
ACCOUNTABILITY

July 24, 2023

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

RE: Campaign for Accountability comment on KalshiEX, LLC's proposed futures contracts for election outcomes (Release No. 8728-23)

Dear Chairman Behnam and Commissioners,

Campaign for Accountability is writing to express opposition to KalshiEX, LLC's (Kalshi) proposed contracts that would effectively allow betting on which political party will control the chambers of the U.S. Congress. Despite some commenters' assertions that allowing such contracts would primarily be an aid to academic study, it is undeniable that the question at issue is whether or not to allow widespread gambling on the outcome of U.S. elections. CFTC's answer in the affirmative would unnecessarily introduce and likely exacerbate myriad harmful incentives around US elections.

As an organization dedicated to exposing misconduct in public life, Campaign for Accountability has a great deal of experience examining situations where financial incentives promote behavior contrary to the public good. We fear that giving a green light to betting on the outcome of U.S. elections would be one of these situations.

Currently, the people most incentivized to advocate for a certain election outcome are the citizens that make up that election's constituency – at least, that is how it should be. In recent years, we have seen foreign actors stage large-scale attempts to influence the outcomes of U.S. elections when they feel that one outcome may better serve their own interests. We've also seen dark money operations overwhelm smaller races with massive contributions that weaken the power of individual constituents.

While we should work to minimize these outside influences, they can at least be partially mitigated through an understanding of the platforms and policies that special interests are attempting to shape via their preferred candidate. In contrast, individuals allowed to gamble on election outcomes would be incentivized to influence races *without any consideration of what officials will do once elected*. While this incentive does not make American citizens worse off by necessity, it promotes the idea of "electoral victory as end result" that undoubtably draws us away from the aspirations of representative democracy.

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campaignforaccountability.org

July 24, 2023
Page 2

Further, condoning this sort of cold financial calculus around election outcomes entrenches a growing, cynical “gamification” of American politics. Already, political cable news shows strike a tone eerily similar to those covering sectors of American society which are more nakedly concerned with “winners and losers.” Further injecting gambling into politics would exacerbate this. People watch ESPN before placing wagers on sports betting apps, CNBC before making stock trades, and might soon be tuning into CNN or MSNBC before betting on election outcomes.

We hope that the CFTC shares our view that such a reality would be grim, and that the depressing effects that it would have on good-faith civic engagement would overshadow any potential benefits. Reading through public comments, we anticipate you will consider among these benefits assertions from economists and academics that contracts like those proposed by Kalshi will provide interesting datasets which could be used to better forecast human behavior. We insist that, while an emerging market might provide fascinating material for academic study, the behavior encouraged by that market can still be deeply contrary to the public’s best interests.

Sincerely,



Michelle Koppersmith
Executive Director
Campaign for Accountability



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July 24, 2023

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

Re: Comment on KalshiEX LLC's Congressional Control Contracts

Dear Chairman Behnam,

The Center for American Progress (CAP) is writing to the Commodity Futures Trading Commission ("CFTC" or "the Commission") regarding CFTC's request for comment on KalshiEX, LLC's ("Kalshi") proposed Congressional control event contracts (the "Proposal"). CAP is an independent, nonpartisan policy institute dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action. As an organization dedicated to strengthening our democracy, we strongly object to Kalshi's proposal. Kalshi's bid is predicated on a misreading of CFTC jurisdiction under section 5c(c)(5)(C) of the Commodity Exchange Act ("CEA"), codified at 7 U.S.C. § 7a-2 and 17 C.F.R. § 40.11. Furthermore, these proposed Congressional control event contracts endanger American democracy by incentivizing election interference. CAP opposes the authorization of these proposed event contracts, as doing so would be against the public interest.

Kalshi's proposal makes numerous justifications,¹ but it fundamentally amounts to nothing more than betting on the results of elections. The CFTC got it right in 2012 when it did not allow the North American Derivatives Exchange ("Nadex") to host binary political event contracts regarding the results of various U.S. federal elections in 2012.² The Commission's conclusion that the political event contracts at issue in the Nadex proceeding constituted gaming under state and federal law and were contrary to the public interest³ should hold. Kalshi argues that the Nadex holding was incorrect because the underlying activity of political event contracts, elections, are not an excluded commodity. However, political event contracts taken as a whole are considered gaming,⁴ which is an explicitly excluded commodity.⁵ Kalshi's proposal is materially indistinguishable from the 2012 Nadex request and the Commission

¹ Comments from KalshiEX to Commission, Sept. 25, 2022, *available at* <https://www.cftc.gov/sites/default/files/filings/ptc/23/06/ptc0612232836.pdf>.

² "Order Prohibiting The Listing Or Trading Of Political Event Contracts" ("Nadex Order"), April 2, 2012, *available at* https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder_040212.pdf.

³ *Ibid.*

⁴ KalshiEX, "Comments Responding to the Commission's Specific Questions Related to KalshiEX, LLCs Proposed Congressional Control Contracts."

⁵ 7 U.S.C. § 7a-2(c)(5)(C).

should come to the same result. As the Commission previously cited in Nadex, the political event contracts at issue meet state and federal definitions of gaming, and should be examined as instances of gaming.⁶

Viewed as instances of gaming, Kalshi's proposed political event contracts would have deleterious effects on American democracy. Kalshi's proposal strikes at the very heart of democracy—when citizens vote, their task is to vote for the person they believe *should* win the election. But if voters could directly financially benefit from the results of an election, they would instead be incentivized to vote for the person they think (and potentially have bet) *will* win the election.

Kalshi's political event contracts would not only encourage voters to vote against their conscience, but would also threaten the integrity of our elections at large. If there is the possibility of acquiring material gain with the result of an election, participants may interfere with the electoral process. This may include, but is not limited to, disinformation campaigns in various mediums—including the use of generative artificial intelligence (AI), voter intimidation, and election hacking. Congressional officials have already voiced their concerns about algorithmic, AI-generated, and social-media-spurred disinformation in the 2024 general election;⁷ these proposed election wagers would only exacerbate the issue. This Commission has agreed with this fact in the past, stating in the Nadex order that these contracts "can potentially be used in ways that would have an adverse effect on the integrity of elections."⁸

Though Kalshi's present proposal is limited to wagers regarding which party controls the chambers of the U.S. Congress, it is a slippery slope. If the precedent is set to allow this activity, Kalshi and its competitors could likely use its logic to set about creating betting contracts at other levels of government—from the local level to the presidency—and on every conceivable question. This possibility of wholesale betting on U.S. elections could make each individual election more contentious and open to the individualized targeting by malicious actors. This could happen both before and after the results are called. Some evidence suggests that electoral betting fueled the fire of election denial in 2020.⁹ At a time when Americans' faith in election integrity is regrettably low compared to two decades ago,¹⁰ it is against the public interest to introduce financial incentives to our electoral system that would damage it further. Any benefit that could possibly be attributed to these contracts pales in comparison to the threat to our election security and the sanctity of American democracy.

As such, CAP strongly urges the CFTC to deny the proposal set forth by Kalshi just as it correctly did a decade ago with Nadex. Kalshi's proposal to allow gambling on our elections is squarely against the public interest.

⁶ See Nadex Order, *supra* n. 2.

⁷ Tiffany Hsu and Steven Lee Meyers, "A.I.'s Use in Elections Sets Off a Scramble for Guardrails" *NY Times*, June 25, 2023, available at <https://www.nytimes.com/2023/06/25/technology/ai-elections-disinformation-guardrails.html>.

⁸ Nadex Order, *supra* n. 2, at 4.

⁹ Elizabeth Howcroft and Krystal Hu, "As Trump refuses to concede, some bettors hold out too," Reuters, Nov. 12, 2020, available at <https://www.reuters.com/article/us-usa-election-betting/as-trump-refuses-to-concede-some-bettors-hold-out-too-idUSKBN27S1P5>.

¹⁰ Justin McCarthy, "Confidence in Election Integrity Hides Deep Partisan Divide," Gallup, Nov. 4, 2022, available at <https://news.gallup.com/poll/404675/confidence-election-integrity-hides-deep-partisan-divide.aspx>.

Congress of the United States
Washington, DC 20510

July 24, 2023

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

Re: Comment on KalshiEX LLC's Congressional Control Contracts

Dear Chair Behnam:

We write today in response to the Commodity Futures Trading Commission (CFTC) review of and request for public comment on KalshiEX, LLC's (Kalshi) congressional control event contract proposal. As Members of Congress, we feel a special responsibility to ensure that the democratic process by which we are elected is safeguarded at every turn and we view Kalshi's proposed event contract as posing a fundamental threat to that goal. Especially at a time when a majority of American voters believe democracy is under threat, the stakes are too high to incentivize activities that would further erode trust in the integrity of our democratic institutions or elected leaders. We strongly believe that Kalshi's proposed congressional control event contract is contrary to the public interest and urge the Commission to bar its listing.

As you know, the CFTC regulates derivatives and commodities – like wheat, soybeans and cattle – that are vital to all Americans. Properly regulating and policing those markets ensures commodities are delivered in the right amounts at the right times, and at prices that are reasonably reflective of the supply and demand available to the American people. These are critical functions, and CFTC plays an important role in the daily lives of all Americans as it undertakes its mission.

In this instance, however, the CFTC is being asked to make a decision that fundamentally implicates areas outside of its mission: American elections. The CFTC's involvement in gambling and elections would be a wild departure from the core principles and historic foundations of the futures markets it is responsible for regulating and overseeing. The primary purpose of those markets is to serve as a mechanism for hedging risk and facilitating price discovery for physical commercial purchasers and producers of commodities that are vital to every American family. Those markets do not exist to promote, facilitate or enable widespread speculative gambling among retail traders and are not intended or designed to function as casinos.

Kalshi's proposal seeks to have the CFTC consent to allowing Kalshi to offer de facto betting contracts on the outcome of elections in the United States via so-called "event contracts." These contracts would allow participants to place money at risk as they predict which political party will control a chamber of the United States Congress for a given term. Ultimately, participants who correctly predict control of a chamber of Congress would receive a monetary payout based on the market's assessment of the probability of the outcome, while participants who guess incorrectly lose their monetary investment.

Gambling on elections in this way is concerning for many reasons, and the CFTC itself has, in fact, already reached this very conclusion. Under Section 5c(c)(5)(C)(i) of the Commodity Exchange Act, the CFTC may prohibit event contracts that involve(1) an activity that is unlawful under state or federal law,

(2) terrorism, (3) assassination, (4) war or (5) gaming.¹ Additionally, because not all undesirable contracts may fall neatly within the specific categories listed, the CFTC adopted a regulation, 40.11(a)(2), that prohibits event contracts involving an activity that is “similar to” the activities enumerated above so long as the CFTC determines the contract to be “contrary to the public interest.”² The legislative history of CEA Section 5c(c)(5)(C) indicates that the CFTC should consider whether the event contract *as a whole* involves activities listed under Section 5c(c)(5)(C)(i), meaning that the CFTC should consider, among other things, the event underlying the event contract, in this case, elections, and the purpose of the contract, betting on elections. Moreover, the CFTC broadened the scope of Section 5c(c)(5)(C)(i) through the adoption of Regulation 40.11(a)(1), which now prohibits not only an event contract that “involves” the five enumerated activities but also one that “relates to, or references” them.

In 2012, the CFTC was presented with a proposal that was substantially similar to the Kalshi proposal from the North American Derivatives Exchange (NADEX). The NADEX proposal also sought to offer binary event contracts relating to the political control of each chamber of Congress in a given term, and similarly planned to pay out monetary amounts to winning individuals. After analysis of the NADEX proposal, the CFTC, in an April 2, 2012 order, denied the listing of the NADEX contract on the basis that it not only included an activity prohibited under state law and involved or was similar to “gaming,” but also because it was deemed contrary to the public interest. In stating its decision, the CFTC noted such an event contract could “potentially be used in way that would have an adverse effect on the integrity of elections.” We agree and believe the 2012 determination provides a strong basis for a similar determination on Kalshi’s current proposal.

Free, fair and transparent elections are the foundation of American democracy. When our constituents exercise their fundamental right to vote, they are not merely choosing the winner of a contest. They are making a values-based declaration regarding the future direction of our country and the nature of the policy that should govern it. The CFTC should avoid blessing any betting scheme that would frustrate that expectation by undermining the credibility of our democratic elections and contributing to voter cynicism about the political process.

That means rejecting proposals such as those put forward by NADEX and Kalshi. While these proposals are facially similar and what was true of this type of political event contract in 2012 remains true today, now, 11 years later, the stakes are even higher. As betting apps proliferate on mobile phones, widespread gambling on our elections through the simple click of a button has an insidious effect upon the purpose, function and integrity of the electoral process. Moreover, since 2012, our nation has seen a deluge of dark money attempt to drown out the voices of voters, an undercurrent of election denialism and extremism, and an increase in politically-motivated violence. The proposed political event contract would only further incentivize such activity and encourage bad actors, or even those just looking to make a fast dollar, to interfere with our elections and seek to sway voters outside of the democratic process.

For example, it is easy to imagine how artificial intelligence (AI) or social media might be manipulated to quickly circulate false and misleading information within hours or days of an election that could move enough votes to change the results.³ As Bloomberg News reported on July 12, 2023:

¹ 7 U.S.C. § 7a-2(c)(5)(C)(i). The Commodities Exchange Act (CEA) is codified at 7 U.S.C. § 1 *et seq.*
² 17 C.F.R. § 40.11.

³ See, e.g. *AI’s Use in Elections Sets Off a Scramble for Guardrails*, New York Times (June 25, 2023) online at: www.nytimes.com/2023/06/25/technology/ai-elections-disinformation-guardrails.html?smid=nytcore-ios-share&referringSource=articleShare.

AI holds the potential to supercharge the dissemination of misinformation in political campaigns. The technology is capable of quickly creating ‘deepfakes,’ fake pictures and videos that some political operatives predict will soon be indistinguishable from real ones, enabling miscreants to literally put words in their opponents’ mouths. Deepfakes have plagued politics for years, but with AI, savvy editing skills are no longer required to create them.⁴

Deepfakes are already being deployed to impact voters, and as technology advances, so does this threat. Allowing gambling on elections would exacerbate this, as now the fulfillment of an individual’s political goals would not only hang in the balance, but so would their money. Given the current environment where many Americans already question the integrity of U.S. elections, this would be adding fuel to the fire at the worst possible time.

With this incentive would also come the incentive to increase the flow of dark money in our political process. Since the Supreme Court’s disastrous decision in *Citizen’s United v. FEC*, we have witnessed the perverse and pervasive influence of large sums of undisclosed, unchecked and unregulated money in our political process. Kalshi’s proposal would likely exacerbate this in two ways. First, with payouts of up to \$100 million per contract, the proposal would incentivize the flow of funds to boost a candidate’s chances of winning an election and incentivize even higher spending on our elections. And, unlike a traditional campaign contribution, bets placed through the event contract would also provide the bettor – or in this case, a bettor and contributor – the added incentive of effectively recouping the amount of their donation as well as an additional profit. Allowing the personal financial gain of deep-pocketed donors and special interests – rather than the priorities of every day Americans – to dictate our nation’s policymaking agenda is squarely against the public interest.

Second, because the CFTC is not equipped or authorized to enforce election laws, the prospect of the Commission assuming the role of an “election cop” raises very serious concerns about the misalignment of such a role with the CFTC’s historic mission and mandate as established by Congress. While the additional spending related to Kalshi’s proposed event contract could increase the recognition or standing of a given candidate, it would likely not fall under the types of contributions regulated under existing campaign finance law. Absent the Federal Election Commission’s expertise in such forms of regulation, the money spent under the contract could be even more untraceable than existing forms of dark money. That result is clearly contrary to the public interest.

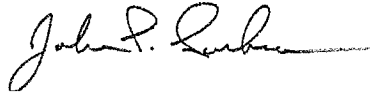
Finally, there is the potential for an event contract like Kalshi’s to increase incidents of terrorism or assassination, two of the categories that are expressly defined as “contrary to public interest.” Harassment, threats and violence against election workers and elected officials continues to rise. According to a 2023 survey conducted by the Brennan Center for Justice, nearly one third of election officials have been harassed, abused or threatened because of their job. Forty five percent of local election officials said they fear for the safety of their colleagues. The potential for monetary gain would only increase the possibility of these grave threats and further undermine the safety and integrity of our elections.⁵

⁴ *AI is Making Politics Easier, Cheaper and More Dangerous*, Bloomberg News (July 11, 2023) online at www.bloomberg.com/news/features/2023-07-11/chatgpt-ai-boom-makes-political-dirty-tricks-easier-and-cheaper?srnd=premium&sref=mQvUqJZj.

⁵ *Poll of Election Officials Shows High Turnover Amid Safety Threats and Political Interference*, Brennan Center for Justice (Apr. 25, 2023) online at: <https://www.brennancenter.org/ourwork/analysis-opinion/poll-election-officials-shows-high-turnover-amid-safety-threats-and>.

No one should be able to wager the rights and opportunities of millions of individuals for his or her personal gain. Elections free from interference, abuse or the corrupting influence of money are in the public interest, as is the prohibition of activities that could reasonably incentivize individuals to interfere with our electoral process. For these reasons, we urge the CFTC to again recognize the dire implications of betting on elections and deny the Kalshi congressional control event contract.

Sincerely,



Representative John P. Sarbanes



Representative Jamie Raskin

ORAL ARGUMENT REQUESTED

No. 24-5205

United States Court of Appeals
For the District of Columbia Circuit

KALSHIEX LLC,

Appellee,

v.

U.S. COMMODITY FUTURES TRADING COMMISSION,
Appellant.

On Appeal from the U.S. District Court for the District of
Columbia

Case No. 1:23-cv-03257-JMC (Hon. Jia M. Cobb)

**JOINT APPENDIX
VOLUME II**

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October 16, 2024

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51. Public Comment Letter by Terrence A. Duffy, 7/24/2023,
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56. Public Comment Letter by Kalshi, 7/23/2023,
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57. Public Comment Letter by Kalshi, 7/24/2023,
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58. Public Comment Letter Sens. Jeffrey A. Merkley, Sheldon Whitehouse,
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60. Appendix B to 2022 Congressional Control Contracts,
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61. Email from Kalshi to CFTC Staff Submitting a Copy of Entire 2022
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67. Public Comment Letter from Angelo Lisboa, JA00844.....APP. 970
68. Letter from Kalshi to CFTC Responding to Specific Questions
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COALITION FOR POLITICAL FORECASTING

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24 July 2023

Submitted via CFTC portal
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, D.C. 20581

Re: Coalition for Political Forecasting response to CFTC's request for public comments on questions related to Kalshi's self-certified congressional control contracts

We are writing on behalf of the Coalition for Political Forecasting in support of Kalshi's proposal to list contracts on which political party will control the U.S. Congress.

The Coalition for Political Forecasting is a nonpartisan, nonprofit organization that aims to liberalize regulations on political betting in order to serve the public interest. The Coalition advocates for a community of researchers, traders, and philanthropists that sees real-money prediction markets and other betting platforms as advanced forecasting tools that can help humanity navigate an uncertain future by aggregating and refining predictions about political events. The Coalition seeks to advise the policymaking community on how betting on political events can improve democratic institutions, promote economic stability, and facilitate innovative research.

All three of us submitted comments to the Commission on this issue in September 2022. Our previous comments address most of the questions on which the Commission again seeks public comment. The views we expressed in those comments have not meaningfully changed. Indeed, the evolution of the political betting industry since the 2022 midterm elections has underscored to us the importance of allowing Kalshi to enter the space.

In this comment, we focus on providing answers to the Commission's questions that did not appear in its August 2022 request.

We hope the Commission will also find informative the attached July 2023 report, "Political Betting Regulation in the United States: Pathways to Liberalization" authored by Chougule and Sia under the auspices of the Coalition for Political Forecasting. We have integrated insights from the report into our responses below. Greater detail and citations for much of the data and information in our responses is available in the report.

Sincerely,

Pratik Chougule
Executive Director, Coalition for Political Forecasting

Flip Pidot
Board Member, Coalition for Political Forecasting

Solomon Sia
Board Member, Coalition for Political Forecasting

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?

The minimum order sizes and position limits are likely to deter traders interested in gaming while drawing a relatively greater degree of liquidity from skilled traders with motives other than gaming, such as hedging.

Of the three categories of traders delineated in Kalshi's proposal—individuals, entities, and eligible contract participants—individuals appear to us to be the most likely to enter the markets with gaming motives.

Our expectation is that the more money individuals are required to wager on the outcome of congressional elections, the more likely they are to approach these markets either with a long-term edge and/or with an understanding of how to use these markets for hedging and price-basing.

Evidence for our thesis can be found in data from the 2020 U.S. elections on PredictIt and UK-based markets. Many of the most irrational, speculative, and gaming-oriented bets we observed were on PredictIt, where the average first time deposit was \$216. Due to the betting limits on PredictIt, the markets had limited ability to correct small-scale speculators who wagered on highly improbable outcomes, such as the possibility that Trump would remain president despite losing the election. As the markets reached new heights of irrationality, the gaming frenzy often grew. Traders who were placing these types of bets were often highly vocal on social media, where they broadcasted their wagers in the hopes of eliciting reactions from fellow MAGA enthusiasts. Once the markets were settled against them, however, they were relatively absent from political betting circles.

On Betfair Exchange, by contrast, which does not have position limits, the biggest winners were smart whales who took advantage of mispriced odds driven by gaming-oriented retail traders. Although 46.6% of the money wagered in these markets was on Trump compared to 50.6% for Biden, the 10 largest bets placed on Betfair were for Biden. These include at least 7 bets on Biden of more than \$400,000.

The main challenge we foresee regarding the enforceability of Kalshi's position limits is the unlikely scenario that individual speculators will falsely claim to have a demonstrated established economic hedging need so that they can wager up to \$250,000 rather than being limited to \$125,000.

It would be reasonable of the Commission to request from Kalshi greater clarity on the precise "means and methods" it intends to use to exercise sole discretion in determining whether a member has demonstrated a sufficient economic hedging need. The number of individuals who could be expected to wager more than \$125,000 on Congressional control markets is relatively small, and only a small percentage of those would do so with a genuine hedging need. Especially as it works on building liquidity on its platform, Kalshi could be tempted to accept alleged hedgers with minimal scrutiny. More transparency on Kalshi's standard would also set a precedent for future market participants.

Overall, however, we see minimal concerns regarding enforceability. The main reason is that Kalshi's contracts create strong incentives for self-regulation. At least in terms of its political and election markets, Kalshi has one overwhelming comparative advantage vis-a-vis its competitors: the regulatory certainty it can provide traders by virtue of its status as a DCM and its strategy of hewing closely to CFTC regulations.

More so than the vast majority of other market operators in the political betting space, Kalshi, in our assessment, has a strong motive to take a highly conservative, risk-averse approach to regulation.

On the trader side, the small number of individuals seeking to wager more than \$125,000 on Congressional control markets can easily place bets on other platforms with far less scrutiny of their motives. Political bettors are already trading political contracts on a growing number of offshore platforms, which are increasingly keen on expanding election lines. As VPNs and other technologies advance and the reality becomes clearer that the government has a minimal capacity and political will to pursue enforcement actions against small-scale retail traders, this activity will likely continue to grow.

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?

We believe that the proposed changes to the contract trading requirements bring them closer in line to practices in futures markets, which increase their likelihood of serving price-basing and hedging functions.

Although the vast majority of political event contracts are used for speculation, we have seen cases of retail traders using these markets for hedging. We are aware of young professionals, for example, who use Kalshi to hedge their student loans. Our concern is that the order size and position limits will deter young, early adopters of political prediction markets from exploring their hedging use case with small amounts of money.

If Kalshi is proposing the order size and position limits at the request of the Commission, we urge the CFTC to grant Kalshi more leeway.

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?

The question of which party will control Congress is determined by so many factors that the price forming information is effectively the totality of the American and global political discourse.

The vast majority of price forming information in these markets cannot be regulated by the government. Polling illustrates why price forming information in election markets is nearly impossible to regulate. Polling is conducted by a wide array of sources with varying degrees of reliability and motivations. Even if the government were to find ways to regulate fraudulent polls, it would need to contend with the reality that it is often not polls themselves, but rather, the interpretation, analysis, and dissemination of polls that drive market prices. For example, predictive models that seek to turn polling data into quantified forecasts are the subject of trader debates due to the way they weight different pollsters.

Price forming information in election contracts tends to be based more on qualitative data points than the informational sources used for pricing commodity derivative products. Market odds of a party controlling the House and Senate are influenced not only by polls, election models, and other quantitative data, but also on news reports and political commentary related to national trends, individual races, and other potential signals. Opinions and analyses by a wide variety of experts, media personalities, and influencers on the rel-

ative strengths of weaknesses of parties and candidates contribute to narratives that drive movements in the markets. This is why market prices frequently seem to be incongruous with polling and other data.

Price information in Congressional control markets is more difficult to regulate than the information used for pricing other commodity derivative products because it is more clearly protected by the First Amendment. Predictions broadcasted by politicians, pundits, and other political commentators inform prices in election contracts. Even when these predictions may be misleading in the sense that they are intended to shape narratives and push agendas, they typically cannot be regulated because they are constitutionally-protected speech.

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?

Manipulative and/or false reporting activity is relatively unusual in markets on the control of Congress. It is more common in smaller scale, lower liquidity markets where there is less public, relevant information; more volatility; higher degrees of uncertainty; and short deadlines.

Insofar as these markets would be targeted for manipulation at all, we believe this would happen primarily through the dissemination of misleading news reports and polls. Given how quickly market participants themselves fact-check these sources, it would be difficult if not impossible for registered entities to address this type of manipulation more effectively than the markets.

The only scenario we can think of where manipulation would have a meaningful distorting impact on price forming information for the contracts would be on election day. In the event of a close election, when media reporting is unreliable and jittery traders are buying and selling in a state of panic, manipulators could cause major movements in the markets.

The easiest way a registered entity could address possible manipulation is by refusing to host discussion boards on their platforms. Comments sections have historically been among the most common vehicles for market manipulators to affect prices on PredictIt. The amount of activity in these comments sections makes it difficult for sites to police them.

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 an attempted election manipulation? Are the limitations reasonably enforceable?

In rare cases, political insiders buy or sell positions in prediction markets to manipulate the price at which a contract is trading. In every instance we have seen this happening, this manipulation is motivated by a desire to generate optimism in the broader political conversation about an individual underdog candidate's electoral prospects. Markets that are targeted for these efforts typically have limited liquidity, which makes market manipulation a cost-effective campaign and public relations strategy. We are highly skeptical that anyone would have sufficient motivation to spend the amount of money it would take to make it seem as if the Republicans or Democrats have a marginally higher chance of achieving overall control of the House or Senate.

The nine categories of individuals Kalshi would exclude are broad and diverse. The degree to which limitations on their participation can be enforced likely varies depending on their profile, employment, and compensation structure. The important point, from our perspective, is that Kalshi is endeavoring in the first place to limit market participation for the sake of advancing democratic norms. In the vast majority of other political betting platforms, market participants are restricted not out of concern for election integrity, but because they are winning accounts that generate more accurate odds at the expense of bookmaker profits.

Kalshi's decision to exclude a broad array of market participants speaks to the company's desire to work with regulators to assuage concerns about the threat election contracts might pose to democratic institutions. If the CFTC prevents Kalshi from offering these markets, the beneficiaries will be other platforms with fewer qualms about enabling election manipulation.

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

As with the registered entity, surveillance and enforcement of market manipulation by the CFTC would generally be an exercise in futility. These attempts would serve little purpose given how efficiently Kalshi's highly liquid Congressional control markets would self-correct.

There is only one type of surveillance or enforcement we believe the Commission should take responsibility for: trading in these markets by CFTC staff. A strict policy prohibiting CFTC staff from trading in these markets might help to bolster the agency's credibility as a regulator. It would assuage doubts that Commission staff have a motive to engage in manipulation and/or false reporting activity in these contracts.

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?

Ever since Chairman Behnam raised the possibility of the CFTC turning into an "election cop" in his interview on the Odd Lots podcast, we have interviewed numerous elections and compliance officials to explore this issue.

We are not aware of anyone in Congress or the policymaking community who believes that the CFTC has authority to be an "election cop" in the electoral process or political fundraising. Indeed, this concern is so speculative that it provokes suspicion about whether it is merely a pretense for the CFTC to avoid decisions on political event contracts.

It is important to consider that the CFTC has had oversight over several political prediction markets that offered contracts for the 2000, 2020, and 2022 U.S. elections. In each of these years, election disputes were litigated across state and federal electoral apparatuses and courts. Notwithstanding the deep, widespread, and, in some cases, violent public reactions that these disputes engendered, they did not require any meaningful CFTC intervention in betting markets. Nor did they even generate any significant legislative or public demand for CFTC involvement.

The easiest way to prevent the Commission from becoming involved in the electoral process is to establish

clear settlement rules for the contracts. We believe that Kalshi and other political betting operators need to prepare for the possibility that election disputes could leave unresolved the question of which party controls Congress well after election day. It would be reasonable for the Commission to encourage Kalshi to develop and publicize contingency plans for this scenario. Clarity among traders and the public on precisely when and under what circumstances the contracts will pay out would prevent the types of outcomes that could invite CFTC involvement.

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

Perhaps because political event contracts are so tightly regulated in the United States, debates on this issue are often defined by arguments that are theoretical and speculative in nature.

The UK would be a useful case study to explore the public interest implications of these markets as it has had a liberal regulatory regime on political betting for more than 60 years.

We would encourage the Commission to seek feedback from British policymakers, academics, and industry leaders on three main questions:

- Have theoretical concerns about the risks betting markets can pose to election integrity materialized in practice in the UK?
- Has the absence of position limits and other regulations facilitated hedging and price basing in British political betting markets?
- Have the purported benefits of political betting for the public interest been realized in the UK?

We would also recommend that the CFTC monitor deliberations in the UK related to the British government’s April 2023 white paper on the Gambling Act of 2005. Discussions regarding reforms on regulations and legislation governing the gambling sector may provide useful lessons for the American context.



COALITION FOR POLITICAL FORECASTING

Political Betting Regulation in the United States: Pathways to Liberalization

July 2023

A Report of the Coalition for Political Forecasting

By Pratik Chougule and Solomon Sia

Cover Design by Sumona Zaman

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A Report of the Coalition for Political Forecasting

About the Coalition for Political Forecasting

The Coalition for Political Forecasting is a nonpartisan, nonprofit organization that aims to liberalize regulations on political betting in order to serve the public interest.

The Coalition advocates for a community of researchers, traders, and philanthropists that sees real-money prediction markets and other betting platforms as advanced forecasting tools that can help humanity navigate an uncertain future by aggregating and refining predictions about political events.

The Coalition seeks to advise the policymaking community on how betting on political events can improve democratic institutions, promote economic stability, and facilitate innovative research.

The views expressed here are those of the authors.

Coalition Leadership

Pratik Chougule, Executive Director

Flip Pidot, Board Member

Solomon Sia, Board Member

Pratik Chougule and Solomon Sia

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Abstract

Regulations on political betting markets today are more uncertain than they have been at any point since 2014. The prediction market community has so far failed to persuade lawmakers and regulators that liberalization of the space serves the public interest. Arguments for doing so have been undermined by the mixed performance of prediction markets in recent elections, the national political environment, and ineffective business decisions by companies in the space. While the U.S. Congress or the courts could intervene to create safe harbors for election contracts, liberalization of the political prediction market space will likely require a long, expensive, and multifaceted advocacy campaign that is unlikely to bear fruit until after the 2024 U.S. presidential elections.

Background

In August of 2022, the Commodity Futures Trading Commission (CFTC) made two major announcements regarding the regulation of political prediction markets.

First, the CFTC withdrew PredictIt's no-action letter and ordered the site to shut down in February 2023.¹ The no-action letter, granted in 2014,² had allowed PredictIt to emerge as the most significant legal political betting exchange in the United States. A group of plaintiffs associated with PredictIt responded by suing the CFTC in an ongoing lawsuit.

Second, the CFTC announced that it would review the proposal of Kalshi, a Designated Contract Market (DCM) dedicated to event contracts,³ to offer markets on the U.S. mid-term elections. The agency set a self-imposed goal of completing its review by October

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1. CFTC, "CFTC Staff Withdraws No-Action Letter to Victoria University of Wellington, New Zealand Regarding a Not-For-Profit Market for Certain Event Contracts," 4 August 2022. <https://www.cftc.gov/PressRoom/PressReleases/8567-22>
 2. CFTC Letter No. 14-130, Division of Market Oversight, 29 October 2014, <https://www.cftc.gov/node/213146>
 3. Kalshi's DCM application is available at: CFTC, "Kalshi DCM Application," File Number: 21-00068, https://www.cftc.gov/FOI/foia_freerequestinfo.html

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28, 2022, just days before the election. Although the CFTC staff reportedly advised the commissioners to reject Kalshi's application, the midterm elections came and went without a formal decision. Pursuant to section 40.11 of the regulations of the CFTC, Kalshi asked the agency to review its request to offer election markets on control of the U.S. Congress by May 22, 2023. When the CFTC missed multiple deadlines and ultimately did not respond, Kalshi withdrew the request.⁴

In June 2023, Kalshi notified the CFTC that it was self-certifying new control of Congress contracts under section 40.2(a) of the regulations of the CFTC. If approved, the contracts would have modified position limits, expanded trading prohibitions, and other revisions from the July 2022 contracts that Kalshi made based on feedback from the comments period.⁵ On June 23, the Commission announced that it had commenced a review of the contracts with a 30-day public comment period, pursuant to CFTC Regulation 40.11(c), and that Kalshi must suspend listing of the contracts during the review.⁶

The CFTC's decisions have diminished hopes that regulations on political betting markets will be eased quickly or even that the space will see greater legal clarity in the near future. Restrictions on political betting are more uncertain today than they have been

4. See Kalshi filings at CFTC. "Trading Organization Products Associated Documents," <https://sirt.cftc.gov/sirt/sirt.aspx?Topic=TradingOrganizationProductsAD&Key=48820>
5. Mick Bransfield, "CFTC Kalshi Cheat Sheet," 23 June 2023, <https://mickbransfield.com/2023/06/22/cftc-june-26th-kalshi-meeting-cheat-sheet/>; Chougule, host, "Another CFTC Review of Kalshi's Election Markets," Star Spangled Gamblers (podcast), <https://starspangledgamblers.libsyn.com/another-cftc-review-of-kalshis-election-markets>; Declan Harty, "Kalshi makes new play for big investors to wager on U.S. elections," *Politico Pro*, 14 June 2023, <https://subscriber.politicopro.com/article/2023/06/kalshi-makes-new-play-for-big-investors-to-wager-on-u-s-elections-00101851>; Letter from Xavier Sottile, Head of Markets, KalshiEX LLC, to Secretary of the Commission, Office of the Secretariat, CFTC, 12 June 2023, <https://kalshi-public-docs.s3.amazonaws.com/regulatory/product-certifications/CONTROL.pdf>; Twitter thread, 27 June 2023, 9:52 AM, https://twitter.com/mansourtarek_/status/1673690840995180546?s=20
6. CFTC Release Number 8728-23, "CFTC Announces Review of Kalshi Congressional Control Contracts and Public Comment Period," 23 June 2023, <https://www.cftc.gov/PressRoom/PressReleases/8728-23>; Chougule, host, "Another CFTC Review of Kalshi's Election Markets"; Letter from Christopher Kirkpatrick to Sottile, 23 June 2023, <https://www.cftc.gov/sites/default/files/filings/ptc/23/06/ptc0623230001.pdf>

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since 2014, when PredictIt launched.

Since June 2022, we have been exploring how regulations on political prediction markets might be reformed to better serve the public interest. For reasons elaborated in our comment to the CFTC, we believe that political betting markets are an advanced forecasting and social consensus building mechanism, which, with time and space to mature, can help humanity navigate an uncertain future.⁷

Our work has been funded by a grant from the Long Term Future Fund.⁸ The fund aims to influence the long-term trajectory of civilization by addressing global catastrophic risks, in part by supporting initiatives that promise to improve society's ability to make and disseminate accurate forecasts.⁹

When we undertook the project, we did not know the extent to which regulations in the space would change in the coming months. In this sense, the timing of this project proved fortuitous. Against the backdrop of the CFTC's review, we conducted dozens of interviews with a variety of stakeholders in the political prediction market space. Some of our most informative conversations were with CFTC commissioners, lawyers, and staff.

This report summarizes our findings on the regulation of political betting in the United States.

Part I explains the different approaches political betting platforms have taken to navigate an uncertain regulatory regime, and the consequences they have had for the prediction market community.

-
7. Sia, Comment for Industry Filing 22-002, CFTC, Comment No: 70745, 23 September 2022. <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70745&SearchText=sia>
 8. "Grants Database," EA Funds, Centre for Effective Altruism, <https://funds.effectivealtruism.org/grants?fund=Long-Term%2520Future%2520Fund&sort=round>
 9. "Long-Term Future Fund," EA Funds, Centre for Effective Altruism, <https://funds.effectivealtruism.org/funds/far-future>

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Part II analyzes the main reasons why political prediction markets are highly regulated in the United States and why the trend line appears to be moving in the direction of stricter regulation.

Part III outlines pathways that could lead to the liberalization of political betting markets before the 2024 U.S. elections.

The report concludes with recommendations for those who share our interest in liberalizing regulations on political betting to serve the public interest.

Current Approaches to Navigating Regulations

Current debates over political prediction markets stem from the choices companies in the space have made to navigate a restrictive and uncertain regulatory landscape. To deal with regulatory challenges, they have pursued various approaches. Each has entailed tradeoffs for the companies as well as the prediction market community.

Operate Under a No-Action Letter

The Iowa Electronic Markets and PredictIt have been operating under no-action letters by the CFTC. Under the terms of the no-action letters they have agreed to operate as academic entities with limits on the types of markets they can offer, the total number and diversity of users they can accommodate, and the size of bets they can take.¹⁰ PredictIt's

10. CFTC Letter No. 93-66, Division of Trading and Markets, 18 June 1993 <https://www.cftc.gov/sites/default/files/idc/groups/public/%40lettergeneral/documents/letter/93-66.pdf>; CFTC Letter No. 14-130; Andrew Corcoran, CFTC Letter to Professor George Neumann, CFTC Letter No. 91-04a, Division of Trading and Markets, CFTC, 5 February 1992, <https://www.cftc.gov/sites/default/files/files/foia/repfoia/foirf0503b002.pdf>; Corcoran letter to Neumann, CFTC Letter No. rf05-003, Division of Trading and Markets, CFTC, 18 June 1993, <https://www.cftc.gov/sites/default/files/files/foia/repfoia/foirf0503b004.pdf>; CFTC, No-Action Letters Concerning the University of Iowa's Iowa Electronic Markets, File Number RF05-003, 18 May 2005, https://www.cftc.gov/foia/repfoia/foirf05-003_1.htm

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decision to test the limits¹¹ of the 2014 agreement has been a factor in the CFTC's deter-
mination that the site "has not operated its market in compliance with the terms of the
letter."¹²

The CFTC's March 2023 filing indicates that the Iowa Electronic Markets are on a more
stable regulatory footing than PredictIt by virtue of its organization, compensation struc-
ture, and relations with the CFTC.¹³ The Iowa Electronic Markets, a money-losing ven-
ture, is limited to 2,000 participants who can place bets of between \$5 and above \$500.¹⁴
Unlike Predictit,¹⁵ the operators of the Iowa Electronic Markets are academics from the
University of Iowa's Tippie College of Business and associated volunteers. These indi-
viduals have shown little inclination to offer political markets to a broad user-base, raise
its maximum bet limit, or directly monetize the project.

Notwithstanding these limitations, the Iowa Electronic Markets and PredictIt, in a regu-
latory sense, are the most successful, modern political prediction markets in the United
States. They have legally and continuously offered diverse political markets with mean-
ingful liquidity, reasonably accurate price signals, and useful data for research purposes.¹⁶
The relatively benign positions the CFTC and other regulators have adopted toward these
projects suggests that academia will remain a promising arena to build political prediction
markets with public interest orientations that are on a stable legal foundation.

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11. Letter from Vincent McGonagle, Division of Market Oversight, CFTC, to Margaret Hyland, Victoria University of Wellington, 2 March 2023, <https://twitter.com/CasinoOrgSteveB/status/1631838950300975105?s=20>
 12. CFTC, "CFTC Staff Withdraws No-Action Letter to Victoria University of Wellington, New Zealand Regarding a Not-For-Profit Market for Certain Event Contracts," 4 August 2022, <https://www.cftc.gov/PressRoom/PressReleases/8567-22>
 13. *Ibid.*
 14. Jeff Sommer, "Forecasting the Future of Election Prediction Markets," *The New York Times*, 4 November 2022, <https://www.nytimes.com/2022/11/04/business/election-prediction-markets-mid-terms.html>
 15. Letter from McGonagle to Hyland, 2 March 2023
 16. "Research Opportunities," PredictIt, <https://www.predictit.org/research/>; "Iowa Electronic Markets," University of Iowa Henry B. Tippie College of Business, <https://iemweb.biz.uiowa.edu/about-iem/>

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Skirt Regulations

Polymarket tried to offer political contracts without registering with the CFTC as a DCM. Polymarket claimed that it is a decentralized platform that does not take custody of traders' funds. This approach allowed Polymarket to offer a wide array of markets and generate considerable volume on the site, reaching more than 4 billion shares within a year after its launch.¹⁷ However, the CFTC subsequently took action against the company. In a settlement announced in January of 2022 Polymarket paid a civil penalty of \$1.4 million and was forced to move offshore. The CFTC determined that Polymarket's event-based binary options contracts constituted swaps that were not fully decentralized.¹⁸ This has set a limiting precedent for new competitors in the space like Insight Prediction, which now effectively face the choice of remaining offshore, pursuing the onerous and seemingly stalled process of registering and operating as a DCM, or risking CFTC enforcement actions.

While Polymarket's most committed U.S.-based users still access the site by using VPNs or leaving U.S. territory, the CFTC's enforcement action has deterred liquidity on the site, curtailed its growth as a company, and undermined its ability to invest in the political prediction market community.¹⁹ The latter has been particularly problematic for the political betting community given that Polymarket, before the CFTC enforcement action, was a leader in building the space.²⁰ In April 2021, as an example, Polymarket launched a mi-

17. Benjamin Bain, Sridhar Natarajan, and Liam Vaughan, "Crypto Venue for Bets on Trump, JLo and Covid Faces U.S. Probe," *Bloomberg*, 23 October 2021, <https://www.bloomberg.com/news/articles/2021-10-23/crypto-venue-for-bets-on-trump-jlo-and-covid-faces-u-s-probe>

18. CFTC, "CFTC Orders Event-Based Binary Options Markets Operate to Pay \$1.4 Million Penalty," 3 January 2022. <https://www.cftc.gov/PressRoom/PressReleases/8478-22>

19. Pat Crawley, host, "How to Trade Prediction Markets and Fade Political Hype," *Stock Market Stories* (podcast), 7 November 2022, <https://youtu.be/xJao6rHgiFE>; Alex Keeney and Chougule, hosts, "Meet Insight Prediction's Founder & CEO, Doug Campbell," *Star Spangled Gamblers* (podcast), 15 September 2022, <https://starspangledgamblers.com/2022/09/15/meet-insight-predictions/>; Ben Terris, *The Big Break: The Gamblers, Party Animals and True Believers Trying to Win in Washington While America Loses Its Mind*, New York: Twelve, 2023, 283.

20. Andrew Eaddy and Clay Graubard, hosts, "Jason Trost, Smarkets Founder and CEO," *Crowd Money Cast* (podcast), 14 October 2021, <https://youtu.be/vySli47rBJw?t=105>

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crogrants program to help support content, community, and research projects within the prediction market community. The program offered grants of up to \$75,000 but has been curtailed significantly as the company's revenues have dried up.²¹ Polymarket has also been forced to lay off staff and suspend hires focused on political contracts.

Register as a DCM and Apply for Permission with the CFTC

Branding itself as the “first federally regulated exchange,” Kalshi has tried to hew as closely as possible to the CFTC’s guidelines.²² As Kalshi CEO Tarek Mansour has explained, the company’s regulatory posture as a DCM allows it to be “uniquely-positioned” to “build a full-scale exchange—one that can attract...institutions, and brokers, and market-makers.”²³

An important consequence of this regulatory strategy is that Kalshi is limited in the political markets it can provide. Kalshi sees election contracts, which it characterizes as the “holy grail of events trading,” as being “core” to its mission and identity.²⁴ Yet while

21. Polymarket, “Introducing Polymarket Microgrants,” 19 April 2021, <https://blog.polymarket.com/introducing-polymarket-microgrants/>. An example of a project funded by the microgrants program and then discontinued is Pidot’s YouTube show “Polymarket Insiders,” which featured commentary and analysis on Polymarket’s prediction markets. The show’s archive is available at https://youtube.com/playlist?list=PLnkuV6troAf1X5sbeQ0Wtg_Pgrv82NQu
22. Chougule, host, “How to Bet the Trump Indictments + Julie Su’s Confirmation Problems,” Star Spangled Gamblers (podcast), 7 April 2023, <https://starspangledgamblers.com/2023/04/07/how-to-bet-the-trump-indictment-julie-sus-confirmation-problems/>; Jeff Joseph, host, “Kalshi: Bet on Everything (#42),” The Prediction Trade (podcast), 5 August 2021, <https://youtu.be/fITN1XQUhIU>; Connie Loizos, “This Sequoia- and Henry Kravis-backed prediction market wants to turn opinions into money,” *TechCrunch*, 31 August 2021, <https://techcrunch.com/2021/08/30/this-sequoia-and-henry-kravis-backed-prediction-market-wants-to-turn-opinions-into-money/>; Rex Salisbury, host, “Tarek Mansour, Founder & CEO at Kalshi: Building a Prediction Market,” 31 August 2021, <https://youtu.be/lmvGj1YEyki>
23. Eaddy and Graubard, hosts, “Tarek Mansour and Luana Lopes Lara (Kalshi Co-Founders),” Crowd Money Cast (podcast), 15 September 2021, 28:20-28:32, https://youtu.be/M7CmVN3B_gI?t=1689.
24. Chougule, host, “Did Kalshi Kill PredictIt and Polymarket? + Harvard Affirmative Action Case,” Star Spangled Gamblers (podcast), 22 February 2023, <https://starspangledgamblers.com/2023/02/22/did-kalshi-kill-predictit-and-polymarket-harvard-affirmative-action-case/>; Twitter post, 29 August 2022, 2:14 PM, https://twitter.com/mansourtarek_/status/1564315602184978435?s=20

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some of Kalshi's markets are directly related to politics, most are in tangential areas such as economics, finance, law, pandemics, and transportation. Of the 17 markets on Kalshi that have ever reached trading volume greater than 500,000, none were on political as opposed to financial or economic topics.²⁵

Neither Kalshi's engagement with the CFTC, nor the high-profile comments that were submitted to the agency on its behalf,²⁶ have convinced the Commission to grant Kalshi approval to offer election markets.²⁷ In the absence of CFTC approval for election markets, Kalshi has struggled to determine the types of political markets it is permitted to offer.²⁸ Amid this ambiguity, Kalshi has chosen to refrain from offering markets not only on elections, but also on a wide variety of markets on political questions generally that are generating interest on other sites.

Seeing little prospect for liberalization under CFTC Chairman Rostin Behnam, Kalshi has scaled back efforts to influence the policy community. Along with other layoffs, Kalshi has not renewed contracts for certain political consultants and has not followed through

25. Bransfield, "Kalshi Turns Two," 1 July 2023, <https://mickbransfield.com/2023/07/01/kalshi-turns-two/>

26. For reporting on the comments, see Chougule, host, "Another CFTC Review of Kalshi's Election Markets"; Harty, "Political betting: Is it a 'gambling den' or 'better than polls'?" *Politico*, 28 October 2022, <https://www.politico.com/news/2022/10/28/inside-the-fight-to-legalize-election-betting-before-the-midterms-00063693>

27. The comments are available at CFTC, Comment for Industry Filing 22-002, <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>. Letters from the Futures Industry Association, Jason Furman, former Chairman of the Council of Economic Advisers under President Obama, Robert Shiller, recipient of the Nobel Prize in Economic Sciences (joined by seven other academics in economics, law, and political science), and Christopher Hehmeyer, former Chairman of the National Futures Association and board member of the Futures Industry Association were specifically referenced by Mersinger in her dissent from the Commission's decision to commence a 90-day review of Kalshi's revised election contracts. CFTC, "Dissenting Statement of Commissioner Summer K. Mersinger Regarding Commencement of 90-Day Review Regarding Certified Derivatives Contracts with Respect to Political Control of the U.S. Senate and House of Representatives," 23 June 2023, n19, n3, <https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement062323>

28. Chougule, host, "Did Kalshi Kill PredictIt and Polymarket? + Harvard Affirmative Action Case," *Star Spangled Gamblers* (podcast), 22 February 2023, <https://starspangledgamblers.com/2023/02/22/did-kalshi-kill-predictit-and-polymarket-harvard-affirmative-action-case/>

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on some of its plans to engage Washington-based think-tanks in an effort to enlist support for election markets. Regarding the CFTC's current review of Kalshi's election contracts and the associated public comment period, Mansour announced on June 27 that Kalshi is "not going to spend a ton of time repeating an advocacy campaign for the same matter."²⁹

Kalshi's ability to contribute to the broader prediction market community has been constrained without permission to offer election markets and other political lines. Although Kalshi is focused on markets in the financial and economic spaces, U.S. election markets tend to generate particular interest among traders and political influencers. British gamblers, as an example, wager more money on American elections than those in their own country.³⁰ Superforecasters also have a particular interest in U.S. election markets, as they offer regularly-scheduled opportunities to train and build credibility and confidence in their long-term political forecasting methods. This interest in U.S. elections drives revenue and social currency for prediction markets and political betting more generally.

Kalshi's attempts to increase volume and liquidity in its political markets with generous incentives to traders are yielding limited success. The three-fold growth in trading volume Kalshi has seen from 2021 to 2023 has come disproportionately from its daily NASDAQ-100 and S&P 500 markets, which account for about a third of all volume on the site.³¹ A relatively small number of users, some working for the company, still account for a disproportionate amount of activity on its political order books.³² This weakens Kalshi's arguments to regulators about the ability of its political contracts to serve hedging and price-basing functions.

Notwithstanding the restrictions associated with operating as a DCM, PredictIt executives see this as a promising path forward in the current regulatory landscape. They are seeking

29. Twitter thread, 9:52 AM, <https://twitter.com/mansourtarek/status/1673690848574177281?s=20>

30. Tony Batt, "Nevada Looks to Follow UK's Lead On Election Betting," *Gambling Compliance*, 27 March 2013, <https://www.leg.state.nv.us/App/NELIS/REL/77th2013/ExhibitDocument/OpenExhibitDocument?exhibitId=3698&fileDownloadName=Article-Gambling%20Compliance.pdf>

31. Bransfield, "Kalshi Turns Two"

32. Chougule, host, "How to Bet the Trump Indictments + Julie Su's Confirmation Problems"

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to establish a DCM called PredictIt Exchange, which would operate separately from PredictIt. Whether PredictIt Exchange's DCM application, which was filed in October 2021 and is substantially complete, will be approved by the CFTC remains to be seen. Nor is it clear what types of markets PredictIt Exchange would be permitted to offer as a DCM. In a note to users, PredictIt maintains that the effort is part of a plan to "offer new election markets for the current political season."³³ Yet PredictIt CEO John Phillips has claimed in a public interview that PredictIt Exchange would not be able to offer election markets due to CFTC precedents.³⁴

Avoid the Regulatory Net

Manifold has decided to use platform currency as opposed to fiat money or cryptocurrency, in part to avoid saddling its markets with regulatory challenges associated with facilitating real money bets. This approach has allowed Manifold to make considerable progress in building community, offering a diversity of markets, and experimenting with novel governance models. Manifold generates more traffic than many of its real-money competitors.³⁵ However, it remains unclear whether a lack of 'skin in the game' will ultimately impede the growth and efficiency of its markets.³⁶

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33. Steve Bittenbender, "PredictIt to Liquidate Political Markets if Injunction Bid Fails, May Reinvent Itself," Casino.org, 20 January 2023, <https://www.casino.org/news/predictit-to-liquidate-political-market-if-injunction-bid-fails-may-become-a-dcm/>
 34. Technology Policy Institute, host, "John Phillips and David Mason of Aristotle Discuss Political Prediction Markets," Two Think Minimum (podcast), 16 February 2023, <https://techpolicyinstitute.org/publications/miscellaneous/john-phillips-and-david-mason-of-aristotle-discuss-political-prediction-markets/>
 35. Twitter thread, 24 May 2023, 1:54 p.m., <https://twitter.com/ManifoldMarkets/status/1661430510285979653?s=20>
 36. Scott Alexander, "Play Money And Reputation Systems," Astral Codex Ten, 21 February 2022, <https://astralcodexten.substack.com/p/play-money-and-reputation-systems>; David Chee, "Reflecting on 2022," Above the Fold, 6 January 2023, <https://news.manifold.markets/p/above-the-fold-reflecting-on-2022>; Austin Chen, "Workshop: Forecasting | Austin Chen | EAG DC 22" Centre for Effective Altruism, 18 January 2023, <https://youtu.be/YfDI7C6UAPw>; Dwarkesh Patel, host, "Manifold Markets Founder - Predictions Markets & Revolutionizing Governance," Lunar Society (podcast), 5 May 2022, <https://youtu.be/XoRXrnHg084>; "Play-money efficacy," Above the Fold, 21 November 2022, <https://news.manifold.markets/p/above-the-fold-play-money-efficacy>; Twitter thread, 7 November 2022, 2:37 p.m., <https://twitter.com/ManifoldMarkets/status/1589703623935565826?s=20>

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While it is too early to draw firm conclusions, the 2022 U.S. midterm elections provide a mixed picture on the potential of Manifold and its regulatory model. Manifold's markets were slightly more accurate than those on Polymarket and PredictIt.³⁷ However, because they drew considerably less interest from traders, Manifold's markets have invited questions about their ability to aggregate the 'wisdom of the crowds.'

Over time, Manifold may provide an important test case of how platform currency markets relate to real money markets. In terms of producing accurate estimates, it is possible that Manifold's market prices will converge to within a few percentage points of similar markets with real money, or even consistently produce more accurate estimates on important questions. Experimentation on Manifold may also help the broader political betting community to improve its business models. The development of platform currency markets that generate meaningful liquidity, and produce accurate price signals on a broad, diverse array of questions could help fulfill the public interest potential of prediction markets without the regulatory scrutiny that has dogged real money political betting sites.

Innovate on the Traditional Prediction Market Model

Entrepreneurs are building political betting platforms that operate under different regulatory restrictions from real-money prediction markets yet provide many of their benefits. A notable example is the over-the-counter (OTC) swaps offered by the American Civics Exchange (ACE), which allow traders to bet on a wide array of political outcomes. Because ACE OTC operates as the sole counterparty and liquidity provider, it is subject to different regulatory restrictions from the event contracts on PredictIt and Kalshi which match orders to other traders. ACE OTC does not operate on an exchange model with an order book. Contracts have a \$500 minimum payout value, but no trading fees or fixed upper position limits. Unlike Kalshi and PredictIt Exchange, ACE OTC has not sought to register with the CFTC as a DCM.

37. Jack Chen, "What can we learn from scoring different election forecasts?" *First Sigma. Substack*. 20 November 2022. <https://firstsigma.substack.com/p/midterm-elections-forecast-comparison-analysis>

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While there is no regulatory limit on the size of bets allowed on the site, participation on ACE OTC is limited by statute to a small class of investors—generally institutions and high net worth individuals. Because the site can only serve U.S.-based eligible contract participants, as defined by the Commodity Exchange Act, the vast majority of retail traders have no legal way of opening an account, usually because they do not have an investment portfolio of more than \$10 million. The extent to which ineligible traders face the threat of sanction for using the site remains unclear. ACE verifies biographical information and requires users to affirm they meet eligibility requirements during the onboarding process. However, ACE does not do independent financial vetting of its customers beyond asking them to affirm that they understand the site’s terms of service and that they meet the legal specifications.³⁸ To date, neither the site, nor any of its users, have faced any kind of enforcement action.

Transactions on ACE OTC do not, in a pure sense, reflect the ‘wisdom of the crowd’ and are not as transparent as those on prediction markets.³⁹ However, prices of the OTC swaps may prove to be more accurate or informative than those in more democratized prediction markets with betting limits. This could be the case in particular on events that tend to attract irrational speculation in prediction markets by low-information and unskilled traders with minimal ‘skin in the game.’ The swaps also facilitate speculation and hedging on conditional and custom contracts, which are not typically offered in prediction markets.

Build Outside of the United States

The most vibrant political prediction markets such as Betfair Exchange, Polymarket, and Smarkets are operating outside of the United States. A challenge with this model is that it is difficult for American users to access these markets. The lack of an American user-base exacerbates challenges associated with running a profitable prediction market with suffi-

38. Chougule, host, “A New Way to Bet on Politics...Legally,” Star Spangled Gamblers (podcast), 7 February 2023, <https://starspangledgamblers.com/2023/02/07/a-new-way-to-bet-on-politics-legally/>

39. *Ibid*

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cient liquidity and knowledgeable traders about U.S. politics. This, in turn, deters investment in these companies, as well as media and research interest in their insights. It remains to be seen whether non-American companies will be able to expand into the United States, with all the legal and regulatory hurdles that entails. Insofar as they seek to offer political markets along with their more profitable sports betting lines, it will be difficult for them to focus on the most socially valuable applications of prediction markets.

Drivers of Regulation

We identified in our study several overlapping reasons why political prediction markets are highly regulated in the United States and why the trend line appears to be moving in the direction of tighter regulation.

Opposition By Elected Officials

Elected officials in the United States have shown little appetite for liberalizing regulations on political betting. Opposition by elected officials has been consistent over many decades even as regulations have liberalized on sports betting and gaming. At least 27 states explicitly outlaw betting on elections⁴⁰ and every state prohibits bookmakers from taking wagers on these events. Recent initiatives to permit election betting in Nevada and West Virginia were blocked by elected officials who feared that they would corrupt the democratic process and tarnish their state's reputations.⁴¹

Prohibitions on political betting and the treatment of election betting as gaming at the state level inform restrictions at the federal level. The CFTC's order to prohibit the North

40. "CFTC Faces Lobbying Blitz Over Bets on U.S. Elections," *Capitol Account*, 27 September 2022, <https://www.capitolaccountdc.com/p/cftc-faces-lobbying-blitz-over-bets>

41. David McIntire, "They Won't Take Your Bet On The Election In Las Vegas," *FiveThirtyEight*, 3 November 2016, <https://fivethirtyeight.com/features/they-wont-take-your-bet-on-the-election-in-las-vegas/>; Katherine Sayre, "West Virginia Approves, Then Disapproves, Betting on Elections," *Wall Street Journal*, 8 April 2020

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American Derivatives Exchange (Nadex) from offering election contracts under CFTC Regulation 40.11 in 2012 cited the fact that “several state statutes, on their face, link the terms gaming or gambling...to betting on elections.”⁴² In both their 2022 and 2023 questions for public comment on Kalshi’s Congressional control contracts, the CFTC asked whether it should consider if election betting is defined as gaming under state law and whether state laws permit betting on elections or political outcomes.⁴³

Attitudes of American politicians stand in marked contrast to those in the UK. Liberal regulations on political prediction markets were enacted by parliament in 1960 through the Betting and Gaming Act and have not been tightened meaningfully since then. Political betting has become part of mainstream British political culture. With the rise of online betting exchanges and sportsbooks, public interest in political betting has increased over the past decade.⁴⁴

A Complex Web of Legal Regimes

Political betting is regulated under a complex web of federal and state laws, federal agency regulations, and legal precedents, which create severe roadblocks for companies that seek to offer political prediction markets. Relevant restrictions on gaming and event contracts are codified in the Federal Wire Act of 1961, the Unlawful Internet Gaming Enforcement Act of 2006,⁴⁵ the Dodd-Frank Act of 2010, the Commodity Exchange Act,

42. 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, Order Prohibiting the Listing or Trading of Political Event Contracts, 2. Note 1 in the order specifically cites statutes in Illinois, Nebraska, New Mexico North Dakota, Georgia, Mississippi, South Carolina, and Texas.

43. See CFTC Release Number 8578-22, questions 2 and 4; CFTC Release Number 8728-23, questions 3 and 5

44. Chougule, host, “Does Political Betting Threaten Democracy? Lessons from the UK,” Star Spangled Gamblers (podcast), 15 July 2023, <https://starspangledgamblers.libsyn.com/does-political-betting-threaten-democracy-lessons-from-the-uk>; “The UK Has a Long History with Political Betting,” *London Post*, 4 May 2021, <https://london-post.co.uk/the-uk-has-a-long-history-with-political-betting/>

45. Ye Li, “Online Information Markets and the Unintended Consequences of Internet Gambling Legislation,” *US-China Law Review* 11, no. 12 (December 2014): 1587-1608.

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CFTC regulations, and state gaming laws. All of these laws and regulations raise questions as to whether political event contracts constitute an illegal form of gaming, are contrary to the public interest, or are otherwise prohibited from being listed.

The CFTC faces difficult questions related to how political event contracts should be regulated under the Commodity Exchange Act. CFTC Rule 40.11 and agency precedents related to event contracts have been interpreted by CFTC commissioners in ways that curtail political prediction markets. The Commission has yet to allow a for-profit venture to offer election contracts. The Nadex decision has prompted a debate within the CFTC on whether the order creates precedents, broad limitations, or rules of general applicability that apply to Kalshi's applications to offer contracts on election markets.

Predictions that the legalization of sports betting since the Supreme Court's 2018 decision in *Murphy v. NCAA* would lead to a similar cascade in the political betting arena have not materialized.⁴⁶ In some respects, the opposite has occurred. Once the Court struck down the Professional and Amateur Sports Protection Act on federalism grounds, numerous states moved to legalize sports betting, undeterred by the possibility of future enforcement actions by the CFTC under the Commodity Exchange Act. Yet many of these same advocates of sports betting have refused to endorse political betting, fearing that the "taint" of political markets could undermine support for sports betting and other legal lines that generate far more profit than what political lines would bring in even under the most optimistic projections.⁴⁷ At the same time, concerns about the power, tactics, and agendas of the sports betting lobby have created a more skeptical outlook among politicians and regulators toward the gaming industry generally, further adversely impacting political betting interests.⁴⁸

46. Parallels between the liberalization of sports betting and political betting were discussed by Behnam in his October 2022 public remarks, available at: Chris Brummer, "DC Fintech Week 2022," 6th Annual DC Fintech Week, 11 October 2022, interview, 3:23:21-3:23:47, <https://www.youtube.com/live/Kzcb9cRIEpl?feature=share&t=12201>.

47. McIntire, "They Won't Take Your Bet On the Election In Las Vegas"

48. Chougule, host, "2024 Republican Longshots for President + Debt Ceiling Negotiations," Star Spangled Gamblers (podcast), 11 April 2023, <https://starspangledgamblers.com/2023/04/16/2024-republican-longshots-and-debt-ceiling-negotiations/>; Twitter post, 23 July 2023, 4:49 AM, <https://twitter.com/shadsy/status/1683036717203218433?s=20>

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The refusal of the states, the District of Columbia, and U.S. territories to follow suit on political betting leaves unsettled the question of whether the political betting industry could pursue a regulatory pathway similar to the one undertaken by the sports betting industry. Somewhat paradoxically, Casino.org reporter Steve Bittenbender, who has covered both the sports and political betting industries extensively, believes that the political betting industry might benefit from greater federal regulation of sports betting. This is because sports betting regulation could potentially fall under the purview of a single regulatory body. Such a body could, in turn, permit sports betting operators to offer political lines. The earliest Bittenbender foresees this happening is in the run-up to the 2028 U.S. elections.⁴⁹

Creating safe harbors for political betting in the current legal regime requires regulators and elected officials to adopt controversial positions and spend considerable political capital. Permitting election markets could expose the CFTC to the criticism that it had de facto preempted state laws without authorization from Congress. Federal and state legislators advocating for the liberalization of existing laws could face a great deal of blowback, likely without any commensurate political or financial upside for them or their constituents.

CFTC Decision-Making

Regulation of political event contracts at the federal level falls under the CFTC,⁵⁰ which is overseen by the House and Senate Agriculture Committees. Although the CFTC has provided more leeway to prediction market operators than any other federal or state regulator, the current commissioners, particularly the Democratic appointees, have moved to tighten regulations.⁵¹ In the absence of clear guidance from Congress, a combination of

49. *Ibid*

50. On the CFTC's oversight over political event contracts, see Brian Quintenz, Comment for Industry Filing 22-002, CFTC, Comment No: 70786, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786&SearchText=>

51. "Republican Congressional Takeover May Spur Biden's Regulators to Move Even Faster," *Capitol Account*, 7 November 2022, <https://www.capitolaccountdc.com/p/republican-congressional-takeover>

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personal conviction, legal precedent, and bureaucratic incentives appear to be steering the CFTC towards a restrictive approach on political event contracts. Although CFTC commissioners have not published thorough explanations of their views,⁵² there appear to be four primary considerations weighing on their calculus.

First, Behnam is disinclined to spend the political capital necessary to bring clarity to the space. In public remarks in October 2022, Behnam characterized prediction market regulation as “something that is high on my priority list.”⁵³ However, policywise, his higher priority as commissioner is to gain new funding and authorities for the CFTC, particularly jurisdiction over the regulation of digital assets. Delaying a decision on event contracts furthers his strategy of avoiding litigation or confrontation with Congress and the public while he pursues his priorities.

Second, CFTC officials are unpersuaded that they can allow companies to offer political and election markets in a way that is consistent with federal and state laws and that advances the public interest. Even where the CFTC has opened the door to political betting markets in limited ways such as on PredictIt and Kalshi, the CFTC has struggled to define the parameters of a “significant political event,” “meaningful political question,” and other tests related to the scope of allowable political event contracts. Division of Market Oversight (DMO) officials have offered differing interpretations of these tests since 2014, without formal regulatory changes. More constricted readings have prevailed at the agency in recent years.⁵⁴ Informing the CFTC’s deliberations in this respect is the fact that agency officials, in contrast to prediction market operators, have deemed markets on certain topics such as COVID-19 to be in “poor taste.”⁵⁵

52. For Behnam’s public remarks on political event contracts, see Brummer, “DC Fintech Week 2022,” 3:19:21-3:24:08, <https://www.youtube.com/live/Kzcb9cRlEpl?feature=share&t=11961>.

53. *Ibid*, 3:19:59-3:20:00

54. Chougule, host, “Did Kalshi Kill PredictIt and Polymarket?”; Chougule, host, “The Right’s Problems with Educated Voters,” *Star Spangled Gamblers* (podcast), 24 May 2023, <https://podcasts.apple.com/us/podcast/star-spangled-gamblers/id1437934639?i=1000614353172>; Letter from Steve Nightingale and Scott Barker, Buddle Findlay, to McGonagle, 6 April 2023, <https://az620379.vo.msecnd.net/static/files/docs/ffbf556e-977e-4931-b9dc-6948261e2e6a.pdf>.

55. Donald Luskin, “The Feds Don’t Want You Betting on Elections,” *Wall Street Journal*, 1 November

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Third, CFTC officials are concerned that the regulation of political event contracts requires the agency to spend resources and expand its jurisdiction in ways that exceed its mandate. In his letter to Victoria University explaining why the DMO was withdrawing PredictIt's no-action letter, DMO Director Vincent McGonagle noted that the considerable time CFTC staff had spent on PredictIt "far exceeded the level of CFTC staff involvement contemplated by Letter 14-30 [the no-action letter]" and that, in the DMO's judgment, this is "not an appropriate use of taxpayer resources."⁵⁶ Behnam has warned that CFTC approval of election contracts could exacerbate this issue because it carries the risk of turning the CFTC into an "election cop" in ways that would extend beyond Congressional intent.⁵⁷

Finally, CFTC officials' conflicting views on process and procedure have made it difficult for the Commission to reach consensus on how to bring regulatory clarity to the political betting space. Commissioner Caroline Pham dissented from the CFTC's decision in August 2022 to review and impose a stay on Kalshi's Congressional control contracts, arguing instead for allowing Kalshi to operate the markets immediately.⁵⁸ Commissioner Summer Mersinger is reportedly among the more supportive voices at the CFTC for approving political event contracts, but she has expressed concern about the wisdom of relying on no-action letters for long periods of time without laying down predictable

2022, <https://www.wsj.com/articles/federal-wager-politics-cftc-predictit-no-action-letter-presidential-election-futures-contract-regulation-11667310803>; Jeff Solomon, "Why Prediction Markets are Better at Predicting Covid than Public Health Experts," Polymarket, <https://blog.polymarket.com/prediction-markets-better-predict-covid-health>; Twitter post, 4 January 2022, 9:17 AM, <https://twitter.com/TradeandMoney/status/1478370060083286018?s=20>. For details on PredictIt's deliberations regarding COVID markets, see James Altucher, host, "How to Supplement your Income with Money Betting with PredictIt.Org Co-Founder John Phillips," The James Altucher Show, 18 March 2020, 1:33:59-1:35:21, https://youtu.be/li_Dtc5RCR0?t=5639.

56. Letter from McGonagle to Hyland, 2 March 2023, <https://twitter.com/Bittenbettor/status/1631839206996680707/photo/2>

57. Joe Weisenthal and Tracy Alloway, hosts, "CFTC Chair Rostin Behnam on the Fight to Regulate Crypto," Bloomberg's Odd Lots (podcast), 18 May 2023, <https://omny.fm/shows/odd-lots/cftc-chair-rostin-behnam-on-the-fight-to-regulate>

58. CFTC, "Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts," 26 August 2022, <https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement082622>

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rules.⁵⁹ CFTC no-action letters have not only allowed PredictIt to operate, but also enabled Kalshi to offer binary options on economic and commercial events without the Commission addressing whether these options are “consistent with any statutory or regulatory requirement.”⁶⁰

The Commission’s decision to initiate a 90-day review of Kalshi’s revised election contracts has also exposed process-related divisions among the Commissioners. Pham dissented from the decision based on the way the review arguably relates to the PredictIt lawsuit and due to her belief that it is unfair for PredictIt but not Kalshi to offer election contracts.⁶¹ Mersinger dissented on the grounds that the delay in approving the contracts is inconsistent with the Commodity Exchange Act, is a “fundamentally unfair” delay tactic, and amounts to a punishment of Kalshi for the Commission’s “failure to avail itself” of a “necessary and overdue” rulemaking process that would allow the CFTC “to give thorough consideration to the issue of DCM event contracts, including those related to political control.”⁶²

Amid these divisions, the Commission’s prevailing approaches have led to litigation with PredictIt, suspended Congressional contracts by Kalshi, stalled the approval process for other firms in the political event contract space seeking to register as DCM’s, and left the political betting community without regulatory clarity.

59. Mark Baker, “No-action action: Why Mersinger wants the CFTC to stop wasting its time,” *Euromoney*, 18 October 2022, <https://www.euromoney.com/article/2arpowssc9okk0f7m598g/capital-markets/no-action-action-why-mersinger-wants-the-cftc-to-stop-wasting-its-time>

60. CFTC Letter No. 21-11, 22 April 2021, <https://www.cftc.gov/LawRegulation/DoddFrankAct/CurrentlyEffectiveStaffLetters/index.htm>

61. CFTC, “Dissenting Statement of Commissioner Caroline D. Pham on Political Event Contracts,” 23 June 2023, <https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement062323>

62. “Dissenting Statement of Commissioner Summer K. Mersinger Regarding Commencement of 90-Day Review Regarding Certified Derivatives Contracts with Respect to Political Control of the U.S. Senate and House of Representatives”; Harty and Zachary Warmbrodt, “A political betting revival?” *Politico Morning Money*, 30 June 2023, <https://www.politico.com/newsletters/morning-money/2023/06/30/a-political-betting-revival-00104355>. For background on CFTC rulemaking, see CFTC, “Commission Rulemaking Explained,” <https://www.cftc.gov/LawRegulation/Commission-RulemakingExplained/index.htm>

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Prediction Market Performance

A core thesis of prediction market enthusiasts is that the ‘wisdom of the crowds’ can disrupt a discourse characterized by poor forecasts, unreliable polling, and fake news. Variants of this argument, advanced routinely by Kalshi, Polymarket, and PredictIt,⁶³ have weighed on the CFTC. The possibility that these markets could become “better than polling,” Behnam acknowledged in his October 2022 remarks, is among the reasons why regulatory issues in this space are “a very important question.”⁶⁴

Even as liquidity has increased, however, market prices have not shown enough predictive value in recent elections to demonstrate that prediction markets are clearly superior forecasting tools to the polls, models, and expert analyses that are more familiar to political establishments.⁶⁵ The perceived failure of prediction markets in the last few election cycles to forecast accurately the outcomes in high-profile races has undercut the thesis

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63. See for example, Altucher, host, “How to Supplement your Income with Money Betting with PredictIt.Org Co-Founder John Phillips”; Richard Chen, host, “Polymarket with Shayne Coplan and Richard Chen,” 1confirmation (podcast), 9 February 2021, <https://youtu.be/WNturf2x18o>; Eaddy and Graubard, hosts, “John Phillips, PredictIt Co-Founder and CEO,” Crowd Money Cast (podcast), 9 December 2021, <https://youtu.be/xRxZ-ihniAc>; Joseph, host, “John Phillips: A-Bomb Kid Powers PredictIt,” The Political Trade (podcast), 17 April 2020, <https://youtu.be/LIPPZJLW-xw>; Keeney and Chougule, hosts, “Pod: Are We About to Become POLYMARKET Prophets?” Star Spangled Gamblers (podcast), 19 October 2020, <https://starspangledgamblers.com/2020/10/19/pod-are-we-about-to-become-polymarket-prophets/>; Keeney and Chougule, hosts, “PredictIt CEO: We’re Not Quitting,” Star Spangled Gamblers (podcast), 8 August 2022, <https://starspangledgamblers.com/2022/08/08/predictit-ceo-were-not-quitting/>; Luana Lopes Lara, Comment for Industry Filing 22-002, CFTC, Comment No: 70795, 25 September 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70795&SearchText=luana>; Andy Pickering, host, “The Information Market - Polymarket lets traders bet on real-world events,” Brave New Coin (podcast), 5 October 2020, <https://youtu.be/gggSgPUYGtc>; Polymarket, “Introducing Polymarket Microgrants”; Polymarket, “Why Prediction Markets are Good for Society,” Polymarket, <https://blog.polymarket.com/why-prediction-markets-are-good-for-society/>; Jacob Stern, “PredictIt Already Won,” *The Atlantic*, 14 November 2022, <https://www.theatlantic.com/technology/archive/2022/11/political-betting-elections-forecasting-future/672113/>; Terris, *The Big Break*, 104.
64. Brummer, “DC Fintech Week 2022,” 3:23:47-3:23:53; <https://www.youtube.com/live/Kzcb9cRIEpI?-feature=share&t=12227>
65. Maxim Lott, “Deep Dive: Election Betting vs 538,” *Maximum Truth. Substack*. 28 November 2022. <https://maximumtruth.substack.com/p/deep-dive-on-predicting-elections>

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that these markets serve the public interest. Among the most conspicuous of these failures occurred in the November 2022 U.S. midterm elections. At a time when prediction markets were under heightened regulatory scrutiny, betting markets, unlike the polls, forecasted a large Republican wave that did not materialize. This mispricing was widely noted in coverage of the issue.⁶⁶

Much of the scrutiny from the policy community on prediction markets has been directed at PredictIt. Notwithstanding the attention PredictIt is receiving by virtue of its lawsuit against the CFTC, PredictIt executives have not provided a compelling defense of their markets' public interest value in the wake of the 2022 elections. David Mason, counsel to PredictIt's service provider Aristotle, hypothesized that PredictIt's performance can be blamed on the site's regulatory challenges, which allegedly drove away skilled traders.⁶⁷ This explanation, while plausible, does little to account for why UK bookmakers⁶⁸ and Polymarket also forecasted a large Republican victory. Phillips, meanwhile, simply asserted as recently as February 2023 that prediction markets are "notoriously more accurate than pollsters and pundits when it comes to forecasting election outcomes."⁶⁹

Election Integrity Concerns

66. Bransfield, "Did Bookmakers & Prediction Markets Fare That Badly in the 2022 Senate Races?" 18 December 2022, <https://mickbransfield.com/2022/12/18/did-bookmakers-prediction-markets-fare-that-badly-in-the-2022-senate-races/>; George Calhoun, "Prediction Markets Failed The Midterm (Election) Exams," *Forbes*, 14 November 2022, <https://www.forbes.com/sites/george-calhoun/2022/11/14/the-un-wisdom-of-crowds-prediction-markets-failed-their-midterm-exams/?sh=71f9099d179a>; Anthony Pickles, "A Republican bubble? How pollsters and pundits got the US midterms so wrong," *The Conversation*, 22 November 2022, <https://theconversation.com/a-republican-bubble-how-pollsters-and-pundits-got-the-us-midterms-so-wrong-194684>; Stern, "PredictIt Already Won"
67. Technology Policy Institute, host, "John Phillips and David Mason of Aristotle Discuss Political Prediction Markets"
68. Devin O'Connor, "Republicans Heavy Betting Favorites on Eve of 2022 Midterms," *Casino.org*, 7 November 2022, <https://www.casino.org/news/republicans-heavy-betting-favorites-on-eve-of-2022-midterms/>
69. Technology Policy Institute, "John Phillips and David Mason of Aristotle Discuss Political Prediction Markets"

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Concerns that political betting markets might corrupt the democratic process have deepened since the fallout of the 2020 elections. Accusations by prominent political leaders of widespread voter fraud and waning confidence in the integrity of elections have underscored fears that liberalized political event contracts would exacerbate risks to democratic institutions.⁷⁰ Former CFTC Commissioner Jill Sommers, who voted against Nadedx's application in 2012 to offer election contracts, stated in regard to Kalshi's proposal, "When we think about what happened in 2020, do we really want another excuse for the American people to question the integrity of our elections?...This is not something we want to be introducing into federally regulated financial markets."⁷¹ These arguments are resonating in particular in progressive circles.⁷²

While the overall impact of political prediction markets on the democratic process is a source of debate, critics of political prediction markets can point to numerous instances of market manipulation on PredictIt and in the UK markets. These include spending by political campaigns in prediction markets to inflate candidate prices, alleged death threats by traders against political candidates potentially related to betting lines, and the dissemination of fake polls to move market prices.⁷³ Some in the prediction market community believe that, at the end of 2022, it was a PredictIt trader who submitted a fake candidate filing to the Federal Election Commission. This was allegedly to profit in the PredictIt market on the issue of whether former Vice President Mike Pence would announce his candidacy for president before the end of that year. While none of this activity, to our

70. Harty, "Political betting"

71. Harty, "Washington weighs plan to let Americans wager on elections," *Politico*, 5 September 2022, <https://www.politico.com/news/2022/09/05/voters-betting-elections-trading-00054723>

72. Chougule, host, "When Will Biden Announce His Re-Election Bid," *Star Spangled Gamblers* (podcast), 2 March 2023, <https://starspangledgamblers.com/2023/03/02/when-will-biden-announce-his-re-election-bid/>

73. Chougule, host, "Bet Against Senator Feinstein Resigning," *Star Spangled Gamblers* (podcast), 10 June 2023, <https://starspangledgamblers.libsyn.com/bet-against-senator-feinstein-resigning>; Chougule, host, "Does Political Betting Threaten Democracy? Lessons from the UK"; Tom Harris, "The Curious Case of Brian Rose: Is the London Mayoral Candidate Betting on Himself?" 5 February 2021, <https://www.tomharris.org.uk/politics/the-curious-case-of-brian-rose-is-the-london-mayoral-candidate-betting-on-himself/>; Adam Sherman, Comment for Industry Filing 22-002, CFTC. Comment No: 69618, 30 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69618&SearchText=>; Sia, Comment for Industry Filing 22-002

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knowledge, has meaningfully impacted the outcome of any event, some critics argue that they distort the political discourse enough to warrant criminal liability.⁷⁴ Phillips has acknowledged that the PredictIt comments boards are replete with “spinning and counter-spinning and bluffing,”⁷⁵ but the company has done little to prevent traders from using the comments sections on its site to manipulate market prices.⁷⁶

The intersection of political betting markets and election integrity concerns has caused the CFTC to tread cautiously in approving election contracts. In a May 2023 podcast, Behnam pointed to the possibility that allegations of election manipulation could lead to demands that the Commission police hardware, software, and news associated with CFTC-approved election contracts that are supposedly implicated in the alleged fraud. This type of scenario, in Behnam’s view, raises “a lot of legal questions and policy questions about whether or not you would want a financial regulator policing elections.”⁷⁷ Thirteen of the 41 questions the CFTC has requested public comments on in the context of Kalshi’s congressional markets—nine of which were among the 24 questions in the most recent batch—relate to election integrity concerns.

Economic Instability

Concerns that political prediction markets can exacerbate systemic financial risk have gained currency in light of the 2022 ‘crypto winter’ and FTX’s collapse. Critics have seized on the idea that political event contracts are similar to cryptocurrencies in that they

74. Tyler Yeagain, *Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability*, 85 Mo. L. Rev. (2020), <https://scholarship.law.missouri.edu/mlr/vol85/iss1/7>

75. Eaddy and Graubard, hosts, “John Phillips, PredictIt Co-Founder and CEO”

76. David Hill, “The Wolves of K Street,” *The Ringer*, 21 March 2018, <https://www.theringer.com/2018/3/21/17130490/predictit-politics-elections-gambling>; Brian Golden, “The Art of the Pump,” *Washington Monthly*, 3 April 2022, <https://washingtonmonthly.com/2022/04/03/the-art-of-the-pump>; Joseph, host, “John Phillips: A-Bomb Kid Powers PredictIt”; Twitter post, 5 August 2022, 11:26 AM, <https://twitter.com/Domahhhh/status/1555575894961446914?s=20>; Twitter post, 5 August 2022, <https://twitter.com/Domahhhh/status/1555575897553526785?s=20>; Twitter post, 5 August 2022, <https://twitter.com/Domahhhh/status/1555575900380487680?s=20>

77. Weisenthal and Alloway, hosts, “CFTC Chair Rostin Behnam on the Fight to Regulate Crypto”

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‘gamify’ finance and create losses for the majority of retail investors. Reports that FTX was offering tokens on Donald Trump’s electoral fortunes feed into this narrative.⁷⁸

Limited Advocacy Presence

While political prediction markets have drawn support from a distinguished group of Americans across industries, the political prediction market community generally has been poorly organized and suffered setbacks in advocating for its agenda.⁷⁹ A standing, Washington-based non-profit organization would help address many of these issues, but it would need sufficient funding to spearhead legal challenges, engage regulators and political leaders, convene working groups and conduct grassroots campaigns. To date, the political prediction market community has not shown the capacity to engage effectively in these activities.

Instead, retail traders, researchers, political leaders, and other users tend to rely on companies for advocacy efforts even though their interests often do not align with the broader community. Politicians and regulators, as a result, feel little constituent pressure to prioritize the issue.

When journalists, researchers, and regulators seek out information on political betting, they stumble upon the most conspicuous element of the community: gambling forums replete with toxic discourse. To an outsider’s eye, this status quo fuels skepticism about the wisdom empowering self-described ‘degens’ who seem more adept at trolling, fabricating polls, and pumping positions than forecasting elections or engaging the political process.⁸⁰

78. Sam Reynolds, “FTX’s TRUMPLOSE Token Isn’t Proof of an FTX-Democrat-Ukraine Conspiracy,” *CoinDesk*, 15 November 2022, <https://www.coindesk.com/markets/2022/11/15/analysis-ftxs-trumplose-token-isnt-proof-of-an-ftx-democrat-ukraine-conspiracy/>

79. Keeney and Chougule, hosts, “How PredictIt Got Knifed,” *Star Spangled Gamblers* (podcast), 4 August 2022, <https://starspangledgamblers.com/2022/08/04/how-predictit-got-knifed/>

80. For notable examples, see Stern, “PredictIt Already Won”: “Scrolling through the discussion forms that PredictIt hosts for each market, you will find the same unhinged trolling and rampant disinformation and culture-war battle cries that you will find most everywhere else online...You will find

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Negative public perceptions of FTX CEO Sam Bankman-Fried have further eroded the credibility of the political betting community. In large part, this is due to the corresponding reputational blow taken by the effective altruism movement, one of the few political actors that has been willing to invest meaningful resources to advocate on behalf of political prediction markets.⁸¹

Case in point is the controversy surrounding Data for Progress founder, former Kalshi consultant, and self-described effective altruist Sean McElwee. Prior to the FTX scandal, McElwee openly bet tens of thousands of dollars on PredictIt while building a progressive think-tank and polling firm. He encouraged his staff to do the same in order to “train heuristics” and “calibrate” political instincts. McElwee led weekly wagering sessions at Data for Progress in order to help his team “understand and engage with risk.”⁸²

bettors engaging in psychological warfare in an effort to tilt the markets in their favor (‘pumps’), and you will find bidders engaging in magical thinking because markets are not tilting in their favor (‘copium’). You will find some of the most extreme megalomania observable anywhere on the internet—which is saying something. As outcomes start to become clear, you will find gloating, endless gloating...And if you look hard enough, sprinkled in here and there, you will find a bit of genuinely astute analysis.”; Golden, “The Art of the Pump”: “To say that prediction markets reward truth is not to say they are immune from the poisonous political world they exist to reflect. The comments under any PredictIt market demonstrate this reality...PredictIt is, by its own admission, a male-dominated space, and the same casual racism, sexism, homophobia, obnoxiousness, juvenile idiocy, and outright irredeemable batshit nonsense exists here that subsumes many online spaces...As in many online spaces, the racist, lunatic fire just burns too hot for it to be completely put out.”

81. On effective altruism investment in political prediction market infrastructure, see, for example, Long-Term Future Fund grants at “Long-Term Future Fund.” For authors’ discussion of the effective altruism movement’s interest in political prediction markets, see Keeney, host, “The Behind the Scenes Battle at the CFTC,” *Star Spangled Gamblers* (podcast), 27 October 2022, <https://starspangledgamblers.com/2022/10/27/the-behind-the-scenes-battle-at-the-cftc>
82. Zac McCrary, host, “Politics According to Sean McElwee,” *Pro Politics* (podcast), 16 August 2022, <https://podcasts.apple.com/bb/podcast/politics-according-to-sean-mcelwee/id1554218352?i=1000576216809>; Terris, *The Big Break*, 105-6; Terris, “This site bet big on political gambling. Regulators want it shut down.” *The Washington Post*, 24 January 2023, <https://www.washingtonpost.com/lifestyle/2023/01/24/predictit-gambling-on-politics>. For McElwee’s views on prediction markets, see McElwee, “Why Prediction Markets Make The World A Better Place,” *Medium*, 26 October 2022, <https://medium.com/@SeanMcElwee/why-prediction-markets-would-make-the-world-a-better-place-ceded9760846>.

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McElwee's practices have raised eyebrows within progressive circles, particularly due to perceptions that he had conflicts of interest. McElwee disclosed to *Washington Post* reporter Ben Terris that he "make[s] a lot of bets that would make progressives cry"—that is, bets against progressive candidates, sometimes informed by privileged data he would acquire from doing polling work for them.⁸³

Nevertheless, McElwee's alignment with the effective altruism community bolstered his credibility as an advocate in the political prediction market space. Gabe Bankman-Fried, who hired McElwee to assist him with effective altruism advocacy, viewed McElwee political betting activities as a "really good practice" that enhanced his ability to defend claims.⁸⁴ This support in turn helped McElwee to mobilize prominent progressive leaders, including Congressman Richie Torres, in an advocacy campaign on behalf of election prediction markets.⁸⁵

The FTX scandal generated criticisms of McElwee's ties to the Bankman-Frieds and his political betting.⁸⁶ The air of controversy allowed critics of McElwee's engagement with political betting markets an opportunity to oust him as executive director of Data for

83. Terris, *The Big Break*, 3-4, 7-8.

84. *Ibid*, 160-1.

85. Harty, "Ritchie Torres and a group of progressive advocates are urging regulators to let Americans bet on U.S. elections, arguing it would help build public trust in democracy." *Politico*, 1 November 2022, <https://www.politico.com/minutes/congress/11-1-2022/torres-leads-election-bet-push/>

86. Ed Burmila, "How Trump Left Washington Even Swampier," *The New Republic*, 21 May 2023, <https://newrepublic.com/article/172475/trump-left-washington-even-swampier>; "Adherents of 'Effective Altruism' claim that betting on political outcomes is a for of reinforcing one's beliefs, a kind of putting money where one's mouth is. Maybe so. But it comes off more as simply frattish behavior, a big kid with a big pot of money, blowing it on online poker with supreme confidence that there will always be more of someone else's money with which to play."; David Freedlander, "Fall of the Progressive Boy King," *New York Magazine*, 22 December 2022, <https://nymag.com/intelligencer/2022/12/sam-bankman-fried-and-sean-mcelwees-fateful-alliance.html>; Jeet Heer, "Sean McElwee's Betting Against Democracy," *The Nation*, 1 May 2023, <https://www.thenation.com/article/politics/sean-mcelwee-democracy-betting/>; Kaleigh Rogers, "How The Cool Kid Of Progressive Politics Gambled It All Away," *FiveThirtyEight*, 23 February 2023, <https://fivethirtyeight.com/features/how-the-cool-kid-of-progressive-politics-gambled-it-all-away/>

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Progress and institute at the organization a new “Gambling and Wagering Policy” prohibiting employees from betting on events related to Data for Progress clients or projects.⁸⁷ Subsequent investigations by Data for Progress and FiveThirtyEight found no evidence that McElwee manipulated polls for financial gain⁸⁸—an accusation McElwee categorically denies.⁸⁹ Nevertheless, FiveThirtyEight banned polls conducted under McElwee’s direction from its polling averages, database, and forecasts. FiveThirtyEight’s rationale is that “a pollster betting on politics can be akin to insider trading,” and that “pollsters having a financial stake in these markets raises questions about their polls’ intent and the integrity of their design and results.”⁹⁰

Limited Market Interest and Revenues

Political betting lines are relatively unprofitable for both retail traders and companies in the space. Traders struggle with the relative infrequency and inconsistency of political events that lend themselves to betting with a sustained edge. Paul Krishnamurty, as an example, one of the most prominent political gambler in the world, recently estimated that only about five percent of his winnings as a professional gambler over the past 20 years have come from politics, the rest being from sports.⁹¹ While sportsbooks make money off political lines, in large part by banning accounts perceived to have an edge, companies offering traditional prediction markets often lose money on political markets and justify

87. Ryan Lizza, Rachel Bade, and Eugene Daniels, “Inside the scramble to trace SBF’s dirty money,” *Politico Playbook*, 22 December 2022, <https://www.politico.com/newsletters/playbook/2022/12/22/inside-the-scramble-to-trace-sbfs-dirty-money-00075128>; Rogers, “How The Cool Kid Of Progressive Politics Gambled It All Away”; Terris, *The Big Break*, 294-6.

88. Rogers, “How The Cool Kid Of Progressive Politics Gambled It All Away”

89. Chougule, host, “When Will Biden Announce His Re-Election Bid.”

90. Nathaniel Rakich and Mary Radcliffe, “Why We’re Preemptively Banning A Pollster—And Not Banning Another,” *FiveThirtyEight*, 23 February 2023, <https://fivethirtyeight.com/features/why-were-preemptively-banning-a-pollster-and-not-banning-another>.

91. Chougule, host, “Is DeSantis Definitely Running for President?” *Star Spangled Gamblers* (podcast), 15 March 2023, <https://starspangledgamblers.com/2023/03/15/is-desantis-definitely-running-for-president>. For background on Krishnamurty, see Krishnamurty, “How I Became A Pro Gambler,” *SL.Man*, 11 April 2020, <https://slman.com/life/how-i-became-pro-gambler>; Pete Ling (host), “Episode #43—Paul Krishnamurty/Political Betting Expert,” *The Smart Betting Club Podcast*, October 2022, <https://open.spotify.com/episode/0P6X8k2dH19yk5oGGKTcEo?si=EjgzA5q9Qfmz-VuSbXC4VPg>; Adam Payne, “Meet the professional gambler who has made a living betting on Brexit

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their costs as loss leaders, academic endeavors, or as a public service. Even state legislators who favor legalized election betting acknowledge that revenues from political lines would be relatively small. In a state like Nevada, with a mature gaming industry, political bets would amount to a “tiny” subset of sports betting revenues.⁹²

Conservative forecasts about the commercial viability and revenue generating potential of political prediction markets have been borne out to some extent by publicly available data on PredictIt’s users and finances. In their filing to the CFTC, plaintiffs associated with PredictIt tout the fact that, between 2014 and 2022, more than 120,000 participants have traded on the site.⁹³ Activity on PredictIt peaked in the run-up to the 2020 U.S. presidential election, when close to \$150 million was traded on the site. This is the only time in the site’s history when PredictIt revenues exceeded its expenses.⁹⁴ In the run-up to the 2022 U.S. midterm elections, the site averaged around 80,000-100,000 users, 30,000 of which PredictIt described as active traders.⁹⁵ While an increase from 22,000 users in 2016,⁹⁶ the site has not grown its user base much since 2018.⁹⁷ Additionally, only a small

and Corbyn,” *Business Insider*, 8 September 2016, <https://www.businessinsider.com/paul-krishnamurty-political-betting-gambling-labour-corbyn-us-election-2016-9>; “The Political Gambler,” <https://www.politicalgambler.com>; Alex Vella, host, “Politics Betting,” Trademate Sports Betting Podcast, 23 July 2021, <https://youtu.be/A0eor5Bo2Kk>

92. Katy Steinmetz, “Bet on Red! Nevada May Legalize Gambling on Federal Elections,” *Time*, 27 March 2013, <https://swampland.time.com/2013/03/27/bet-on-red-nevada-may-legalize-gambling-on-federal-elections/>
93. Complaint for Declaratory and Injunctive Relief at 16, Kevin Clarke, in his individual capacity, Trevor Boeckmann, in his individual capacity, Corwin Smidt, in his individual capacity, PredictIt, inc., a Delaware corporation, Aristotle International, Inc., a Delaware v. Commodity Futures Trading Commission (2022), 1:22-cv-00909-LY, <https://www.courthousenews.com/wp-content/uploads/2023/02/predictit-versus-commodity-futures-trading-commission.pdf>
94. Letter from Nightingale and Barker to McGonagle, 6 April 2023
95. Danny Funt, “Betting on Elections Can Tell Us a Lot. Why Is It Mostly Illegal?” *The New Yorker*, 3 November 2022, <https://www.newyorker.com/news/the-political-scene/betting-on-elections-can-tell-us-a-lot-why-is-it-mostly-illegal>; Golden, “The Art of the Pump”; Joseph, host, “Palin, PredictIt & Political Wagering,” *The Prediction Trade* (podcast), 14 April 2022, <https://www.podcastone.com/episode/Palin-Predictit-Political-Wagering-48>
96. Chougule, “Volume and Liquidity on PredictIt,” *Political Prediction Markets*, <https://politicalpredictionmarkets.com/volume-and-liquidity-on-predictit/>
97. David Hill, “The Wolves of K Street,” *The Ringer*, 21 March 2018, <https://www.theringer.com/2018/3/21/17130490/predictit-politics-elections-gambling>

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percentage of PredictIt users trade on a weekly or monthly basis, and most do not appear to trade large amounts of money. In 2020, the average first time deposit was \$216.⁹⁸ PredictIt's no-action letter requires the site to limit each market to 5,000 participants, but that number is typically only reached in a handful of marquis election markets close to election day. As a consequence, PredictIt's expenses have exceeded revenues over the history of the site's operation.⁹⁹

Currently, PredictIt's user base and revenues are almost certainly below its 2022 levels. Beyond the fact that engagement on the site drops in non-election years, PredictIt has seen an exodus due to its regulatory constraints and uncertainties. PredictIt's counsel disclosed before the Fifth Circuit that 14,478 traders held positions in 75 contracts on the site that were expected to expire after February 15, the deadline the CFTC gave PredictIt in August 2022.¹⁰⁰ In the months following the August 2022 notice, many of the site's highest-volume, prominent traders withdrew funds, particularly after the November 2022 midterm elections and the December 7 Georgia run-offs. Between August and December 2022, traders withdrew \$18 million from PredictIt; 7,500 traders withdrew all of their funds and shut down their accounts. More than 4,700 of these traders did so between November and December.¹⁰¹ By December, trading volume on PredictIt lost more than 75% of the volume it had before the CFTC's August 2022 announcement.¹⁰² Exacerbating doubts about the site's future has been PredictIt's refusal to clarify how it would resolve existing markets if their legal appeals fail. PredictIt's decision not to create new markets or even, until late June 2022, add new candidates to its election market has further diminished interest in the site. Lingered traders have been left with low liquidity, highly vola-

98. Altucher, host, "How to Supplement your Income with Money Betting with PredictIt.Org Co-Founder John Phillips"

99. Letter from Nightingale and Barker to McGonagle, 6 April 2023

100. Clarke et. al. v. CFTC, 22-51124, Plaintiffs-Appellants' Opening Brief, (5th Circ. 26 January 2023), 7, https://mickbransfield.com/wp-content/uploads/2023/02/A40_Appellant_Brief.pdf

101. Declaration of John Phillips, 31 December 2022, in Clarke et. al. v. CFTC, 22-51124, Appendix to Plaintiffs-Appellants' Opposed Motion for Injunction Pending Appeal or, in the Alternative, Petition for a Writ of Mandamus, (5th Circ. 3 January 2023), 117, https://mickbransfield.com/wp-content/uploads/2023/02/22-51124_Documents.pdf

102. *Ibid*, 118.

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tile markets.¹⁰³

Evidence from the UK suggests that the limited interest and profitability of political betting in the United States is only partly related to regulation. On the one hand, in the absence of restrictive regulations, major political events—notably U.S. presidential elections—have been among the largest single and most profitable betting events for UK bookmakers.¹⁰⁴ Compared to \$261 million (\$281.9 million adjusted for inflation) in the 2016 U.S. election, \$744 million was bet on Betfair Exchange alone on the 2020 U.S. presidential election, making it the largest betting event in the site’s history. These sums far surpassed comparable sporting events. For comparison, the August 2017 fight be-

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103. Bittenbender, “PredictIt Founder Gets More Time to Respond to CFTC Claims as Lawsuit Continues,” Casino.org, 21 March 2023, <https://www.casino.org/news/predictit-founder-gets-more-time-to-respond-to-cftc-claims-as-lawsuit-continues/>; Chougule, host, “2024 Republican Longshots and Debt Ceiling Negotiations”; Chougule, host, “Argentina’s Upcoming Presidential Elections,” Star Spangled Gamblers (podcast), 30 April 2023, 45:36-52:03, <https://starspangledgamblers.com/2023/04/30/argentinas-upcoming-presidential-elections/>; Declaration of Clarke, 18 November 2022, in Clarke et. al. v. CFTC, 22-51124, Appendix to Plaintiffs-Appellants’ Opposed Motion for Injunction Pending Appeal or, in the Alternative, Petition for a Writ of Mandamus, (5th Circ. 3 January 2023), 66-, https://mickbransfield.com/wp-content/uploads/2023/02/22-51124_Documents.pdf; Joseph (host), “This Part-Time (Profitable) Political Trader Shares His Midterm Bets,” The Prediction Trade (podcast), 18 August 2022, <https://www.tastylive.com/shows/the-prediction-trade/episodes/this-part-time-profitable-political-trader-shares-his-midterm-bets-08-17-2022>. Trader pessimism about PredictIt’s prospects can be seen through the prices on markets offered by Insight Prediction, Polymarket, and Manifold about questions such as how long the site will continue operating, and whether it will release new contracts. For details, see Bransfield, “Prediction Markets Bet On PredictIt Surviving in the Short Term,” 31 January 2023, <https://mickbransfield.com/2023/01/31/prediction-markets-bet-on-predictit-surviving-in-the-short-term/>; Bransfield, “Remaining PredictIt Markets with 75 Days Left,” 2 December 2022, <https://mickbransfield.com/2022/12/02/remaining-predictit-markets-with-75-days-left/>; Chougule, host, “CFTC Makes Its Case Against PredictIt,” Star Spangled Gamblers (podcast), 25 March 2023, <https://starspangledgamblers.com/2023/03/25/cftc-makes-its-case-against-predictit/>; Keeney and Chougule, hosts, “PredictIt CEO: We’re Not Quitting”, 42:45-43:12. In June 2023, PredictIt, without explanation, added Robert Kennedy Jr. to its market on the Democratic nominee for president in 2024, and Chris Christie and Vivek Ramaswamy to its market on the Republican nominee for president in 2024.
104. Chougule, host, “Is DeSantis Definitely Running for President?”; Devin O’Connor, “2020 Presidential Election Setting Betting Records, \$1B in Wagers Possible,” Casino.org, 28 October 2020, <https://www.casino.org/news/2020-presidential-election-betting-records-1b-wagers-possible/>

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tween Conor McGregor and Floyd Mayweather, the most-bet-on sporting event Betfair had offered to date, brought in \$71.5 million.¹⁰⁵ On Betonline.ag, more money was bet on the 2020 election than that year's Super Bowl.¹⁰⁶

The absence of betting limits appears to have drawn 'smart whales' to take advantage of mispriced odds driven by retail traders. Although 46.6% of the money wagered was on Trump compared to 50.6% for Joe Biden, the 10 largest bets placed on Betfair were for Biden. These include a \$1.3 million bet on Biden, which was the third largest wager in Betfair history, and at least six other Biden bets of more than \$400,000.¹⁰⁷

Nevertheless, election betting revenues in the UK pale in comparison to lines such as horse racing and soccer, which present far more repeatable betting opportunities than elections.¹⁰⁸ The limited profitability potential of current affairs markets is compounded by the fact that operators must hire experts who can write complex rules for infrequent, unrepeatable events that can be understood by traders well enough to avoid ambiguous settlement situations.¹⁰⁹ The UK-based betting exchange Smarkets, as an example, was founded by an American CEO, Jason Trost, who became interested in the space after learning about political prediction markets. However, the economics of the industry have led Smarkets to treat current events markets as a niche "passion project" subsidized by sports and other lines more likely to see growth.¹¹⁰ Because Smarkets's goal of produc-

105. Charles Riley, "The person who bet \$1.3 million on a Biden win hasn't been paid yet," *CNN*, 9 November 2020, <https://www.cnn.com/2020/11/09/business/biden-betfair-wager/index.html>; Darren Rovell, "2020 Election Odds: Record \$564 Million Bet on Trump vs. Biden Presidential Race at Betfair, Double 2016 Election," *Action Network*, 14 December 2021, <https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

106. Chris Bumbaca, "2020 U.S. presidential election expected to involve more than \$1 billion in wagers," *USA Today*, 3 November 2020, <https://www.usatoday.com/story/sports/gambling/2020/11/02/2020-election-betting-odds-donald-trump-joe-biden/6128882002/>

107. Riley, "The person who bet \$1.3 million on a Biden win hasn't been paid yet"; Rovell, "2020 Election Odds"

108. Batt, "Nevada Looks To Follow UK's Lead on Election Betting"

109. Eaddy and Graubard, hosts, "Jason Trost, Smarkets Founder and CEO"; Star Sports, "#BettingPeople Interview MATTHEW SHADDICK Smarkets Head of Politics 2/4," 19 October 2021, Interview with William Kedjanyi, <https://youtu.be/zcjGZsJLuOE?t=607>

110. Eaddy and Graubard, hosts, "Jason Trost, Smarkets Founder and CEO"; Keeney and Chougule, hosts, "Smarkets CEO Jason Trost Joins the Boys for 2020 Political Picks," *Star Spangled Gamblers*

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ing a publicly-available, “very accurate set of probabilities” with “social utility” requires the site to attract “clever, clued-up, informed” bettors, Smarkets deprioritizes profitability considerations for its current events lines and welcomes long-term winning accounts even as their competitors restrict them.¹¹¹ Nevertheless, Trost concedes that he “wouldn’t put too much stock” in Smarkets’s political markets as an “information source” because they are “thinly-traded” and lack “critical mass” and a sufficiently “diverse group of bettors.”¹¹²

While the 2020 elections point to a favorable trend for political betting, the awareness they have generated for political betting may prove to be a fleeting phenomenon.¹¹³ Industry veteran Matthew Shaddick has cautioned that recent spikes in political betting involvement, which crossed \$1 billion globally in 2020, may largely stem from the unique “worldwide fame and notoriety and interest” that Trump personally engenders. Shaddick questions whether more conventional politicians would produce comparable levels of “excitement” in the betting markets.¹¹⁴ These doubts make it difficult for companies to expand product development, hire talented specialists in the political prediction betting space, and invest in the lobbying, public relations, and research efforts needed to influence regulators and build the political forecasting community.¹¹⁵ Even when they do occur, such investments tend to be inconsistent, as this area is one of the most obvious and immediate targets when companies are forced to cut costs.

(podcast), 29 July 2020, https://youtu.be/hnxwn2_9EyE; Star Sports, “#BettingPeople Interview MATTHEW SHADDICK Smarkets Head of Politics 2/4”

111. Eaddy and Graubard, hosts, “Jason Trost, Smarkets Founder and CEO”; Star Sports, “#BettingPeople Interview MATTHEW SHADDICK Smarkets Head of Politics 2/4”

112. Eaddy and Graubard, hosts, “Jason Trost, Smarkets Founder and CEO,” <https://youtu.be/vySli47rB-jw?t=2168>

113. Star Sports, “#BettingPeople Interview MATTHEW SHADDICK Smarkets Head of Politics 2/4”

114. Mack DeGeurin, “Is the U.S. Ready for Election Betting? We’re About to Find Out,” *Gizmodo*, 28 October 2022, <https://gizmodo.com/election-betting-sports-betting-midterm-elections-1849715401>; Pierre Lindh, host, “Podcast #30 - Matthew Shaddick, Head of Politics GVC (Topic: US election predictions),” iGaming NEXT (podcast), 30 October 2020, https://youtu.be/klvu_NKdpck. On the relation between Trump and interest in political betting, see also Ling (host), “Episode #43—Paul Krishnamurty/Political Betting Expert”

115. Eaddy and Graubard, hosts, “Jason Trost, Smarkets Founder and CEO”

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Industry Missteps

Companies seeking to offer political prediction markets have made strategic choices that have yielded limited success in liberalizing the regulatory climate.

The choices these companies have made have led regulators to approach the space with a skeptical eye. The ways that they have navigated the regulatory environment are not only questionable in retrospect, but have been criticized consistently and prophetically by a wide cross-section of the political betting community. An irony of their missteps is that they are replete with the same types of forecasting errors and overreliance on experts that their products are ostensibly aimed at correcting. A full catalog of their dubious decisions is beyond the scope of this report, but the case studies of PredictIt and Kalshi described below are illustrative.¹¹⁶

It is little surprise that the CFTC withdrew PredictIt's no-action letter in light of how cavalierly the company managed its relations with the agency. Indeed, while we are sympathetic to PredictIt's mission and its team, our research into the topic left us wondering how PredictIt even managed to retain no-action relief for as long as it did. PredictIt's agreement with the CFTC makes clear that the Commission was granting PredictIt regulatory relief in order to operate a non-profit, educational experiment overseen by university faculty, which would offer only limited political event contracts. Whether or not PredictIt violated the letter of its agreement as the CFTC alleges, it is difficult to understand why the seasoned Washington operatives managing PredictIt concluded that the company's business practices were consistent with the spirit of its understanding with the CFTC. Nor is it clear why PredictIt persisted in many of these practices even after being confronted repeatedly by CFTC officials who claim unilateral authority to rescind its no-action letter.¹¹⁷

116. For Chougule's insights on the regulatory approaches of Kalshi and PredictIt, see Keeney and Chougule, hosts, "Yikes! Trump (& PredictIt) Raided By the Feds," Star Spangled Gamblers (podcast), 11 August 2022, <https://starspangledgamblers.com/2022/08/11/yikes-trump-predictit-raided-by-the-feds>

117. Chougule, host, "CFTC Makes Its Case Against PredictIt"

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The no-action letter permits PredictIt to charge fees necessary to cover regulatory compliance and operating costs for a non-profit, academic venture. In this sense, the rationale behind PredictIt's fee structure is unclear. On the one hand, PredictIt claims to be operating at a loss. At the same time, PredictIt charges fees on trades and withdrawals that are so high they distort the research value of its data and deter investors from opening accounts on the site.¹¹⁸ In an interview on Star Spangled Gamblers in October 2021, Phillips conceded the market distorting impact of the fees but refused to lower them.¹¹⁹ Nor has the fee structure satisfied CFTC concerns about whether PredictIt is adhering to the terms of its no-action letter. A potential explanation for why PredictIt persists with this fee structure is that it is part of a scheme in which PredictIt monetizes its markets and its users in coordination with data analytics firm Aristotle and its affiliates. Considering that Victoria University has not made money from PredictIt, collecting payments of just \$2,000 per month for a university subsidiary, Aristotle's business model raises questions about the extent to which PredictIt is in fact a non-profit venture.¹²⁰ Court rulings and journalistic investigations may shed greater light on the details of PredictIt's finances.

In terms of the contracts on the site, PredictIt has offered betting lines that bear little relation to the public interest. In its court filing before the Fifth Circuit, the CFTC specifically lists 17 markets PredictIt has offered that are "outside of the bounds" of the no-action letter.¹²¹ One is a market on the number of times U.S. Representative Alexandria Ocasio-Cortez would tweet in a random week in March.¹²² Victoria University maintains that "all markets" identified by the CFTC are "within a reasonable and good faith interpreta-

118. Crawley, host, "How to Trade Prediction Markets and Fade Political Hype"

119. Keeney and Chougule, hosts, "PredictIt's CEO Answers All Your Questions," Star Spangled Gamblers (podcast), 28 October 2021, <https://starspangledgamblers.com/2021/10/28/predictits-ceo-answers-all-your-questions/>

120. Bittenbender, "CFTC's PredictIt Claims Focus on Relationship Between Aristotle and New Zealand University," Casino.org, 6 March 2023, <https://www.casino.org/news/cftcs-predictit-claims-focus-on-relationship-between-aristotle-and-new-zealand-university/>; Chougule, host, "The Right's Problems with Educated Voters"; Letter from Nightingale and Barker to McGonagle, 6 April 2023; Victoria University Statement in "PredictIt Announcements," PredictIt, <https://www.predictit.org/platform-announcements>

121. Letter from McGonagle to Hyland, 2 March 2023.

122. *Ibid.*

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tion of the scope of contracts approved by the NAL [no-action letter].¹²³ For example, the market on Ocasio-Cortez’s tweets is justified by the university on the grounds that the “volume of her Tweets both constitute and relate to significant political events.”¹²⁴ The CFTC could have included even more dubious markets PredictIt has offered in the past. An infamous example is the market PredictIt offered on whether Trump would dance with Caitlyn Jenner at the White House ball. In another case, PredictIt markets may have led to death threats against presidential candidate Andrew Yang from someone with a stake in the number of times he would tweet.

Frequent warnings by PredictIt users about the way the company was navigating its political risk were dismissed by PredictIt’s management. As early as February 2016, Domer, one of the most prominent political bettors in the world,¹²⁵ began emailing PredictIt his concerns about how the site was handling regulatory risk with the CFTC. Domer argued that PredictIt was “far too cavalier in blurring the line between predicting politics and gambling.”¹²⁶ The following year, the chief counsel of the CFTC’s Division of Market Oversight questioned Aristotle about “how contracts predicting the number of candidate tweets were political event contracts.”¹²⁷ Chougule echoed these points in a series of tweets in 2019 and 2020. He reported that PredictIt’s markets on the number of times politicians were tweeting were controversial to the CFTC, likely because they were not the type of markets that “regulators had in mind when they permitted PredictIt.” Chougule warned that these markets would “invite regulatory scrutiny” and that “regulators would use them as an excuse to crack down on PredictIt broadly.” Rather than pursuing markets that “casts doubt on PredictIt’s claim that it is an academic research project,” Chougule counseled “a more cautious regulatory approach that leads to eventual deregulation of

123. Letter from Nightingale and Barker to McGonagle, 6 April 2023

124. *Ibid.*

125. For background on Domer, see Aaron Fifield, host, “The Information Edge: Winning in Prediction Markets w/ Domer,” Chat with Traders (podcast), 26 May 2022, <https://youtu.be/TEBeRDMD-3ml>; Golden, “The Art of the Pump.” See also Domer’s appearances on Star Spangled Gamblers at <https://starspangledgamblers.com/?s=domer>.

126. Twitter post, 4 August 2022, 6:29 p.m., <https://twitter.com/Domahhhh/status/1555320074524770304?s=20>.

127. Letter from Nightingale and Barker to McGonagle, 6 April 2023

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political prediction markets.”¹²⁸ Around the same time, prominent PredictIt user James Altucher publicly questioned Phillips on the “random” nature of Trump tweet markets in an interview. Phillips defended the markets without mentioning the regulatory scrutiny they were inviting.¹²⁹

Eventually, the CFTC did indeed prohibit the tweet markets as part of a broader review of PredictIt’s compliance with its no-action letter. This review culminated in an agency order to shut down the site. Among the reasons cited by the DMO was that PredictIt’s “listing of contracts well outside of the scope of Letter 14-130 creates the false impression that DMO staff has determined that these contracts are acceptable.”¹³⁰

Kalshi’s strategy, meanwhile, was centered around overconfident assumptions that misread the political environment in Washington. Encouraged by their success in gaining approval to offer event contracts as a DCM,¹³¹ Kalshi’s leadership expressed confidence that the CFTC, even under a new Democratic presidential administration, would approve their application to offer election markets.

In their appeals to the CFTC, Kalshi drew attention to the fact that their competitors were allowed to operate similar markets without being registered as DCMs.¹³² Kalshi may have

128. Twitter post, 19 May 2020, 5:14 a.m., <https://twitter.com/pichougule/status/1262672924831625216>; Twitter post, 1 June 2020, 1:46 p.m., <https://twitter.com/pichougule/status/1267512917831962633?s=20>; Twitter post, 1 June 2020, 1:52 p.m., <https://twitter.com/pichougule/status/1267514286454251525?s=20>; Twitter post, 18 May 2020, 10:06 p.m., <https://twitter.com/pichougule/status/1262565225460641794?s=20>. For Chougule’s reflections on these warnings, see Keeney and Chougule, hosts, “How Predictit Got Knifed.” For background on Chougule’s involvement in political betting, see Chougule, *How to Make Money from Political Predictions: A Guide to Generating High, Steady Returns on PredictIt*, 2016, <https://a.co/d/1t7YYQm>; Crawley, host, “How to Trade Prediction Markets and Fade Political Hype”

129. “How to Supplement your Income with Money Betting with PredictIt.Org Co-Founder John Phillips”

130. Letter from McGonagle to Hyland, 2 March 2023

131. Harry Stebbings (host), “Kalshi CEO Tarek Mansour: How to Build Moats Against Incumbents; How to Hire Engineers,” 20VC (podcast), 8:59-9:57, <https://youtu.be/h7IUgHnOb28?t=539>

132. See for example Eli Mishory to Secretary of the Commission, Office of the Secretariat, CFTC, 19 July 2022, <https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm001.pdf>:

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calculated that they would gain first mover advantage as a DCM in a growing election market space¹³³ once the CFTC approved their application and their competitors' business models were scrutinized by regulators. Instead, Kalshi's strategy not only failed to win approval for the company in its bid to offer election markets, it pushed the CFTC to act more urgently and aggressively against a status quo in which Polymarket and PredictIt were offering political lines of questionable legality.

Kalshi's failure to address forthrightly its role in the CFTC's actions against Polymarket and PredictIt has undermined not only its standing in the political betting community, but also its arguments to regulators.¹³⁴ In the 2022 CFTC comments period, at least six comments raised concerns about Kalshi's lobbying regarding its competitors and cited this as a rationale for the CFTC to deny Kalshi's election contracts while the agency was revoking PredictIt's no-action letter.¹³⁵

"Contracts on political control of Congress available to US participants have been trading for nearly a decade. Since 2014, a similar contract has been available for trading on an unregistered trading venue that purports to operate under a No-Action Letter that was issued by the Division of Market Oversight in 2014 and granted relief to operate without complying with a number of aspects of the Commodity Exchange Act and Commission Regulations."

133. On Kalshi's competition, see Graubard and Eaddy, hosts, "Jason Trost, Smarkets Founder and CEO"

134. Alexander, "The Passing of PredictIt," Astral Codex Ten, 15 August 2022, <https://astralcodexten.substack.com/p/mantic-monday-81522>; Christopher Brunet, "Kalshi Murders PredictIt," *Karlstack Substack*. 7 August 2022. <https://www.karlstack.com/p/a-textbook-case-of-regulatory-capture>; Chougule, host, "Another CFTC Review of Kalshi's Election Markets"; Chougule, host, "CFTC Makes Its Case Against PredictIt"; Bennett Conlin, "Did Kalshi Kill PredictIt? Friday's Decision On Election Wagering Will Be Revealing," *USBets*, 26 October 2022, <https://www.usbets.com/did-kalshi-kill-predictit/>; Keeney and Chougule, hosts, "How PredictIt Got Knifed"; Keeney and Chougule, hosts, "Yikes! Trump (& PredictIt) Raided By the Feds"; Nuño Sempere, "Forecasting Newsletter: August 2022," *Forecasting Substack*. 10 September 2022. <https://forecasting.substack.com/p/forecasting-newsletter-august-2022>; Twitter post, 5 August 2022, 12:05 AM, <https://twitter.com/mansourtarek/status/1555404658541305856?s=20>. Although we were in close touch with the Kalshi team throughout the course of our study, Kalshi did not respond to our request for comment on the role of the company and its lobbyists and lawyers in the CFTC's enforcement action against Polymarket. Kalshi has likewise consistently refused to respond to questions on these issues from journalists.

135. Sarah Abhishek, Comment for Industry Filing 22-002, CFTC, Comment No. 69607, 29 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69607&SearchText=>; Bryce, Comment for Industry Filing 22-002, CFTC, Comment No: 69611, 30 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69611&SearchText=>; Peter Henderson,

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Of the many factors that help explain why companies have mismanaged the regulatory challenge, one is particularly noteworthy. Executives at the major companies have placed inordinate confidence in Washington-based lawyers and lobbyists.¹³⁶ While we are not entirely privy to the counsel they have received, we believe that the lawyers and lobbyists they retained sold these companies on the idea that they had sway with members of Congress and regulators, that their arguments would be well-received in the current political climate, and that a low-profile, secretive approach would prove the most prudent course of action.¹³⁷

Kalshi's lawyers and lobbyists¹³⁸ facilitated meetings with members of Congress and the CFTC. Between late 2021 and August 2022 alone, Kalshi had some 36 meetings with CFTC commissioners and staff.¹³⁹ However, these meetings not only failed to convince

Comment for Industry Filing 22-002, CFTC, Comment No: 69605, 29 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69605&SearchText=>; Trevor Kelton, Comment for Industry Filing 22-002, CFTC, Comment No: 69630, 31 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69630&SearchText=>; Alan Phillips, Comment for Industry Filing 22-002, CFTC, Comment No: 69598, 29 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69598&SearchText=>; Nathan Prime, Comment for Industry Filing 22-002, CFTC, Comment No: 69599, 29 August 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69599&SearchText=>

136. For discussion on the companies' reliance on lawyers and lobbyists, see Chougule, "7 Thoughts on the CFTC's Polymarket Settlement," *Star Spangled Gamblers*, 3 January 2022, <https://starspangledgamblers.com/2022/01/03/polymarket-cftc-7/>; Chougule, host, "Another CFTC Review of Kalshi's Election Markets; Keeney and Chougule, hosts, "PredictIt CEO: We're Not Quitting"; Keeney and Chougule, hosts, "How PredictIt Got Knifed"; Keeney and Chougule, hosts, "Yikes! Trump (& PredictIt) Raided By the Feds"; Stebbings (host), "Kalshi CEO Tarek Mansour"

137. See for example, Conlin, "Did Kalshi Kill PredictIt? Friday's Decision On Election Wagering Will Be Revealing"; "Gambling on Politics: An Inside Look at the Issue That's Driving the CFTC Crazy," Capitol Account, 20 October 2022, <https://www.capitolaccountdc.com/p/gambling-on-politics-an-inside-look>; Keeney and Chougule, hosts, "PredictIt CEO: We're Not Quitting"; Vaughan and Bain, "A New Prediction Market Lets Investors Bet Big on Almost Anything, 26 May 2022, <https://www.bloomberg.com/news/features/2022-05-26/kalshi-s-stock-market-of-the-world-let-s-you-bet-on-anything>.

138. To date, Kalshi has spent at least \$290,000 on lobbying expenditures. "Client Profile: Kalshi Inc," Open Secrets, <https://www.opensecrets.org/federal-lobbying/clients/summary?cycle=2023&id=D000098069>

139. CFTC, "Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts"

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the agency, they may have contributed to a blowback by the Commission against the political prediction market industry. In a meeting on August 1, 2022 about the Commission's decision to shut down PredictIt, Behnam told Phillips that he's "tired of getting pressure from others who want to do what you do."¹⁴⁰

While failing to achieve their regulatory goals, reliance on these insiders has saddled the political betting industry with allegations of cronyism. These perceptions are fueled by the fact that many of the lawyers and lobbyists for political prediction market companies previously worked in senior roles at the CFTC.¹⁴¹ At a time when CFTC commissioners are facing criticisms that the agency is too indulgent of industry interests, acquiescing to the requests of Kalshi, Polymarket, and PredictIt—all of which retained former CFTC officials—risks inviting further allegations of regulatory capture.

The advice these companies received from their legal and political advisors likely played to the instincts of executives who were prone to misjudging the regulatory landscape and

140. Terris, "This site bet big on political gambling. Regulators want it shut down."

141. See, for example, Abhishek, Comment for Industry Filing 22-002; Brunet, "Kalshi Murders PredictIt"; Bryce, Comment for Industry Filing 22-002; Henderson, Comment for Industry Filing 22-002; David L, Comment for Industry Filing 22-002, CFTC, Comment No: 70744, 29 September 2022, <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70744&SearchText=>. The former CFTC officials include Kalshi Regulatory Strategy lead Jeff Bandman, Kalshi outside counsel Daniel Davis and Jonathan Marcus, Kalshi lobbyist De'Ana Dow, Kalshi Chief Regulatory Office and General Counsel Mishory, Kalshi board member Quintenz, PredictIt adviser Richard Shilts, Polymarket advisory board chairman Christopher Giancarlo, and Polymarket counsel James McDonald. See Letter from Davis, Katten, to Mishory, 31 May 2022, <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexkalshiexhibitsff1221102.pdf>; Letter from Marcus, Reed Smith, to Sebastian Schott, Acting Deputy Director, Product Review Branch Division of Market Oversight Commodity Futures Trading Commission, 25 May 2022, <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexkalshiexhibitsff1221102.pdf>; Kalshi, "Former CFTC Commissioner Brian Quintenz Joins Our Board," Kalshi Learn, 16 November 2021; Sridhar Natarajan, "Crypto Betting Service Polymarket Taps Ex-CFTC Head as Chair After Agency Probe," *Bloomberg*, 19 May 2022, <https://www.bloomberg.com/news/articles/2022-05-19/polymarket-names-cryptodad-board-chair-months-after-cftc-probe#xj4y7vzkg>; Twitter thread, 4 January 2022, 9:17 AM, <https://twitter.com/TradeandMoney/status/1478370047735341056?s=20>; Twitter thread, 19 May 2022, 4:25 PM, https://twitter.com/shayne_coplan/status/1527384974239748097?s=20.

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who showed little interest in leading grassroots advocacy campaigns on behalf of political betting. CFTC commissioners, lawyers, and staff, as an example, made frequent public appearances in forums in which they were available for questions and conversation. These events proved to be among the most insightful sources of information during our study. They provided opportunities for candid, off-the-record exchanges with those close to the decision-making process as well as with those in the policy community and in the public with an interest in the topic. Yet representatives of the companies rarely attended these events. Based on our conversations with executives and lawyers in the space, our impression is that they were too quick to assume that CFTC officials were not engaging transparently and in good faith in their public appearances, and that engagement in these forums was pointless in light of the inside tracks they believed they had.

At the same time, the companies have failed to invest sufficiently in their advocates in the prediction market community. They have provided relatively little support to traders, content creators, and analysts in the prediction market community, even though they have broken news with limited resources, their analyses have proven prophetic, and their advocacy has drawn favorable attention in national media.¹⁴² Company executives are rarely transparent about their regulatory situation. While asking users for information and support, they tend to treat user feedback on regulatory matters as more of a chore to manage than an invaluable resource. What could have been a hand-in-glove partnership between companies and stakeholders in the prediction market space all too often has turned into an acrimonious relationship. Resentments and distrust aired on social media and Discord groups have spilled into the inboxes of reporters and regulators. Company executives have seethed when their users publicly criticized them. User complaints, while sometimes impolitic, have proved prescient in the sense that they foresaw how prediction market companies' ill-fated regulatory approaches would backfire against the entire community.

While companies in the space are taking some encouraging steps to engage the prediction

142. For coverage of the prediction market community, see for example Golden, "The Art of the Pump"; Courtney Rubin, "Inside the wild subculture of traders who bet on elections," *Fast Company*, 7 November 2022, <https://www.fastcompany.com/90796054/inside-the-wild-subculture-of-traders-who-bet-on-elections>; Terris, "This site bet big on political gambling."

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market community, the aforementioned dynamics generally have not changed.

Pathways to Liberalization Before the 2024 Elections

Regardless of how regulations evolve in the space, retail traders will have opportunities of varying legal risk to place bets on political outcomes. Offshore, online betting sites and sportsbooks are increasingly offering political lines that are accessible to Americans.¹⁴³ If political betting continues to be one of the most rapidly growing categories, offshore sites and sportsbooks may emerge as the largest destination for 2024 election bets.

From a public interest perspective, it would be an unfortunate development if retail traders gravitate to offshore books. The business models and incentives of offshore sites make it difficult for them to serve the public interest in ways comparable to prediction markets. Many bookmakers move aggressively to restrict or prohibit gamblers from taking positions on political lines if they appear to have an edge in the market. In this respect, anti-money-laundering, know-your-customer, and other regulations work to the benefit of bookmakers. This is because these regulations give bookmakers the ability to deter traders with a perceived edge from using their sites by burdening them with onerous, intrusive requests to verify their income, identity, and other information. While there are offshore books that are committed to political betting and take high volumes for their political lines such as Star Sports and BetOnline, the tradeoff is often big margins and prices that are considerably different from the ‘crowd wisdom’ in prediction markets. The transparency, liquidity, and community that allow prediction markets to facilitate price discovery, hedging, and other public interest benefits are generally lacking with offshore books.¹⁴⁴

The question facing regulators is not whether Americans will have the ability to bet on

143. Chris Blain, “Political Betting Online: Odds, Elections and Events,” 9 November 2021, <https://www.thesportsgeek.com/political-betting/>

144. For a discussion of the tradeoffs between political lines in sportsbooks and political prediction markets, see Chougule, host, “Is DeSantis Definitely Running for President?”

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politics, but rather, whether prediction markets will be the main outlet for this activity. Liberalization of regulations on political prediction markets before the 2024 elections will likely require either an intervention from Congress or the courts, or unprecedented reforms across state legislatures.

Detailed below are pathways for how this could occur.

Lawsuits

There are several scenarios in which the courts could intervene to liberalize regulations on political prediction markets.

Plaintiffs associated with PredictIt are suing the CFTC, alleging that the Commission's decision to withdraw PredictIt's no-action letter violates the Administrative Procedure Act. Plaintiffs are asking the courts to allow the site to "resolve in an orderly manner" its existing contracts, such as its 2024 presidential election markets. The Fifth Circuit Court of Appeals provided PredictIt with an injunction, allowing the site to continue operating while the appeals process plays out.¹⁴⁵ In February 2023, the Fifth Circuit convened a hearing to assess the case on the merits.¹⁴⁶ Victoria University and Aristotle have requested no-action relief to offer new markets with higher limits. Meanwhile, the CFTC has revoked its 2022 letter that vacated PredictIt's no-action letter. In doing so, the agency filed a motion to render the injunction moot and have the appeal by plaintiffs associated with PredictIt dismissed.¹⁴⁷ On May 1, the Fifth Circuit denied the motion and clarified that the CFTC is enjoined from "closing the PredictIt Market or otherwise prohibiting

145. Bittenbender, "PredictIt Gets Reprieve, for Now, as February 15 Liquidation Deadline Halted," Casino.org, 26 January 2023, <https://www.casino.org/news/predictit-gets-reprieve-for-now-as-feb-15-liquidation-deadline-halted/>

146. Clarke v. CFTR, 22-51124 (5th Cir. 2023), https://www.ca5.uscourts.gov/OralArgRecordings/22/22-51124_2-8-2023.mp3

147. Bittenbender, "CFTC PredictIt Claims Focus on Aristotle-Victoria U. Relationship," Casino.org, 6 March 2023, <https://www.casino.org/news/cftcs-predictit-claims-focus-on-relationship-between-aristotle-and-new-zealand-university/>; Bittenbender, "CFTC Says PredictIt Founder Will Get Fair

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or deterring the trading of Market contracts until 60 days after a final judgment in this matter.”¹⁴⁸ On July 21, the Fifth Circuit ruled that the “CFTC’s rescission of the no-action letter was likely arbitrary” and remanded for the district court to enter a preliminary injunction for PredictIt while considering the case.¹⁴⁹

Although the outcome of the case is uncertain as of this writing, the Fifth Circuit’s order has had important consequences for political prediction markets. PredictIt is adding new names to its contracts on the Republican and Democratic nominees for president in 2024 and now seems to have permission to roll out new markets. The Fifth Circuit’s order may also be deterring the CFTC from a confrontational approach with Kalshi that could lead to litigation. This is because, as Pham notes in her recent dissent, the Fifth Circuit’s order “may prevent the Commission from suspending or prohibiting the listing or trading” of Kalshi’s certified congressional control contracts because PredictIt lists the same contracts.¹⁵⁰

If administrative appeals do not succeed in the courts, PredictIt and its market service provider could consider constitutional challenges. Plaintiffs could argue that political prediction markets constitute protected expression under the First Amendment. This argument has been advanced by legal scholars dating back at least to 2008¹⁵¹ and, argu-

Chance to Refute Allegations Against Exchange,” Casino.org, 24 March 2023, <https://www.casino.org/news/cftc-says-predictit-founder-will-get-fair-opportunity-to-refute-allegations-against-exchange/>; Bittenbender, “CFTC Takes New Direction in Attempt to Shut Down PredictIt,” Casino.org, 3 March 2023, <https://www.casino.org/news/cftc-takes-new-direction-in-attempt-to-shut-down-predictit/>; Bittenbender, “PredictIt Founder Gets More Time to Respond to CFTC Claims as Lawsuit Continues”; Chougule, host, “How to Bet the Trump Indictments + Julie Su’s Confirmation Problems”; Chougule, host, “CFTC Makes Its Case Against PredictIt”; Letter from McGonagle to Hyland, 2 March 2023.

148. Clarke v. CFTR, 22-51124 (5th Cir. 2023), Unpublished Order, 1 May 2023, <https://az620379.vo.msecnd.net/static/files/docs/ecf879d1-e837-4d16-8bf8-492f842c8db8.pdf>

149. Clarke v. CFTR, 22-51124 (5th Cir. 2023), Unpublished Order, 21 June 2023, <https://www.ca5.uscourts.gov/opinions/pub/22/22-51124-CV0.pdf>

150. “Dissenting Statement of Commissioner Caroline D. Pham on Political Event Contracts”

151. Miriam Cherry and Robert L. Rogers. 2008. “Prediction Markets and the First Amendment.” University of Illinois Law Review 3.

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ably, received support in the Supreme Court's recent decision in *Citizens United*, which extended free speech protections to political campaign contributions.¹⁵²

A decision by the CFTC on Kalshi's congressional contracts could also prompt litigation. If the CFTC denies its application, a lawsuit by Kalshi would likely contend, among other things, that the CFTC ruled incorrectly in its Nadex ruling.¹⁵³ If, on the other hand, the CFTC approves Kalshi's contracts, consumer advocacy group Better Markets would contemplate a lawsuit. A lawsuit by Better Markets would likely challenge the hedging and price discovery value of the contracts, claim that they are illegal gaming, and argue that they threaten democracy.¹⁵⁴

An outcome of these lawsuits could be that the courts limit the CFTC's jurisdiction over political event contracts and create a roadmap for how companies can offer election contracts.

While the issue merits further legal analysis, our research indicates that, in the current political environment, regulators would pursue ways to restrict these markets regardless of how the courts rule on the CFTC's powers. This is especially true if, as a consequence of these legal challenges, election markets fall under the jurisdictions of even more heavy-handed regulators than the CFTC.¹⁵⁵

152. Nico Perrino, host, "Eugene Volokh and new frontiers in the First Amendment," So to Speak: The Free Speech Podcast (podcast), 18 May 2017, <https://www.thefire.org/news/so-speak-podcast-eugene-volokh-and-new-frontiers-first-amendment>; Sia, Comment for Industry Filing 22-002

153. Harty, "Political betting"; Paul Kiernan, "Betting on Elections Could Return to U.S. in Time for Midterms, if Regulators Approve," *Wall Street Journal*, 26 October 2022, <https://www.wsj.com/articles/regulators-weigh-whether-to-allow-betting-on-midterms-11666782001>; "Republican Congressional Takeover May Spur Biden's Regulators to Move Even Faster," *Capital Account*, 7 November 2022, <https://www.capitolaccountdc.com/p/republican-congressional-takeover>

154. Harty, "Political betting"

155. On the CFTC's jurisdiction over event contracts, see CFTC, Concept Release on the Appropriate Regulatory Treatment of Event Contracts," 73 Fed. Reg. 25,669 (2008), <http://www.cftc.gov/law-and-regulation/federalregister/proposedrules/2008/e8-9981.html>; Federal Register Comment File: 08-004, <https://www.cftc.gov/LawRegulation/PublicComments/08-004.html>; Letter from Erik Sirri, Division of Trading and Markets, Securities and Exchange Commission to David Stawick, Secretary,

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CFTC Review

In January 2023, the Office of Information and Regulatory Affairs released the Fall 2022 Unified Agenda of Regulatory and Deregulatory actions. Among the contributions related to the CFTC is a notice that the CFTC staff “expects to recommend that the Commission propose amendments on the regulation of event contracts under Regulation 40.11.”¹⁵⁶ In the context of the Unified Agenda’s relation to event contracts, Behnam publicly announced that the agency would “tackle this issue and get a little more prescriptive in terms of clarity about what contracts can be listed and what contracts can’t be listed.”¹⁵⁷

The contracts Kalshi self-certified in June 2023 have meaningful differences from the ones it proposed in 2022. The contracts have different position limits for individuals, entities, and eligible contract participants, and permit higher limits for those with a “demonstrated established economic hedging need.” Traders would only be permitted to purchase these contracts in multiples of 5,000 at a time. Nine categories of political insiders are prohibited from trading, including pollsters and Congressional and campaign staff.¹⁵⁸ According to Mansour, the “analysis and framework” of its revised Congressional contracts are informed by the Commission’s “feedback” and its “willingness to engage on what are perceived to be difficult issues,” as well as the “valuable information that the public provided during the comment period.”¹⁵⁹

CFTC, 3 September 2008, <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/frcomment/08-004c028.pdf>; Sullivan & Cromwell LLP, “Event Contract Markets,” 9 May 2008

156. <https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202210&RIN=3038-AF14>

157. Brummer, “DC Fintech Week 2022,” 3:23:05-3:23:17

158. Lydia Beyoud, “Hedge Funds Could Bet \$100 Million on US Election in Kalshi Plan,” *Bloomberg*, 16 June 2023, <https://www.bloomberg.com/news/articles/2023-06-16/hedge-funds-could-bet-100-million-on-us-election-in-kaishi-plan>; Bransfield, “CFTC Kalshi Cheat Sheet”; Bransfield, Comment for Industry Filing 23-01, Comment No: 71115, 23 June 2023, <https://comments.cftc.gov/Public-Comments/ViewComment.aspx?id=71115&SearchText=>; Chougule, host, “Another CFTC Review of Kalshi’s Election Markets”; Harty, “Kalshi makes new play for big investors to wager on U.S. elections”; Letter from Sottile to Secretary of the Commission.

159. Beyoud, “Hedge Funds Could Bet \$100 Million on US Election in Kalshi Plan”; Harty, “Kalshi makes new play for big investors to wager on U.S. elections”

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How the CFTC's review will impact the regulatory landscape remains unclear as of this writing. On the one hand, CFTC staff appear to be receptive to engagement on the issue. CFTC staff have proposed the idea of convening public roundtables about election event contracts, reportedly after being influenced by the advocacy campaigns of retail traders and others who weighed in on Kalshi's behalf.¹⁶⁰ Consistent with these reports, Behnam stated in a May 2023 podcast that the Commission "has to dig in and get stakeholder input" on political event contracts.¹⁶¹ Some of the 24 questions the CFTC has put forward for public comment have not been raised in previous comment periods and speak to genuine dilemmas weighing on the Commissioners and staff. Examples include questions related to the enforceability of position limits, price forming information in election contracts, and the Commission's role in cases of suspected market manipulation.¹⁶² The current 90-day review may mark a step forward in a path that leads to a rulemaking process on event contracts.

On the other hand, if the current CFTC leadership's actions to date are any indication, the agency's willingness to deliberate on the issue is little guarantee that it will ultimately be disposed toward political event contracts or inclined to spend political capital to ease regulations in this space.¹⁶³ In her dissent, Mersinger raises the possibility that the actual purpose of the 90-day review "may be simply to give those opposed to the contracts a second chance to make their case" and "to suggest additional grounds of attack for commenters opposed to the contracts."¹⁶⁴ Mersinger also notes that the review is effectively a

160. "CFTC Looks to Soften the Blow From Its Coming Rejection of Political Betting," *Capitol Account*, 31 October 2022, <https://www.capitolaccountdc.com/p/cftc-looks-to-soften-the-blow-from>.

161. Weisenthal and Alloway, hosts, "CFTC Chair Rostin Behnam on the Fight to Regulate Crypto"

162. Question on the KalshiEx, LLC Congressional Control Contracts, available at CFTC Release Number 8728-23

163. For further discussion on the regulation of political event contracts by the CFTC, see Chougule, host, "How to Bet the Trump Indictments + Julie Su's Confirmation Problems"; Chougule, host, "CFTC Makes Its Case Against PredictIt," Chougule, host, "Did Kalshi Kill PredictIt and Polymarket?"; Chougule, host, "PredictIt Survives for Now and Brian Golden's Perfect Midterm Picks," *Star Spangled Gamblers* (podcast), 1 February 2023, <https://starspangledgamblers.com/2023/02/01/predictit-survives-for-now-and-brian-goldens-perfect-midterm-picks/>

164. "Dissenting Statement of Commissioner Summer K. Mersinger Regarding Commencement of 90-Day Review Regarding Certified Derivatives Contracts with Respect to Political Control of the U.S. Senate and House of Representatives"

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substitute from a rulemaking process that would “build a foundation for evaluating event contracts.”¹⁶⁵ In Mersinger’s view, the “unmistakable take-away for DCMS” in the absence of a rulemaking process, “is not to expend resources developing innovative event contracts because the Commission may randomly subject them to a public interest analysis without providing any certainty as to the definitions and standards it will apply in doing so.”¹⁶⁶

Congress

Congress could pass legislation clarifying its position on prediction markets. The most likely opportunity for Congress to act will be in 2023 as part of its deliberations on digital asset regulation. A more permanent, though highly improbable, legislative solution would involve repeals of pertinent aspects of the Federal Wire Act, Unlawful Internet Gaming Enforcement Act, Dodd-Frank Act, and Commodity Exchange Act.

Particularly in light of the FTX fallout, we see little incentive for members of Congress to complicate legislation on digital asset regulation and other pressing issues for the sake of a contentious debate over political betting markets. These markets generate a relatively miniscule amount of economic activity, campaign contributions, and lobbying pressure when compared to other industries. Kalshi appears not to be making a strong lobbying push in this respect, as it was previously considering, and the grassroots activism that currently exists on behalf of prediction markets is likely insufficient to overcome inertia in Congress.

Insofar as there is appetite on Capitol Hill to act on this issue in the new Congress, we believe that the initiative would need to come from the House and Senate Agriculture Committees as well as from Massachusetts Senator Elizabeth Warren given her clout in the Biden administration and the Democratic Party on related issues. Kalshi’s advocacy as well as the comments that were submitted on behalf of its proposed contracts appear

165. *Ibid*

166. *Ibid*

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to have overcome some doubts among Agriculture Committee members and staff about the wisdom of approving congressional control markets. The possibility, however, that Senator Warren will publicly denounce political event contracts is among the factors that creates political risk around any effort to advocate for liberalization of the space. The extent to which the Biden administration has been influenced by Senator Warren and her office on issues related to financial regulation, consumer protection, and executive branch appointments suggests that her position on political event contracts could prove consequential during this presidency.¹⁶⁷ Short of a legislative fix, members of the Agriculture committees and other influential members of Congress could pressure the CFTC to liberalize regulations on political event contracts through the leverage they enjoy via their oversight, appropriations, and confirmation powers.

The States

Initiatives at the state level could introduce political betting within certain areas of the country. This effort would require legislative action to revisit laws and norms against election betting, which, in some cases, date back to the 19th century. It would also require a baseline level of support from important political actors such as state attorneys general, secretaries of state, gaming boards, and lottery commissions.

Recent attempts to offer election betting in West Virginia provides a case study on the challenges at the state level. In 2020, West Virginia was poised to become the first state to allow betting on U.S. elections when the state's lottery commission allowed FanDuel to post odds on the presidential election. Fifteen minutes later, the West Virginia Lottery

167. On Warren's influence in the Biden administration, see Perry Bacon, "Joe Biden is in the Oval Office. So are Elizabeth Warren's ideas." *The Washington Post*, 29 December 2022, <https://www.washingtonpost.com/opinions/2022/12/29/elizabeth-warren-ideas-biden-presidency/>; Jess Bidgood, "Elizabeth Warren's influence in Washington rises as allies take Biden administration posts," *Boston Globe*, 6 February 2021; Kara Voght, "How Elizabeth Warren's Acolytes Infiltrated Biden-world," *Mother Jones*, 11 March 2021, <https://www.motherjones.com/politics/2021/03/how-elizabeth-warrens-acolytes-infiltrated-bidenworld/>; Zachary Warmbrodt, "'Most influential voice': Warren's network spreads throughout Biden administration," *Politico*, 15 March 2021, <https://www.politico.com/news/2021/03/15/elizabeth-warren-aides-biden-administration-475653>

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suspended its approval. Realizing that reports of legalized election betting were more than a “joke”, Governor Jim Justice lambasted the decision as “humorous” but “absolutely ridiculous.” Lingering hopes were quashed when the Secretary of State issued a statement that betting on presidential elections would violate state law dating back to 1868. “Gambling on the outcome of an election,” the statement added, “has no place in our American democracy. Not today. Not tomorrow. Not ever. This is a terrible idea.”¹⁶⁸ Rather than challenging state officials, the West Virginia Lottery Director apologized for the “mistake,” asserting that he lacked the “authority” to approve the betting line.¹⁶⁹

Non-Enforcement

Although incumbents in the political prediction market space have been stymied by regulators, entrepreneurs are innovating faster than law enforcement and tax bureaucracies can respond. They are seeking new jurisdictions, not only offshore, but in areas that present novel legal questions such as internet sites with a physical presence on Indian reservations.¹⁷⁰ They are facilitating political bets through creative legal structures, such as the over-the-counter swaps offered by the American Civics Exchange. Meanwhile, the increasing cohesiveness of the political betting community allows traders to place side bets with each other with ease. These bets are often publicized on social media.¹⁷¹ The govern-

168. “‘Are You Kidding Me?’: Presidential Betting Gets Axed Fast In West Virginia Katherine Sayre,” *CBS News Pittsburgh*, 8 April 2020, <https://www.cbsnews.com/pittsburgh/news/presidential-betting-gets-axed-fast-in-west-virginia/>; “West Virginia Approves, Then Disapproves, Betting on Elections,” *Wall Street Journal*, 8 April 2020, <https://www.wsj.com/articles/west-virginia-approves-then-disapproves-betting-on-elections-11586384497>

169. David Li, “West Virginia became the first state to offer bets on politics - then quickly retreated,” *NBC News*, 8 April 2020, <https://www.nbcnews.com/news/us-news/west-virginia-became-first-state-offer-bets-politics-then-quickly-n1179391>

170. An intriguing possibility is that a prediction market could be created in the Catawba Digital Economic Zone, which would raise interesting questions about the jurisdiction of the CFTC. See Tom W. Bell, *The Catawba Digital Economic Zone: A Native American SEZ* (August 21, 2022). 3 J. Special Jurisdictions 25 (2022), Available at SSRN: <https://ssrn.com/abstract=4283973>

171. Chougule, host, “DeSantis’s Weirdness and Why He’s Overpriced,” *Star Spangled Gamblers* (podcast), 10 June 2023, <https://starspangledgamblers.com/2023/06/10/desantiss-weirdness-and-why-hes-overpriced/>; Chougule, host, “Trump Nicknames for DeSantis,” *Star Spangled Gamblers* (podcast), 30 June 2023, <https://starspangledgamblers.libsyn.com/trump-nicknames-for-desantis>

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ment has shown little inclination to crack down against retail traders who are using VPNs to trade in offshore political prediction markets like Polymarket and Insight Prediction. Political prediction markets with a diversity of contracts could become an accepted fact of life, notwithstanding formal legal regimes, if governments prove incapable or unwilling to take enforcement actions in this space.¹⁷²

Recommendations on the Long Game

Liberalizing regulations on political prediction markets in the United States and creating regulatory certainty in the space, in all likelihood, will require a long, uncertain, and potentially expensive campaign. Achieving this goal by the 2026 midterm elections could be a reasonable target, but it also could take considerably longer depending on an array of factors.

Below are areas we suggest prioritizing for those who are committed to the challenge.

Contribute to CFTC Public Comment Periods

In the current regulatory framework, the CFTC is the agency best-situated to liberalize regulations on political prediction markets. Public comment periods commenced by the CFTC on event contracts, gaming, and related issues provide opportunities to deliver arguments on behalf of political betting markets directly to the most powerful regulators with jurisdiction over the issue. CFTC comment periods are the rare occasions on which senior officials in the U.S. government dedicate time and resources to engage on this issue, which is typically niche and rarely breaks into the news cycle. That the CFTC is staffed disproportionately by lawyers helps ensure that even long, complex comments are considered by government officials who have the training and inclination to engage complicated issues deliberately. The questions on which the CFTC seeks public comment are highly specific and indicative of the concerns weighing on regulators—concerns that,

172. Crawley, host, “How to Trade Prediction Markets and Fade Political Hype”

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otherwise, are often not publicized.

Even during periods when the CFTC leadership is inclined toward inaction, the process of submitting comments contributes to the long-term effort to liberalize regulations. Formulating responses to the CFTC's questions spurs dialogue and collaboration, which leads the political betting community to refine arguments and explore areas of both consensus and disagreement. The comments generate earned media. And in the absence of clear polling and other metrics, the quantity, quality, and sources of the comments are treated as a barometer of public sentiment on the issue.

The totality of public comments submitted to the CFTC on event contracts, notably in 2008 and 2022, are arguably among the most influential body of work that the political betting community has produced for the direct consumption of regulators. As seen by Mersinger's June 2023 dissent, the comments are already generating momentum for a rulemaking process that could legalize political event contracts with more regulatory certainty.

Pursue Freedom of Information Act (FOIA) Requests and Litigation

A small number of bureaucrats with limited democratic accountability play an outsized role in shaping regulation in this space. Recent history has shown that prediction market companies tend to try to influence them quietly and outside the public eye, even when this is not the most promising approach. In their correspondence to the CFTC, for example, attorneys for both Kalshi and Aristotle have requested FOIA confidential treatment.¹⁷³ Understanding the dynamics that are influencing regulation of this area will require the prediction market community to have greater insight into these deliberations. Previous FOIA requests have led to the release of the Iowa Electronic Markets no-action letters

173. Paul Architzel to Assistant Secretary of the CFTC for FOIA Matters, 29 July 2021, <https://www.cftc.gov/sites/default/files/filings/documents/2022/orgarstAppConfPetReg220223.pdf>; Keeney and Chougule, hosts, "How PredictIt Got Knifed"; Mishory to Assistant Secretary of the Commission for FOI, Privacy and Sunshine Acts Compliance, U.S. Commodity Futures Trading Commission, <https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm002.pdf>

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from the CFTC, Kalshi's DCM application, and Victoria University's correspondence with the CFTC related to PredictIt.¹⁷⁴ Unredacted documents related to the CFTC decision-making process on PredictIt, Polymarket, and Kalshi would be particularly illuminating for today's debates. FOIA requests are a promising route to acquiring these documents, but meaningful disclosure could entail litigation.

Invest in New Prediction Market Platforms

To realize the public interest potential of political prediction markets, we believe that platforms will need to solve five main challenges:

- Manage regulation
- Build reliable technology with appealing products
- Keep fees low and competitive
- Offer meaningful lines with sufficient liquidity
- Cultivate community

No company, university, or non-profit in recent decades has achieved all five.

The suboptimal business decisions that PredictIt, Polymarket, and Kalshi have made, in our assessment, may have stemmed from the fact that they lacked competitive pressure in the market. Each company, in different ways, tried to gain first mover advantage among a small pool of competitors in an uncertain regulatory environment. Their strategies were understandable but proved imprudent. Greater competition will allow for more innovation in all respects, including in the management of political and legal risk. If the number of market participants with a diverse array of legal structures grows beyond a certain point, enforcement actions in the space will test the limits of regulator capabilities. Greater competition from platforms with different models may also, in the aggregate, help realize

174. CFTC, "Kalshi DCM Application"; CFTC, "Material Released Pursuant to FOIA Requests Which has Been, or is Likely to Be, the Subject of Future FOIA Requests," https://www.cftc.gov/foia/repfoia/foirf05-003_1.htm; CFTC, "Request for No-Action by Victoria University of Wellington," File Number: 21-00011, https://www.cftc.gov/FOI/foia_freqrequestinfo.html; CFTC, "Victoria University Communications," File Number: 19-00088, https://www.cftc.gov/FOI/foia_freqrequestinfo.html;

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public interest goals in ways that no individual platform can reasonably do so.¹⁷⁵

Support Content Creators

Considering the limited resources at their disposal, content creators in the political betting space have made remarkable gains in helping the community realize its own potential. They have organized the political betting community, broken news, shared information, generated earned media, filed lawsuits, and improved the quality of forecasts emerging from traders.¹⁷⁶ Even as political betting analysis breaks into the mainstream discourse, the day-to-day coverage content creators in the space provide is unlikely to be matched by those outside the community who are not wagering their own money, who are guided by myriad incentives, and who possess limited forecasting skills and relevant expertise. As of now, the most prominent media assets in the political prediction markets space have garnered loyal followings but have not grown enough to conduct a meaningful degree of field research, polling, or investigative journalism. This in turn has limited their revenues and political clout.

It would be worth exploring how to increase the number, quality, and reach of content creators in the political betting community. The community is a diverse ecosystem that includes traders, platform operators, researchers, and forecasters. There is ample opportunity to increase cohesiveness of the community and its ability to share and disseminate information.

175. On the potential fragmentation of political prediction markets, see Eaddy and Graubard, hosts, "Jason Trost, Smarkets Founder and CEO"

176. See for example Richard Hanania, "Why I'm Suing the Federal Government over PredictIt," *Richard Hanania's Newsletter. Substack*, 28 September 2022, <https://www.richardhanania.com/p/why-im-suing-the-federal-government>; Keendawg, "URGENT: Tell the CFTC Why Elections Matter," *Star Spangled Gamblers*, 29 August 2022, <https://starspangledgamblers.com/2022/08/29/urgent-tell-the-cftc-why-elections-matter> (Keeney, who was the editor of *Star Spangled Gamblers* in 2022, estimates that the *Star Spangled Gamblers* podcast and blog alone led to the submission of close to 1,000 comments to the CFTC through the Save PredictIt campaign.); Twitter post, 18 May 2023, 3:36 PM, <https://twitter.com/ManifoldMarkets/status/1659281738726555649?s=20>; vandemonian, "The Base Rate Times, news through prediction markets," *LessWrong*, 6 June 2023, <https://www.lesswrong.com/posts/DfQ3Ls45WnYuguqfc/the-base-rate-times-news-through-prediction-markets>.

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Sponsor Research on the Regulation of Prediction Markets

Although data from PredictIt has furthered academic research on political prediction markets,¹⁷⁷ the novel dilemmas associated with the regulation of political prediction markets remains an understudied area. Research and polling on key questions in this space would give the prediction market community greater insights and guidance on how to influence the political process.

Below is a research agenda we recommend prioritizing:

Public Opinion: Why has American public opinion remained resistant to the liberalization of political prediction markets even as legalized gaming is expanding in other areas? Why is betting on politics often regarded as unseemly? What are the similarities and differences in American public attitudes compared to those in other countries like the UK, which have more permissive regulatory regimes? What is the source of perceptions that political prediction markets impact the integrity of elections? Do concerns about political prediction markets differ meaningfully at the federal and state levels?

Legal and Regulatory Reform: What factors influence the ways Congress, the CFTC, and the states approach the issue of political prediction markets? What legal strategies stand the greatest chance of moving the debate forward? Is there a First Amendment or other constitutional challenge that stands a reasonable chance of inviting judicial intervention on behalf of political prediction markets? What can be done to ensure that individuals and movements friendly to political prediction markets are represented in key regulatory bodies? Are there regulatory reforms that would lend themselves to better regulation of prediction markets? Are there jurisdictions that should be explored as safe harbors for political prediction markets?

Economic Purpose: How can political prediction markets be used more widely for their

177. Letter from Nightingale and Barker to McGonagle, 6 April 2023; "Research Opportunities," PredictIt, <https://www.predictit.org/research>

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price discovery and hedging functions? What prevents traders and other market participants, even in highly liquid markets, from using political prediction markets to hedge risk? Can political prediction markets be designed so that political event contracts play more of a role in price-basing for commercial transactions? Can political prediction markets be created that clearly meet the CFTC's economic purpose test by enabling price discovery and hedging in the manner of a traditional derivatives market? To what extent is it inevitable that retail speculation comprises the overwhelming percentage of market activity in political prediction markets?

Prediction Market Community: Who trades in prediction markets? Who uses insights from these markets? Who researches them? What motivates these groups? Where do they organize? What impact have they had on the regulation of political prediction markets?

It is critical that these studies involve a broad array of researchers who can disseminate findings to stakeholders across the policy community. Cutting-edge research from the academic community has not fully penetrated the political discourse, which may account for why regulators still have a limited understanding of these markets' impact on the public interest. Part of the solution may involve partnerships between academics and think-tanks, advocacy groups, and content creators who are better situated than academics in shaping the political discourse.

Engage in Political Campaigns

The political prediction market space needs elected officials at the federal and state levels who believe in this cause enough to spend time, resources, and political capital on the issue without the promise of electoral benefits. A PAC and other vehicles would need to be established and funded to recruit like-minded candidates, brief them, and provide them with the support they need to get elected. Priority should be placed on electing a U.S. president and House and Senate Agriculture committee members who will appoint and confirm executive branch officials with a mandate to liberalize regulations on political betting.

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About the Authors

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Pratik Chougule is the Executive Director of the Coalition on Political Forecasting. He has been involved with political betting for more than twenty years as a trader, political analyst, and content creator. He is the host of *Star Spangled Gamblers*, a podcast focused on political betting. His commentary and analysis on political prediction markets has appeared in a variety of publications including *Forbes*, *The Washington Post*, and *Vice News*. Chougule was previously a consultant for Insight Prediction. He graduated Phi Beta Kappa from Brown University and holds a J.D. from Yale Law School. Chougule is an ‘Oracle’ on PredictIt, the highest echelon of trader on the site.

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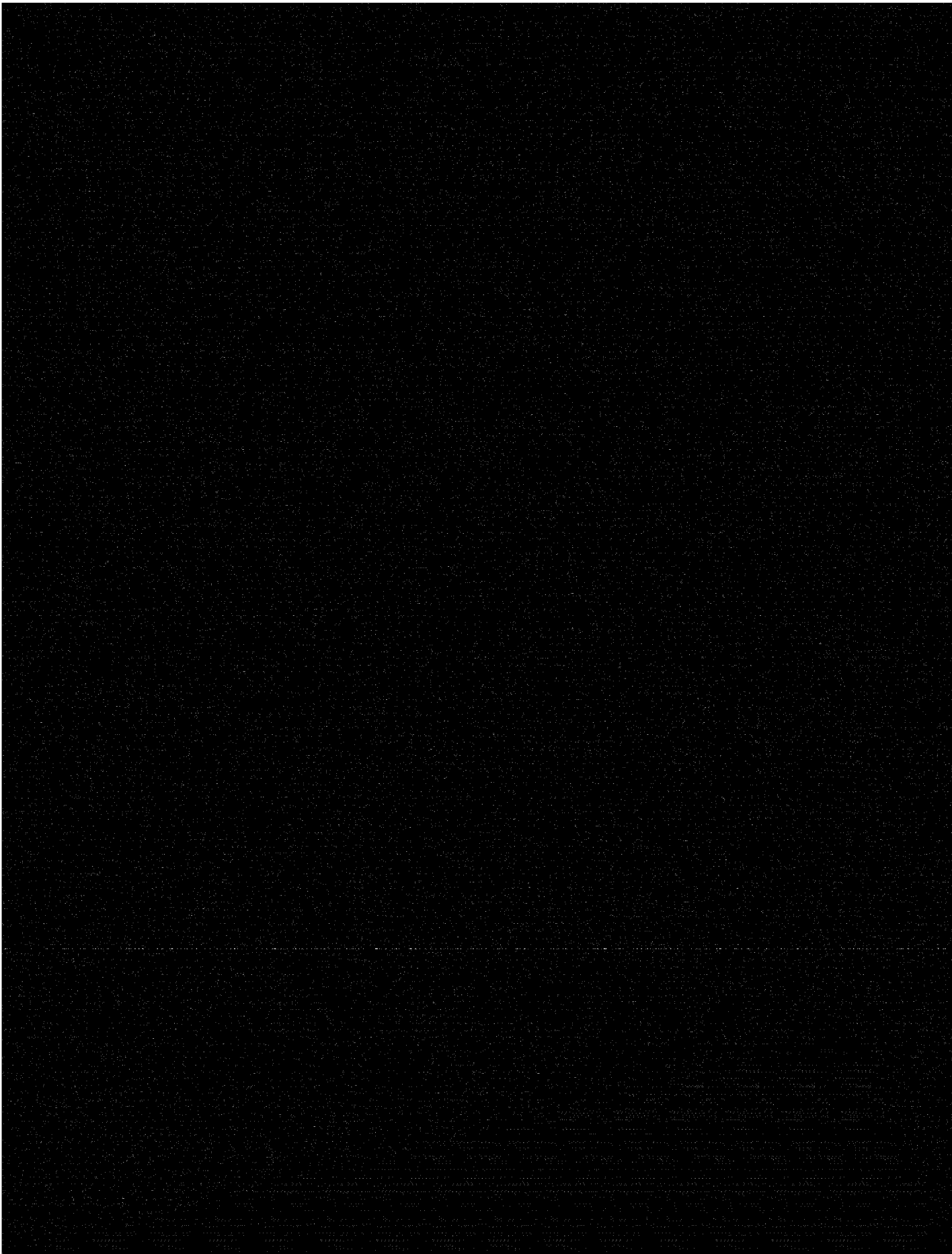
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In the course of our research and advocacy, we conducted interviews with more than forty experts on political betting and prediction markets. These include regulators, academics, lawyers, industry executives, retail traders, and content creators in the space. Although many agreed to speak with us only on background or in informal settings, we are able to acknowledge several individuals for their insights. They include: Michael Abramowicz, Tom W. Bell, Harry Crane, James Grugett, Stephen Grugett, Alex Keeney, Paul Krishnamurthy, Sean McElwee, Flip Pidot, Nuño Sempere, Koleman Strumpf, Tyler Whitmer, Peter Wildeford, and John Williams.

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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/opabchnam26>.

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/ptc082422kexdem001.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).

³⁷ 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

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.”).

³⁸ 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 . . .”).

‘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

⁴⁴ 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.").

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.

⁴⁷ 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).

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=krmct>.

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 iPredict'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."^{102,103} 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.”

¹⁰⁶ Robin Hanson and Ryan Oprea. 2008. “A Manipulator Can Aid Prediction Market Accuracy.” *Economica*.

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

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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 iPredict'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.

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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.

¹²⁸ Philip Tetlock. "Expert Political Judgment". 2005.

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.

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.¹³⁰ 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.

¹²⁹ *Ibid*

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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.cfte.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 Zitowitz (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 Zitowitz 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*

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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.

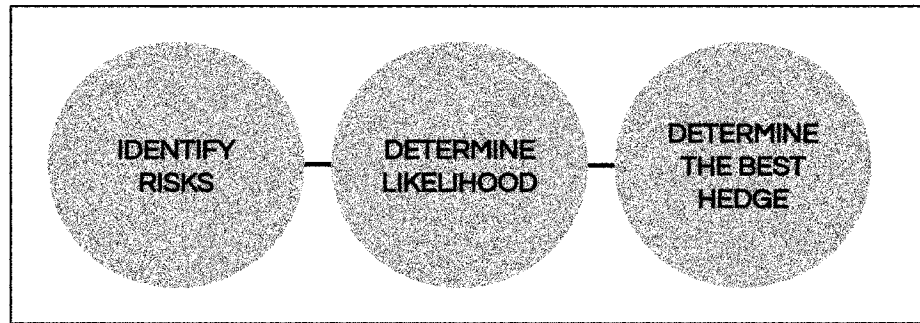
A. General risk management

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

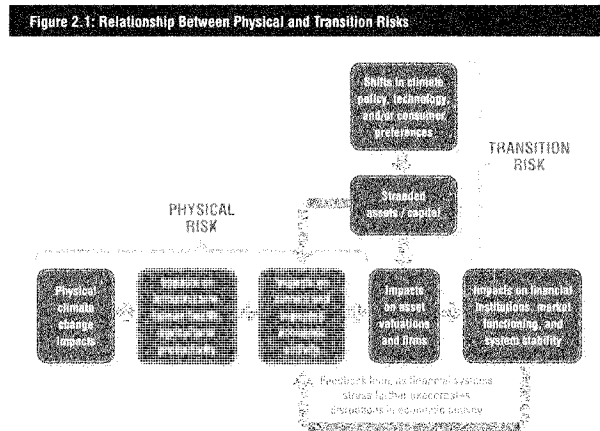
² Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System". <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

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 cyclical, 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 Hehmyer, 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.

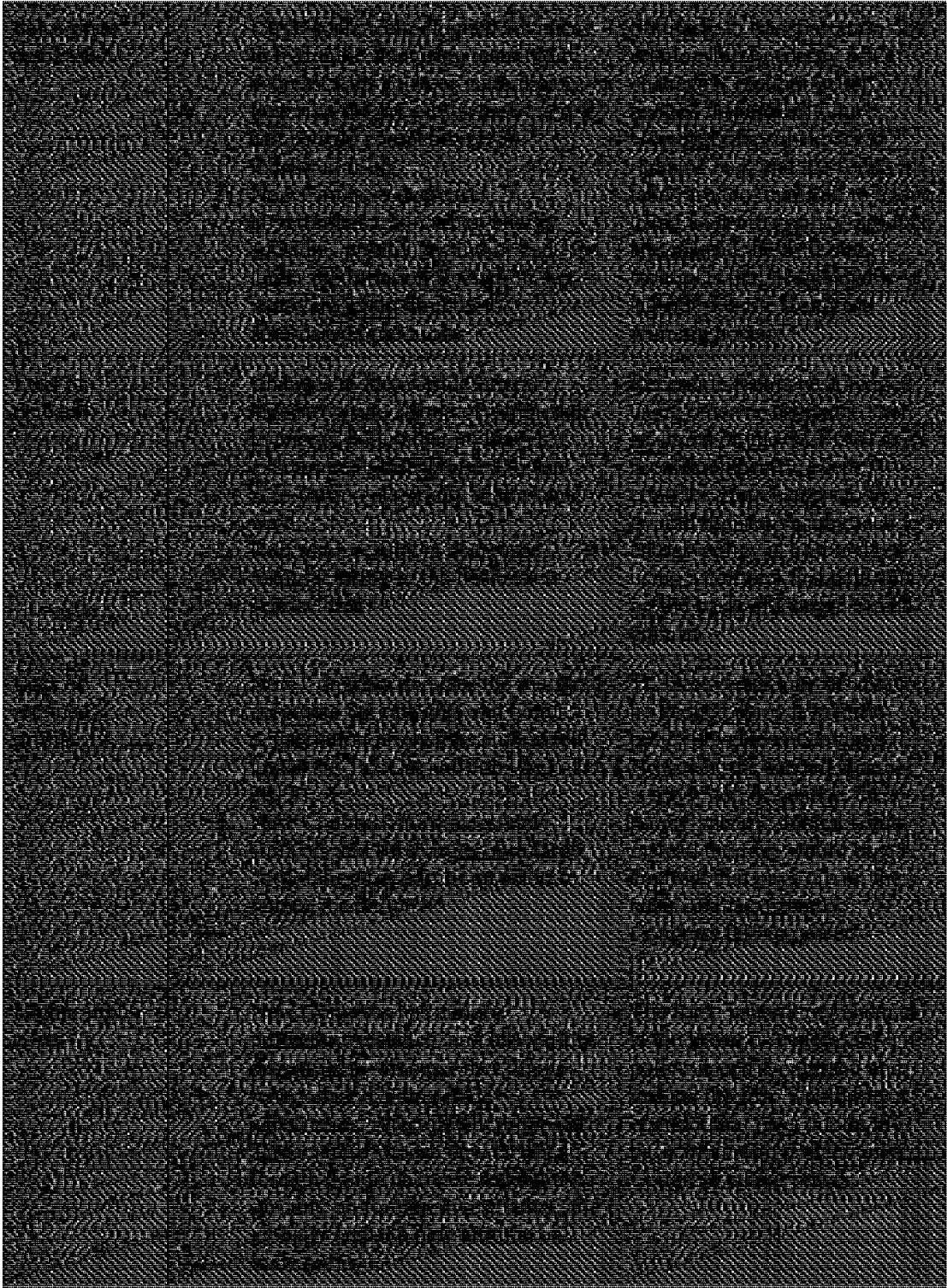
The chart below summarizes this process. [REDACTED] indicate risks that can be mitigated using the CONTROL contract, whereas magenta-colored rows indicate risks that would not be hedged by the CONTROL contract.

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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Loss of expansion opportunities	<ol style="list-style-type: none"> Judicial action strikes down modifications to state-level permitting law reforms, thereby allowing frequent NEPA litigation over site development 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"> 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.

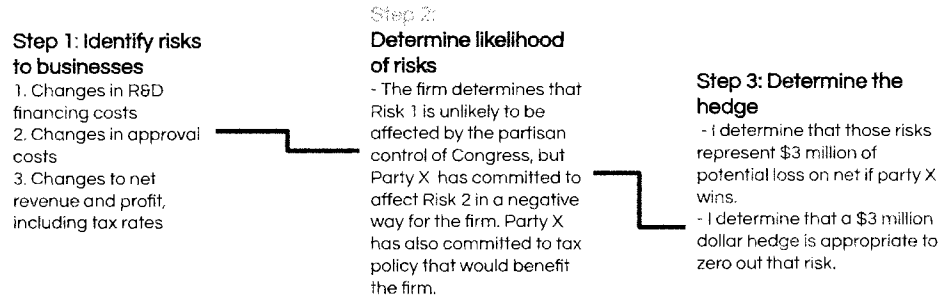
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How hedging political risk works

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Example of how a lab-developed test company will hedge



Hedging example ECP (cont.)

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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/ericzitzewitzltr0203i2.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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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 Kolemman 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=kmmet>.

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/iftdocs/ericzitzewitzltr020312.pdf>.

⁹ See public comments 70761, 69708, and 69735.

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 valued, 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 Allenworth, 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.cfc.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.^{24,25,26} 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.efic.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.efic.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 Heilmeyer 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>

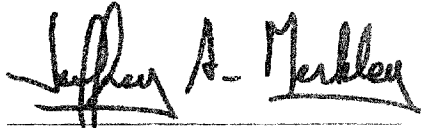
² 17 CFR § 40.11

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.

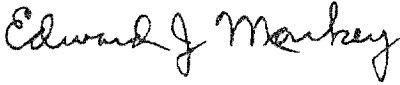
Sincerely,



Jeffrey A. Merkley
United States Senator



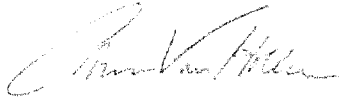
Sheldon Whitehouse
United States Senator



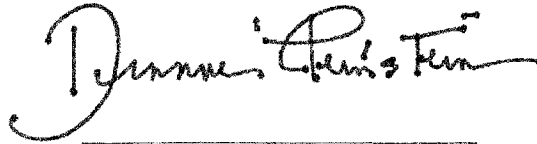
Edward J. Markey
United States Senator



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

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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.¹⁸¹⁹²⁰²¹²²²³²⁴²⁵

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/WI106_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:

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

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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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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.⁶⁶⁶⁷ 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/bills/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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Sebastian,
Apologies for the delay in responding to your email yesterday! We submitted the political control contract this morning under Commission Regulation 40.3, *Voluntary submission of new products for Commission review and approval*. If you have any questions or would like to discuss, please feel free to call me on my cell phone at any time. (443) 839-3192. Thank you again for all the engagement that you have given us on these issues; I really appreciate it!!

I thought it might be convenient for you to have the contract in a single document that includes internal links from the index for easier navigation. Because of the way the portal is set up, I couldn't submit this there, so I'm just emailing it here in case it's useful to you.

Warmly,
Elie

p.s. KalshiEX LLC requests FOIA confidential treatment for this email and the attachments, as noted in detail on the attached letter.

KalshiEX LLC

7/19/2022

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: KalshiEX LLC - Commission Regulation 40.3(a), *Voluntary submission of new products for Commission review and approval*, regarding the “Will <party> be in control of the <chamber of Congress>?” Contract

Dear Sir or Madam,

Pursuant to Section 5c(e) of the Commodity Exchange Act and Rule 40.3(a) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi or Exchange) hereby voluntarily submits the new “Will <party> be in control of the <chamber of Congress>?” contract (Contract) for Commission review and approval. The Exchange intends to list the contract on a biannual basis (every two years). The Contract’s terms and conditions (Appendix A) include the following strike conditions:

- <party> (the political party)
- <chamber of Congress> (the House or the Senate)
- <term> (e.g. the 118th Congress)

Along with this letter, Kalshi submits the following documents:

- A concise explanation, analysis and background of the Contract;
- Certification;
- Appendix A with the Contract’s Terms and Conditions;
- Confidential Appendices with further information; and
- A request for FOIA confidential treatment.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

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KalshiEX LLC
 Official Product Name: Will <party> be in control of the <chamber of Congress>?
 Rulebook: CONGRESS
 Kalshi Contract Category: Political Decision
 Control of Congress
 7/19/2022

CONCISE EXPLANATION AND ANALYSIS OF THE PRODUCT AND ITS COMPLIANCE WITH APPLICABLE PROVISIONS OF THE ACT, INCLUDING CORE PRINCIPLES AND THE COMMISSION'S REGULATIONS THEREUNDER

Pursuant to Commission Regulation 40.3(a)(4), the following is a concise explanation and analysis of the product and its compliance with the Act, including the relevant Core Principles, and the Commission’s regulations thereunder.

I. Introduction

The “Will <party> win <chamber of Congress>?” Contract (Contract) is a contract relating to the partisan control of Congress.

Contracts on political control of Congress available to US participants have been trading for nearly a decade. Since 2014, a similar contract has been available for trading on an unregistered trading venue that purports to operate under a No-Action Letter that was issued by the Division of Market Oversight in 2014 and granted relief to operate without complying with a number of aspects of the Commodity Exchange Act and Commission Regulations.

The Exchange is proposing to bring such contracts onto a fully regulated exchange operating under the core principles applicable to a DCM, with participant funds safeguarded at a DCO operating under the core principles applicable to a DCO. The Exchange believes it is time to offer these widely used but unregulated contracts on a fully regulated basis so that U.S. persons can hedge risks arising from political control on a market with robust safeguards and transparency.

In the 2018 cycle, the following contracts were traded, and had the following number of contracts traded¹, as stated by that unregistered trading venue:

● Control of the Senate	1,600,000 contracts traded
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¹ The volume numbers in the following tables are rounded.

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<ul style="list-style-type: none"> Control of the House 	4,600,000 contracts traded
<ul style="list-style-type: none"> Control of Congress 	2,900,000 contracts traded
<ul style="list-style-type: none"> Number of Republican seats in the Senate 	19,400,000 contracts traded
<ul style="list-style-type: none"> Number of Republican seats in the House 	8,100,000 contracts traded
<ul style="list-style-type: none"> Number of Democrat seats in the House 	6,300,000 contracts traded

In the 2020 cycle, the following contracts were traded, and had the following volume, as stated by that unregistered trading venue:

<ul style="list-style-type: none"> Control of the Senate 	13,800,000 contracts traded
<ul style="list-style-type: none"> Control of the House 	7,500,000 contracts traded
<ul style="list-style-type: none"> Control of Congress 	29,200,000 contracts traded
<ul style="list-style-type: none"> Number of Democrat seats in the House 	6,300,000 contracts traded

For the current cycle, the following contracts are trading, and had the following volume, as stated by that unregistered trading venue on July 19, 2022:

<ul style="list-style-type: none"> Control of the Senate 	1,300,000 contracts traded
<ul style="list-style-type: none"> Control of the House 	1,800,000 contracts traded
<ul style="list-style-type: none"> Control of Congress 	2,400,000 contracts traded
<ul style="list-style-type: none"> Senate Majority Leader 	183,000 contracts traded
<ul style="list-style-type: none"> Speaker of the House 	2,500,000 contracts traded

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<ul style="list-style-type: none"> • Number of Republican seats in the Senate 	1,700,000 contracts traded
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In total, approximately 110,000,000 contracts have traded on political control on this unregistered trading venue² since the 2018 cycle.

General Contract Terms and Conditions: The Contract operates similar to other event contracts that the Exchange lists for trading. The minimum price fluctuation is \$0.01 (one cent). Price bands will apply so that Contracts may only be listed at values of at least \$0.01 and at most \$0.99. The Contract is sized with a one-dollar notional value and has a minimum price fluctuation of \$0.01 to enable Members to match the size of the contracts purchased to their economic risks. The Exchange has further imposed position limits (defined as maximum loss exposure) of \$25,000 USD on the Contract. As outlined in Rule 5.12 of the Rulebook, trading shall be available at all times outside of any maintenance windows, which will be announced in advance by the Exchange. Members will be charged fees in accordance with Rule 3.6 of the Rulebook. Fees are charged in such amounts as may be revised from time to time to be reflected on the Exchange’s Website. Additionally, as outlined in Rule 7.2 of the Rulebook, if any event or any circumstance which may have a material impact on the reliability or transparency of a Contract’s Source Agency or the Underlying related to the Contract arises, Kalshi retains the authority to designate a new Source Agency and Underlying for that Contract and to change any associated Contract specifications after the first day of trading. That new Source Agency and Underlying would be objective and verifiable. Kalshi would announce any such decision on its website. All instructions on how to access the Underlying are non-binding and are provided for convenience only and are not part of the binding Terms and Conditions of the Contract. They may be clarified at any time. Furthermore, the Contract’s payout structure is characterized by the payment of an absolute amount to the holder of one side of the option and no payment to the counterparty. During the time that trading on the Contract is open, Members are able to adjust their positions and trade freely. After trading on the Contract has closed, the Expiration Value and Market Outcome are determined. The market is then settled by the Exchange, and the long position holders and short position holders are paid according to the Market Outcome. In this case, “long position holders” refers to Members who purchased the “Yes” side of the Contract and “short position holders” refers to Members who purchased the “No” side of the Contract. If the Market Outcome is “Yes” (please see Appendix A for the conditions upon which the Market Outcome is “Yes”), then the long position holders are paid an absolute amount proportional to the size of their position and

² As stated by the unregistered trading venue.

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the short position holders receive no payment. If the Market Outcome is “No,” then the short position holders are paid an absolute amount proportional to the size of their position and the long position holders receive no payment. Specification of the circumstances that would trigger a Market Outcome of “Yes” are included below in the section titled “Payout Criterion” in Appendix A. The Expiration Date of the Contract is designed to account for multiple possible contingencies regarding the timing of the determination of control of a given chamber of Congress.

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**CERTIFICATIONS PURSUANT TO SECTION 5c OF THE COMMODITY EXCHANGE
ACT, 7 U.S.C. § 7a-2 AND COMMODITY FUTURES TRADING COMMISSION RULE
40.3, 17 C.F.R. § 40.3**

The Exchange certifies that this submission (other than those appendices for which confidential treatment has been requested) has been concurrently posted on the Exchange's website at <https://kalshi.com/regulatory/filings>.

Should you have any questions concerning the above, please contact the exchange at ProductFilings@kalshi.com.

By: Eliezer Mishory
Title: Chief Regulatory Officer
Date: 7/19/2022

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Attachments:

Appendix A - Contract Terms and Conditions

Index of confidential appendices

Confidential appendices

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APPENDIX A – CONTRACT TERMS AND CONDITIONS

**Official Product Name: Will <party> be in control of the <chamber of Congress>?
Rulebook: CONGRESS**

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CONGRESS

Scope: These rules shall apply to this contract.

Underlying: The Underlying for this Contract is the political party membership of each Member of Congress for <term>, as well as the political party membership of the Speaker of the House and the political party membership of the President Pro Tempore, according to congress.gov. For the purposes of assigning party membership: Senator Angus King of Maine and Senator Bernard Sanders of Vermont shall be treated as members of the Democratic Party. Revisions to the Underlying made after Expiration will not be accounted for in determining the Expiration Value.

Source Agency: The Source Agency is congress.gov.

Type: The type of Contract is an Event Contract.

Issuance: The Contract is based on the outcome of a recurrent data release, which is issued for each new term of Congress. Thus, Contract iterations will be issued on a recurring basis, and future Contract iterations will generally correspond to the next election cycle.

<chamber of Congress>: refers to a chamber of the United States Congress. It can take the value of “U.S. House of Representatives” or “U.S. Senate”.

<term>: refers to a term of the United States Congress. A term of Congress begins and ends every two years.

<party>: refers to a political party. For the 118th Congress, the Exchange will list contract iterations with “Democratic Party” or “Republican Party” values.

Payout Criterion: The Payout Criterion for the Contract encompasses the Expiration Values where the leader of <chamber of Congress> is a member of <party> on the Expiration Date. In the case of the U.S. House of Representatives, this is the Speaker of the House. In the case of the U.S. Senate, this is the President Pro Tempore.

Minimum Tick: The Minimum Tick size for the referred Contract shall be \$0.01.

Position Limit: The Position Limit for the \$1 referred Contract shall be \$25,000 per Member.

Last Trading Date: The Last Trading Date of the Contract will be the same as the Expiration Date. The Last Trading Time will be the same as the Expiration Time.

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Settlement Date: The Settlement Date of the Contract shall be no later than the day after the Expiration Date, unless the Market Outcome is under review pursuant to Rule 7.1.

Expiration Date: The Expiration Date of the Contract shall be February 1 in the year that <term> begins.

Expiration time: The Expiration time of the Contract shall be 10:00 AM ET.

Settlement Value: The Settlement Value for this Contract is \$1.00.

Expiration Value: The Expiration Value is the value of the Underlying as documented by the Source Agency on the Expiration Date at the Expiration time.

Contingencies: Before Settlement, Kalshi may, at its sole discretion, initiate the Market Outcome Review Process pursuant to Rule 6.3(c) of the Rulebook. Additionally, as outlined in Rule 7.2 of the Rulebook, if any event or any circumstance which may have a material impact on the reliability or transparency of a Contract's Source Agency or the Underlying related to the Contract arises, Kalshi retains the authority to designate a new Source Agency and Underlying for that Contract and to change any associated Contract specifications after the first day of trading.

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INDEX OF CONFIDENTIAL APPENDICES

Appendix B (Confidential) - Hedging and Price Basing Utility
Appendix B.1 (Confidential) - Extended Case Studies on the Hedging and Price Basing Utilities of the Contract
Appendix C (Confidential) - Source Agency
Appendix D (Confidential) - Compliance with Core Principles
Appendix E (Confidential) - Engagement Timeline
Appendix F (Confidential) - Commission Jurisdiction and the Special Rule for Event Contracts
Appendix G (Confidential) - Fee

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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 submitted 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 cyclicals, 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.¹⁸¹⁹²⁰²¹²²²³²⁴²⁵

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 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

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.

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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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:

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

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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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 participants' reassessments of the election outcome and the outlook for fiscal policy...Broad stock price indexes increased, on balance, over the intermeeting period

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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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

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,

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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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 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

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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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 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.

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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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 one using economic indicator contracts hedges the change in her risks from changes

³⁹ CX Markets. <https://weather.cxmarkets.com/>

⁴⁰ CME Hurricane Index Futures and Options.

https://www.cmegroup.com/trading/weather/files/WTI06_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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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

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who 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,

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through their own 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:

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

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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 retail exposure and likely promotion of the potential for federal

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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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.

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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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 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.

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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 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

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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“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.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, I Thomas C. Schelling, I 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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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

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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installers, to wind turbine 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.

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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Health Insurance Decision-Making & the 2016 Election

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

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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decades as 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 Gori 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 70 percent of GDP. Moreover, because a good deal of retirement savings is

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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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

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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The 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

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*.

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the Alternative Minimum Tax.⁹³ 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

⁹³ Republican Party. 2012. “Restoring the American Dream: Rebuilding the Economy and Creating Jobs.” *The American Presidency Project*.

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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sicker adults. Since an ACA repeal would also result in the removal of the requirement that health insurance 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 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

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*.

¹⁰⁷ John W. Schoen. 2016. "Trump touts sweeping, and costly, tax-cut plan." *CNBC*.

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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.¹¹⁰ 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.¹¹² 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 individual income taxes as a percentage of personal income fell slightly from 9.6% to 9.2%.¹¹⁵

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/bills/115/1/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 Jansky, and Gabriel Zucman. “Did the Tax Cuts and Jobs Act Reduce Profit Shifting by US Multinational Companies?”

¹¹⁵ Jane G. Gravelle and Donald J. Marples. 2019. “The Economic Effects of the 2017 Tax Revision: Preliminary Observations.” *Congressional Research Service*.

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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 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.

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*.

¹²¹ Robert Orr. 2019. "The impact of the 2017 Child Tax Credit expansion was larger than anyone expected." *Niskanen Center*.

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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 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

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>

¹²⁹ Erik Haagansen. 2021. "American Rescue Plan (Biden's \$1.9 Trillion Stimulus Package)." *Investopedia*.

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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.

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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APPENDIX C (CONFIDENTIAL) – SOURCE AGENCY

The data which is used to determine the Expiration Value of the Contract is published by the Library of Congress, the official government repository of information for the public since 1800.

Congress.gov is an affiliate of the Library of Congress and contains a record of all members of Congress, their leadership status, and party membership. It updates every weekday morning at 8:00 AM with the complete record of the previous day's activities.

As stated on the Congress.gov website:

Congress.gov is the official website for U.S. federal legislative information. The site provides access to accurate, timely, and complete legislative information for Members of Congress, legislative agencies, and the public. It is presented by the Library of Congress (LOC) using data from the Office of the Clerk of the U.S. House of Representatives, the Office of the Secretary of the Senate, the Government Publishing Office, Congressional Budget Office, and the LOC's Congressional Research Service.

Congress.gov is usually updated the morning after a session adjourns. Consult [Coverage Dates for Congress.gov Collections](#) for the specific update schedules and start date for each collection.

Congress.gov supersedes the THOMAS system which was retired on July 5, 2016. Congress.gov was released in beta in September 2012. The THOMAS URL was redirected to Congress.gov in 2013. The beta label was removed in 2014.

The scope of data collections and system functionality have continued to expand since THOMAS was launched in January 1995, when the 104th Congress convened. THOMAS was produced after Congressional leadership directed the Library of Congress to make federal legislative information freely available to the public.

Congressional documents from the first 100 years of the U.S. Congress (1774-1875) can be accessed through [A Century of Lawmaking](#).¹³³

¹³³ <https://www.congress.gov/about>

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The information used to determine the Expiration Value of the Contract is highly visible. Any discrepancy between the true value and the reported values at the Source Agency would be swiftly detected and any individual who engaged in said manipulation of the Source Agency would likely be fired. Importantly, the Exchange has chosen to only use *official government sources* to determine the Expiration Value of the Contract. The Exchange understands that political control can often be hotly contested, with accusations that an election is stolen. Moreover, the Exchange understands that news agencies frequently “call” the results of elections incorrectly. As a result, it does not use any news reporting in our determinations, nor the results of election certifications, as individuals may step down or resign prior to actually taking office. The Exchange thus relies on the official federal government report of *who actually took office*.

In summary, the data which will be used to determine the Expiration Value of the Contract is prepared by the Library of Congress, the official website of the United States Senate, and the official website of the Clerk of the House of Representatives, in a rigorous manner with multiple layers of checks in place to ensure the highest accuracy possible, and there are robust safeguards against any potential manipulation.

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APPENDIX D (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. 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 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

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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 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,

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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.

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.

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(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 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, 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.

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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. Leaking results early in order to trade on the contract would also be very unlikely.

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.”¹³⁴¹³⁵ 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 analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹³⁶

Today, such contracts remain 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.

¹³⁴ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹³⁵ Paul Rhode and Coleman Strumpf. 2012. “The Long History of Political Betting Markets: An International Perspective.”

¹³⁶ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

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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.”¹³⁷ 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.¹³⁸ 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.”¹³⁹

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. Trillions in stock value are deeply dependent on public policy outcomes; 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. Campaigns and party apparatuses have access to levels of cash-on-hand rarely seen in other contexts. No country’s citizens spend more on its elections than the United States. The campaigns of Joe Biden and Donald Trump, and their respective political parties, fundraised almost \$4 billion during the 2020 U.S. presidential campaign.¹⁴⁰ In weak democracies, political parties frequently use public and private funds to buy citizens’ votes, which is not something that

¹³⁷ Paul Rhode and Koleman Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

¹³⁸ Robin Hanson and Ryan Oprea. 2008. “A Manipulator Can Aid Prediction Market Accuracy.” *Economica*.

¹³⁹ Justin Wolfers and Eric Zitzewitz. 2006. “Prediction Markets in Theory and Practice”.

¹⁴⁰ Sean McMinn. 2020. “Money Tracker: How Much Trump And Biden Have Raised In The 2020 Election.” *National Public Radio*.

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is seen in the United States.¹⁴¹¹⁴²¹⁴³ Despite the money, prestige, and political importance at stake in federal elections, attempts at manipulation that would affect the market on political control have not been observed.

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, the Commission awarded PredictIt, a new unregistered trading venue dedicated to election and political event contracts, with a no-action letter. Since then, it has hosted an enormous amount of trading. As noted in the introduction, political control contracts on PredictIt have traded more than \$100 million in volume. As of 2022, PredictIt has more than 250,000 registered users and more than one billion contracts traded.¹⁴⁴¹⁴⁵

This information--that hundreds of millions of dollars can be traded on political control contracts without creating manipulation concerns--was not available to the Commission the last time it considered similar event contracts in 2012.¹⁴⁶ Although the Commission also awarded a no-action letter to another political contract trading venue, the Iowa Electronics Market, in 1992, IEM is smaller and harder to access for individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes. Major reporting outlets cite PredictIt odds to give media consumers information about elections.¹⁴⁷¹⁴⁸

Americans can also readily access cryptocurrency-based decentralized exchanges (DEXes) which offer political control markets on platforms such as Polymarket and Omen.¹⁴⁹¹⁵⁰ Polymarket's markets on Congressional control have traded millions.¹⁵¹ 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

¹⁴¹ Valeria Brusco, Marcelo Nazareno and Susan C. Stokes. 2004. "Vote buying in Argentina." *The Latin American Studies Association*.

¹⁴² Michael Bratton. 2008. "Vote buying and violence in Nigerian election campaigns." *Electoral Studies*.

¹⁴³ Ezequiel Gonzalez-Ocantos, Chad Kiewiet de Jonge, Carlos Meléndez, Javier Osorio, and David W. Nickerson. 2011. "Vote Buying and Social Desirability Bias: Experimental Evidence from Nicaragua." *American Journal of Political Science*.

¹⁴⁴ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJlZGljdGFibGUtbmV3c2xldHRlci0xMTEExOSNtb2JpbGU=>

¹⁴⁵ Former employee, Will Jennings', public LinkedIn profile. <https://www.linkedin.com/in/will-jennings-pi/>

¹⁴⁶ Nadex order. 2012. CFTC.

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

¹⁴⁷ Jonathan Ponciano. 2020. "Online Betting Markets Are More Bullish On A Trump Victory Than Polls, Here's Why." *Forbes*.

¹⁴⁸ Amy Tennery. 2016. "Trump's chance of victory skyrockets on betting exchanges, online market." *Reuters*.

¹⁴⁹ Polymarket. <https://polymarket.com/market/will-gavin-newsom-be-governor-of-california-on-december-31-2021>

¹⁵⁰ Omen.eth. <https://omen.eth.link/#/0x95b2271039b020aba31b933039e042b60b063800/finalize>

¹⁵¹ Polymarket. <https://polymarket.com/market/will-trump-win-the-2020-us-presidential-election>

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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. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation.

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.

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

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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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APPENDIX E (CONFIDENTIAL) - ENGAGEMENT TIMELINE

- Late 2021 ~ Mar 28, 2022 Kalshi informed DMO that it was meeting with the Hill regarding the contracts
- Mar 28 Contract and analysis sent to DMO
- Apr 7 Kalshi meets with DMO
- Apr 13 Kalshi meets with DMO
Kalshi meets with Chairman's office
- Apr 26 Kalshi requests meeting with DMO Director
- Apr 28 Kalshi follows up on meeting request with DMO Director
- May 2 Kalshi meets with Commissioner Goldsmith-Romero's office
- May 3 Kalshi follows up on meeting request with DMO
- May 4 Kalshi meets Chairman's office. Chairman's office requests follow up
Kalshi requests follow up meeting with Chairman's office as instructed
- May 5 Kalshi meets with Commissioner Pham
- ⋮

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- May 6 Kalshi follows up on meeting request with Chairman's office
- May 11 Kalshi has second meeting with the Chairman's office
Kalshi meets with Commissioner Goldsmith-Romero
- May 12 Kalshi certifies a mortgage rate contract, and then pauses all certifications for 47 days while DMO considers the contracts
- May 16 Kalshi meets with Commissioner Mersinger's office
- May 18 Kalshi meets with Commissioner Pham's office
Kalshi meets with Commissioner Johnson's office
- May 24 DMO sends Kalshi numerous questions on its political control contracts
- May 25 Kalshi's counsel (Jonathan Marcus, Reed Smith) sends analysis to DMO
- May 26 Kalshi responds to DMO questions
- May 31 Kalshi's counsel (Dan Davis, Katten) sends analysis to DMO
- Jun 1 Kalshi requests short call to update Chairman's office on timing. Kalshi instructed to continue engaging with DMO instead
- Jun 2 DMO sends an email specifically about the CVF to Kalshi
- Jun 3 Kalshi responds to DMO's questions about the CVF and provides the amended CVF
- ⋮

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- Jun 7 Kalshi follows up on meeting request with DMO Director
- Jun 9 Kalshi's counsel speaks with DMO about the CVF
- Jun 10 Kalshi's counsel sends CVF analysis to DMO
- Jun 16 Kalshi meets with DMO re the CVF
- Jun 17 Kalshi requests meeting with Chairman's office
- Jun 24 Kalshi meets with DMO Director in the DMO office
- Jun 28 Kalshi certifies hurricane contracts, the first contracts in 47 days
- Jun 29 Kalshi meets with Chairman. Kalshi instructed to work with Chairman's office
Kalshi requests meeting with Chairman's office, provides all aggregated materials
- Jul 8 Kalshi's announced "drop dead date" for filing the contracts. Postponed to accommodate scheduling of Chairman's office meeting
- Jul 12 Kalshi meets with Chairman's office to discuss timing
- Jul 13 Kalshi meets with Chairman's office to discuss feedback. Chairman's office requests an update following Kalshi's meeting that night with Hill
- Jul 14 Kalshi updates Chairman's office as requested. Meeting set for 7/18 for further feedback from the Chairman's office
- Jul 18 Chairman's office cancels meeting

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APPENDIX F (CONFIDENTIAL) - COMMISSION JURISDICTION AND THE SPECIAL RULE FOR EVENT CONTRACT

Commission jurisdiction

Section 2(c)(2)(A)(ii) of the Act provides that the Commission has jurisdiction over swaps. Swaps are defined in section 1a(47)(ii) of the Act to include, among other things, “any agreement, contract, or transaction . . . that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence.” The Contract provides for payments that are dependent on the occurrence, nonoccurrence, or the extent of an event. The Contract is therefore a swap, and the listing and trading of the contract on Kalshi are therefore under the Commission’s jurisdiction. Section 5c(c)(5)(B) and Commission Regulation 40.3(b) create a presumption in favor of approving contracts.

Special rule for the review and approval of event contracts

Section 5c(c)(5)(C) of the Act provides a special rule for the review and approval of event contracts. Under this special rule, the “Commission *may* determine” that event contracts or swaps (“based upon the occurrence, extent of an occurrence, or contingency”) are “contrary to the public interest” if those contracts “involve” certain enumerated activities. 7 U.S.C § 7a-2(c)(5)(C)(i).¹⁵² Those enumerated activities are: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.” *Id.* The discretionary use of this special rule for event contracts is implemented in the Commission’s Regulations, 17 C.F.R. § 40.11,¹⁵³ which provides that “the Commission *may determine*” that a certain contract “may involve” one of the enumerated activities and subject that contract to a 90-day review period after which it “shall issue an order” with its determination. 17 C.F.R. § 40.11(c).

¹⁵² If the Commission chooses to review an event contract to determine whether it is contrary to the public interest and finds that a listed event contract is “contrary to the public interest,” that contract may not be “listed or made available for clearing or trading on or through a registered entity.” 7 U.S.C § 7a-2(c)(5)(C)(ii).

¹⁵³ As interpreted by former Commissioner Dan Berkovitz, regulation 40.11 mirrors the statute, 7a-2(c)(5)(C), and sets forth the process for the Commission to determine whether a specific event contract is contrary to the public interest. *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 (“Berkovitz Statement”).

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The CEA's special rule for event contracts applies to contracts that "involve" one of the six enumerated activities: an "(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest." 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI). These specific examples demonstrate that the term "involves" in the statute (and application of the special rule) refers to the actual "occurrence, extent of occurrence, or contingency" that forms the underlying basis for the contract to be traded; and not the trading of the contract itself.

The statute's second enumerated activity is "terrorism," and thus, a contract that "involves" terrorism is subject to the CEA's special rule for event contracts. An event contract will involve terrorism if the underlying event that forms the basis of the contract is terrorism; the act of trading on a contract itself is not terrorism. The same is true for the third and fourth enumerated activities. An event contract will "involve" assassination when the underlying event that forms the basis of the contract is assassination; the act of trading itself is obviously not assassination. An event contract will "involve" war when the underlying event that forms the basis of the contract is war; the act of trading itself is obviously not war. This common sense understanding is explicit in the statute. The statute's first and the sixth enumerated activities are an "*activity* that is unlawful under any Federal or State law" and "*other similar activity* determined by the Commission, by rule or regulation, to be contrary to the public interest." (emphasis added). The noun "*activity*" makes it clear that the statute is referring to the underlying event, not to the *activity* of trading on the contract.¹⁵⁴ Thus, the statute is clear that an event contract "involves" an enumerated activity when the underlying event that forms the basis of the contract, not the trading on the contract, involves the activity.

The statute's first enumerated activity ("activities that are illegal under federal or state law") further buttresses the conclusion that it is the underlying event that forms the basis of the contract that is relevant to the special rule and not the act of trading itself. If "involves" means that the trading on the contract is the enumerated event, that would mean that CEA's special rule applies to trading on a contract *when the trading on the contract itself already violates federal law*. Recall that the special rule does not prohibit such contracts, it merely authorizes the Commission to make that determination. It would be odd for Congress to make a federal law that makes trading on a certain contract illegal, but nonetheless say listing that contract is prohibited only if the CFTC determines that it is against the public interest. Once Congress made it illegal, it is unlikely it would have turned around and allowed it unless the CFTC agrees that the activity is disfavored. .

¹⁵⁴ Although this is abundantly clear with regard to five of the six enumerated events, an argument might be mounted that it is not true with regard to the fifth of the enumerated activities, gaming. This argument fails, as it is a basic tenet of both semantic and substantive statutory interpretation that a single usage of a word, in this case "involve", and single statutory statement, will not have two meanings, one for items 1, 2, 3, 4, and 6 on a list, and a second meaning for item 5 on that same list.

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Instead, it is abundantly clear that the enumerated activity of “illegal under federal law” means that the underlying event that forms the basis of the contract is illegal under federal law, not that the trading on that contract is illegal under federal law. An example of a contract that would fall under this first enumerated activity is a contract on the number of people that commit tax evasion. Tax evasion is a felony under I.R.C. § 7201. Trading on the contract is obviously not tax evasion. Nonetheless, that does not matter. The event in that contract is an activity that is illegal under federal law. The fact that trading on the contract is not illegal under federal law is irrelevant, because whether the CEA’s special rule for event contracts applies to an event contract is determined based on whether the underlying event that forms the basis of the contract is an enumerated activity, not the act of trading on the contract.¹⁵⁵

Because it is the underlying event that forms the basis of the contract that is the only trigger of the CEA’s special rule for event contract review, political control event contracts are clearly not included in that rule. The event that underlies these contracts is the political control of the United States Congress by a political party. Political control of government by a political party is obviously not illegal under federal or state law. It is not an activity that the Commission has determined to be contrary to the public interest. Nor is it terrorism, assassination, war, or a game. As such, political control contracts are not included in the narrow reach of the CEA’s special rule for certain, enumerated activities and the rule and relevant regulations (17 C.F.R. § 40.11) does not apply.¹⁵⁶

Additionally, the activities that are enumerated can be seen as all involving an undesirable activity. Terrorism, war, assassination, illegal activity, and gaming are activities that can be considered “undesireable”. The sixth activity too is essentially any other activity that the Commission considers to be undesirable. Political control is not one of those activities.

Additional analysis on the applicability of the special rule is included in appendices F.1 and F.2. Appendix F.1 is an analysis from the Exchange’s outside counsel Jonathan Marcus. Appendix F.2 is an analysis from the Exchange’s outside counsel Dan Davis.

¹⁵⁵ The rare exception to this would be when the act of trading a contract itself is prohibited, as is the case for contracts “for the sale of motion picture box office receipts (or any index, measure, value, or data related to such receipts) or onions for future delivery” which are expressly prohibited in the Act. 7 U.S.C § 13-1. Trading a political control contract, however, is not prohibited by the Act nor is the underlying event illegal.

¹⁵⁶ The Commission in the Nadex order took a very expansive view of the authority that the CEA conferred on it with the special rule for event contracts. The Nadex Order stated simply “the legislative history of CEA Section 5c(c)(5)(C) indicates 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.” However, the legislative history that the Commission pointed to back then is of the weakest kind, a simple colloquy between two senators, and certainly not enough to override the clear semantic and substantive indications in the statute itself as to what it means. The Commission should not reinforce a flawed legal position from a decade ago.

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APPENDIX F.1 (CONFIDENTIAL) - JONATHAN MARCUS ANALYSIS

KalshiEX LLC - Confidential Treatment Under Regulations 40.8 and 40.9 Requested

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Confidential Treatment Requested by KalshiEX LLC

May 25, 2022

Sebastian Pujol Schott
Acting Deputy Director, Product Review Branch
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Non-Application of Event Contracts Provisions to KalshiEX LLC's Political Control Contracts

Dear Mr. Pujol Schott:

I write to you on behalf of KalshiEX LLC ("Kalshi") with respect to its intention to self-certify certain political control contracts (the "Contracts") to be listed for trading on its designated contract market ("DCM"), and to address any outstanding concerns the Commodity Futures Trading Commission ("CFTC" or "Commission"), including the Division of Market Oversight ("DMO"), might have. We greatly appreciate the Commission's and DMO's continued willingness to allow Kalshi to highlight the many reasons why the Contracts should be listed, including the demonstrated economic purposes they serve.

In the spirit of building upon that productive dialogue, and in advance of Kalshi's self-certification of the Contracts, we wanted to elaborate on why Section 5c(c)(5)(C) of the Commodity Exchange Act ("CEA") and CFTC Regulation 40.11 (together, the "Event Contracts Provisions") do not provide a legal basis for the staff or the Commission to impede self-certification of the Contracts.

As further explained below, Section 5c(c)(5)(C)(i) of the CEA does not hinder self-certification of the Contracts because the activity on which they are based does not "involve" any of the enumerated event categories in the provision. Although the Commission previously determined

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that other political event contracts that were self-certified by a different exchange, the North American Derivatives Exchange (“Nadex”), were subject to the Event Contracts Provisions, that determination was based on a misinterpretation of the Event Contracts Provisions. Therefore, the Commission’s previous determination on Nadex’s proposed contracts should not be followed here with regards to the Contracts.¹ Under the Event Contracts Provisions, and contrary to the Commission’s order relating to Nadex’s political event contracts (“Nadex Order”), which determined that the *trading* of contracts based on the outcomes of elections constituted gaming activity, the Commission must consider whether the occurrence or contingency *on which the Contracts are based* – elections – involves one of the enumerated activities. And because elections do not fit within any of the enumerated event categories, the Event Contracts Provisions provide no basis to delay self-certification. CFTC Regulation 40.11 calls for the same result. Accordingly, even if, arguendo, CFTC Regulation 40.11 contains language that could be construed to support a different result, the Commission should read CFTC Regulation 40.11 to be consistent with Section 5c(c)(5)(C) and, accordingly, the Contracts should be self-certified without delay or encumbrance.

As explained in greater detail below, because the Event Contracts Provisions do not establish any legal or regulatory basis for impeding the Contracts, the Commission should take no action that would delay Kalshi from self-certifying them pursuant to CFTC Regulation 40.2.

I. SECTION 5C(C)(5)(C) OF THE CEA PROVIDES NO BASIS TO IMPEDE SELF-CERTIFICATION OF KALSHI’S POLITICAL CONTROL CONTRACTS.

Section 5c(c)(5)(C)(i) of the CEA establishes that, in connection with the listing of agreements, contracts, or transactions on “excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency[.]”

the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve[:] (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

Section 5c(c)(5)(C)(ii) further specifies that “[n]o agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.” Thus, the CEA, through this

¹ 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>.

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provision, establishes a clear framework under which the Commission can – but is not obligated to – review an event contract that is based upon an “occurrence, extent of an occurrence, or contingency” that involves one of the enumerated underlying activities in order to determine if those contracts would be contrary to the public interest. A Commission determination that the contract is contrary to the public interest would render its listing prohibited.

In short, through Section 5c(c)(5)(C), Congress granted the Commission the discretion to determine that a given event contract is contrary to the public interest, and thereby prohibited, only when the event underlying that contract involves one of the statute’s specifically enumerated activities. Congress did not grant the Commission the authority to prohibit a contract based upon an event that involves an unenumerated activity on the grounds that it would be contrary to the public interest.²

The plain language and structure of Section 5c(c)(5)(C)(i) make clear that the scope of the Commission’s discretionary review is narrowly focused on the nature of the contract’s underlying event, not of trading in the contract itself. Section 5c(c)(5)(C)(i) begins with the clause: “[i]n connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities *that are based upon the occurrence, extent of an occurrence, or contingency[.]*” (emphasis added). Thus, at the outset of the controlling provision, the statute establishes that the distinguishing feature of the contract is the nature of the occurrence or contingency. The final clause of Section 5c(c)(5)(C)(i), immediately prior to the provision’s enumeration of the covered activities, refers back to the first clause of the provision when it says: “the Commission may determine that *such* agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve” the enumerated activities. (emphasis added). When the clauses are read together, Section 5c(c)(5)(C)(i) grants the Commission only limited authority to review a contract that is “based upon [an] occurrence, extent of an occurrence, or contingency” that “involve[s]” one of the enumerated activities.

The plain language of the enumerated events themselves bolsters this interpretation. As Kalshi has pointed out in previous submissions,³ Section 5c(c)(5)(C)(i)’s first and sixth categories are defined respectively as an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added). The inclusion of the noun “activity” (and the reference in the sixth

² This lack of authority includes the sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), as that provision requires the Commission to conduct a rulemaking to determine that another activity is contrary to the public interest and then only if it is similar to one of the other specified underlying activities (crimes, terrorism, assassination, war, or gaming). See Commission Rulemaking Explained, available at: https://www.cftc.gov/LawRegulation/CommissionRule-makingExplained/index.htm#_ftn1.

³ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to DMO March 28, 2022.

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category to all five preceding “similar activit[ies]”) makes clear that Congress intended the underlying activity, not the contract itself, to be the subject of review and scrutiny and it must be assumed that decision was intentional.⁴

The sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), further highlights that Congress’s intention was for the Commission to analyze the activity underlying the contract rather than trading in the contract itself. This final enumerated activity provides the Commission a sort of catchall to determine whether the event involves “similar activity” to the preceding categories and thus might be inappropriate for listing. Since terrorism, assassination, war, and activity unlawful under state or federal law unquestionably refer to the occurrence or contingency underlying the contract, the sixth catch-all category must be read consistently with the rest of the enumerated list (apples must be compared to apples).⁵

Another reason that Section 5c(c)(5)(C) must be read as focusing on the underlying activity is that such focus is congruent with the nature of event contracts themselves. If Congress was concerned about trading in the contract itself, there is no indication why it would have limited the provision to event contracts rather than establishing a general rule that would have authorized the Commission to prohibit any derivatives contract that the trading in is, for example, unlawful under state law.

In the Nadex Order,⁶ the Commission did not interpret Section 5c(c)(5)(C) as focusing on the underlying activity. Instead, the Commission appears to have read the gaming provision (the fifth enumerated activity) to refer to trading in the contract itself. Accordingly, the Commission determined that the gaming provision applied to Nadex’s political event contracts because the contracts involved “a person staking something of value upon a contest of others.”⁷ The Commission likened this trading activity to activity prohibited by state anti-gambling laws. The Commission’s interpretation in this instance ran counter to the plain language and structure of the statute, as explained above.

⁴ The scant legislative history – a colloquy between Senators Diane Feinstein and Blanche Lincoln during the Senate’s consideration of Dodd-Frank’s regulation of event contracts – does not change the analysis. The colloquy did not address whether the underlying event, rather than trading in the contract itself, is the proper subject of analysis; instead, the Senators discussed the distinction in economic purpose between contracts that serve hedging utility and contracts that are designed predominantly for speculation. *See* 56 Cong. Rec. S5906-07 (July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at: <https://www.congress.gov/111/crec/2010/07/15/CRJC-2010-07-15-senate.pdf>. In any event, the language and structure of the statute are clear, so resorting to legislative history is unnecessary.

⁵ We explain below why, notwithstanding the Commission’s Nadex Order, the gaming provision must also refer to the underlying activity and not trading in the contract itself.

⁶ *See supra* note 1.

⁷ Nadex Order at 3 (internal quotation marks omitted).

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Other principles of statutory construction also undercut the application of the Event Contracts Provisions in the Nadex Order. Under the Commission’s interpretation, a person trading a political event contract is engaged in gaming – “staking something of value upon a contest of others.”⁸ By parallel reasoning, a person trading a terrorism contract is engaged in terrorism and a person trading a war contract is engaged in war. That is not a tenable interpretation of the statute. If Congress intended the Commission to focus on the underlying event for some of the enumerated categories, but to focus on trading in the contract itself for others, it would have said so. It certainly cannot be presumed or inferred from silence that Congress intended the Commission to apply disparate analytical approaches to the single list of enumerated activities. When the correct interpretation of Section 5c(c)(5)(C) is applied to the Contracts, the result is clear. Elections are not illegal under state or federal law, are not gaming, and are not similar to any of the enumerated activities – federal or state crimes, terrorism, assassination, war, and gaming – all of which are activities that Congress did not want to legitimize or encourage via event contracts without careful consideration by the Commission. The Commission should therefore not impede Kalshi from self-certifying the Contracts and lacks a legal basis to invoke Section 5c(c)(5)(C) to do so.

While we could stop here, we believe it is worth pointing out that the Nadex Order not only contravenes the language and structure of Section 5c(c)(5)(C), but also threatens to upend the CEA itself. Virtually every futures or swaps contract can be described as staking something of value on the outcome of some future event.⁹ Yet the CFTC’s exclusive jurisdiction over derivatives markets means that the CEA preempts any state law that would attempt to regulate derivatives markets.¹⁰ Therefore, regulated futures and swaps contracts *cannot be* illegal gambling under state law.

In fact, many states ban “gambling” not just on elections, but more generally on the outcomes of future events. These laws would prohibit the entire category of event contracts (at a minimum), which both Congress and the CFTC have expressly permitted to be listed on DCMs. Some of these states provide carve-outs for CFTC-regulated products, or otherwise for activities like commodities and securities trading. However, not all do. New Hampshire, for example, bans gambling and defines it as, “to risk something of value upon a future contingent event not under one’s control or influence.”¹¹ Alaska also bans gambling and defines it similarly as when:

⁸ *Id.*

⁹ This overly broad interpretation of the term “gaming” would threaten to render 5c(c)(5)(C)’s other enumerated provisions superfluous, given that, as explained above, virtually all event contracts could potentially qualify for that categorization. As the Supreme Court has repeatedly observed, there is a “canon against interpreting any statutory provision in a manner that would render another provision superfluous.” *Bilski v. Kappos*, 561 U.S. 593, 607-8 (2010).

¹⁰ *See Am. Agric. Movement v. Bd. of Trade*, 977 F.2d 1147, 1156-57 (7th Cir. 1992) (holding that “When application of state law would directly affect trading on or the operation of a futures market, it would stand ‘as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,’ and hence is preempted.” (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941))).

¹¹ NH Rev Stat § 647:2(II)(d), available at: <https://www.gencourt.state.nh.us/rsa/html/l/xii/647/647-2.htm/>.

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...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.¹²

Finally, various federal laws that address – and largely prohibit – gambling, specifically carve out regulated derivatives products from their definitions of “bet or wager,” highlighting that Congress views the two types of transactions as fundamentally distinct. For example, the Unlawful Internet Gambling Enforcement Act of 2006’s (“UIGEA”) definition of “bet or wager,” specifically “does not include [as relevant here:]”

- (ii) any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act;
- (iii) any over-the-counter derivative instrument;
- (iv) any other transaction that—
 - (I) is excluded or exempt from regulation under the Commodity Exchange Act; or
 - (II) is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.

The Bank Secrecy Act’s definition of “bet or wager,” which the Commission relied upon in its Nadex Order,¹³ has a carve-out for derivatives products identical to UIGEA’s.¹⁴

All of these various provisions illustrate the flaw in evaluating whether *trading* a futures or swaps contract constitutes gaming or gambling activity, as the Commission did in the Nadex Order, or whether *trading* a futures or swaps contract is unlawful under federal or state law. Instead, to maintain the structural integrity of Section 5c(c)(5)(C) and the CEA itself, the Commission should evaluate whether the Contracts involve an underlying activity – elections – that fits into one of the enumerated categories of activities in Section 5c(c)(5)(C). Because elections do not

¹² AK Stat § 11.66.280(2).

¹³ *Supra* note 4 at 3.

¹⁴ 31 U.S.C. § 5362(1)(E) (2006).

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fit within any of the enumerated activities, the Commission should not impede self-certification of the Contracts.

II. CFTC REGULATION 40.11 CALLS FOR THE SAME RESULT.

A determination that Section 5c(c)(5)(C) does not present an obstacle to Kalshi's self-certification of the Contracts should be dispositive, because CFTC Regulation 40.11, which the CFTC adopted to implement Section 5c(c)(5)(C), should likewise be read to allow only for the Commission's consideration of the contract's underlying activity, rather than its consideration of trading in the contract itself. While the language of the rule is not identical to the statute, there is no reason to read the language of CFTC Regulation 40.11 to require an analysis of trading in the contract rather than the contract's underlying activity that constitutes the event.

The scope of CFTC Regulation 40.11 should not be read to go beyond the scope of the special rule in the statute. By using the words "relates to, or references" in addition to "involves," the regulation only reinforces that the relevant activity is the underlying event, not trading on the underlying event. It would not make sense for a futures contract or swap to "reference" trading in the contract; to the contrary, the word "reference" is a clear direction to focus on the underlying event that the contract "references." Thus, under the regulation, like the statute, the relevant activity for purposes of the Commission's event contract analysis is the activity on which the contract is based (or to which the contract refers) rather than the contract itself.¹⁵ Even if the different words in the regulation could conceivably be read to support a different analysis that would broaden the scope of contracts subject to the statute, courts have held that, even under a standard of review that is highly deferential, an agency interpretation will not stand if "it is contrary to clear congressional intent or frustrates the policy Congress sought to implement."¹⁶

¹⁵ Because the Contracts are not based on an enumerated activity, the Commission does not need to consider undertaking a public interest analysis. If the Commission were to conclude otherwise, however, the Commission could either permit the contracts to be listed (the statute authorizes prohibition only upon a Commission determination that the contract would be contrary to the public interest, a determination that the Commission "may" undertake) or conduct a public interest analysis. CFTC Regulation 40.11 should not be read to constitute a blanket prohibition, as that reading could not be squared with the statute. See Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitz-statement040721> ("if sports event contracts involving gaming are found to have an economic purpose, they should be permitted to be listed on a DCM and retail customers cannot be prohibited from trading those contracts"); Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521> ("Congress [through Section 5c(c)(5)(C) of the CEA] unambiguously provided a default rule that all event contracts, including the enumerated ones, are allowed").

¹⁶ *Garcia Carias v. Holder*, 697 F.3d 257, 271 (5th Cir. 2012); *CHW W. Bay v. Thompson*, 246 F.3d 1218, 1223 (9th Cir. 2001) ("deference is not owed to an agency decision if it construes a statute in a way that is contrary to congressional intent or frustrates congressional policy").

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III. CONCLUSION

For all of the reasons stated above, the Commission has no reason to stay Kalshi's self-certification of the Contracts. We welcome your feedback on this position and would appreciate the opportunity to follow-up on these specific considerations in a conference call or in-person meeting to the extent you have further questions.

Very truly yours,

Jonathan Marcus

Jonathan L. Marcus

Cc: Eliezer Mishory
Chief Regulatory Officer and Counsel, Kalshi

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Confidential Treatment Requested by KalshiEX LLC

KalshiEX LLC - Confidential

APPENDIX F.2 (CONFIDENTIAL) - DAN DAVIS ANALYSIS

KalshiEX LLC - Confidential Treatment Under Regulations 40.8 and 40.9 Requested

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Confidential Treatment Requested by KalshiEX LLC

May 31, 2022

Elie Mishory
KalshiEx LLC
594 Broadway
New York, NY 10012

Re: Political Event Contracts, Section 5c(c)(5)(C) of the CEA, and CFTC Rule 40.11

Dear Mr. Mishory:

This letter is in response to your request for legal advice regarding KalshiEx LLC's ("Kalshi") engagement with the Commodity Futures Trading Commission ("CFTC" or "Commission") about the listing of certain event contracts relating to the partisan makeup of Congress, specifically the political control of Congress. One of the factors that Kalshi considers in listing contracts is ensuring regulatory compliance and, as such, you requested advice on the following question:

Are Kalshi's proposed political control contracts subject to the Commodity Exchange Act's ("CEA's") special rule for event contracts described in Section 5c(c)(5)(C) of the CEA and the implementing regulations at 17 C.F.R. § 40.11?

By way of background, in 2012, Nadex listed similar contracts (although with different characteristics) which the Commission prohibited by order ("Nadex Order"),¹ finding that trading in the Nadex contracts violated the CEA. Specifically, the Nadex Order found that Section 5c(c)(5)(C) of the CEA applied to the Nadex contracts because the Nadex contracts constituted gaming.² The Nadex Order also determined that the Nadex contracts were contrary to the public interest because the Nadex contracts could have an adverse effect on the integrity of elections.³

Section 5c(c)(5)(C) and Rule 40.11, however, are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match

¹ 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 (Apr. 2, 2012) (<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/-documents/ffddocs/nadexorder040212.pdf>) (last visited May 30, 2022).

² Nadex Order at 2-3.

³ *Id.* at 4.

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any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation. In reaching this conclusion, I will first provide some background of principles of interpretation and the relevant text of Section 5c(c)(5)(C) and Rule 40.11. I will then apply those principles to the Kalshi political control contracts and describe how the Nadex Order’s conclusions to the contrary are incorrect.

I. BACKGROUND

A. Principles of Interpretation

Since the Nadex Order, the Supreme Court has significantly modified the method through which regulatory text should be interpreted and the circumstances in which an agency will receive deference for its interpretation of regulatory text. The tools for interpreting regulatory text are similar to those for evaluating statutory text. I first discuss these principles and then use them to evaluate Section 5c(c)(5)(C) and CFTC Rule 40.11 and their application to Kalshi’s political event contracts.

The Supreme Court revamped the process for evaluating regulatory text in the 2019 case of *Kisor v. Wilkie*.⁴ In *Kisor*, the court considered whether to overrule *Auer v. Robbins*⁵ and *Bowles v. Seminole Rock*,⁶ cases which found that an agency was entitled to deference of its interpretation of an agency rule so long as it was not “plainly erroneous or inconsistent with the regulation.”⁷ In *Kisor*, the Court did not overrule *Auer* and *Seminole Rock*, but significantly limited their application: “The deference doctrine we describe is potent in its place, but cabined in its scope.”⁸

In reviewing the meaning of Rule 40.11, according to *Kisor*, one must “exhaust the ‘traditional tools’ of statutory construction.”⁹ “Agency regulations can sometimes make the eyes glaze over. But hard interpretive conundrums, even relating to complex rules, can often be solved.”¹⁰ One must “resort[] to all the standard tools of interpretation,”¹¹ including a careful consideration of

⁴ 139 S. Ct. 2400 (2019).

⁵ 519 U.S. 452 (1996).

⁶ 325 U.S. 410 (1945).

⁷ *Seminole Rock*, 325 U.S. at 414.

⁸ *Kisor*, 139 S. Ct. at 2408.

⁹ *Id.* at 2415 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

¹⁰ *Kisor*, 139 S. Ct. at 2415.

¹¹ *Id.* at 2414.

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“the text, structure, history, and purpose of a regulation”¹² to determine whether a rule has “one reasonable construction of a regulation”¹³ or can “at least establish the outer bounds of reasonable interpretation.”¹⁴ In discussing this approach to regulatory construction, the Supreme Court relied heavily on the principles of statutory construction discussed in *Chevron* and its progeny.

B. The Statute And The Rule

With these key principles in mind, I turn to the statute and rule. This analysis begins, of course, with the statutory text of Section 5c(c)(5)(C) of the CEA, from which the CFTC promulgated Rule 40.11. That section of the CEA states:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon **the occurrence, extent of an occurrence, or contingency** (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest **if** the agreements, contracts, or transactions **involve—**

- (I) **activity** that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) **other similar activity** determined by the Commission, by rule or regulation, to be contrary to the public interest.¹⁵

In relevant part for purposes of this analysis, Rule 40.11(a) states:

A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following:

- (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that **involves, relates to,**

¹² *Id.* at 2415.

¹³ *Id.*

¹⁴ *Id.* at 2416. The *Kisor* court goes on to explain that an agency’s interpretation of an ambiguous regulation may still not receive deference. The Court must then determine if “the character and context of the agency interpretation entitles it to controlling weight.” *Id.*

¹⁵ 7 U.S.C. § 7a-2(c)(5)(C)(i)(I)-(VI) (emphases added). If the Commission determines that such an agreement, contract, or transaction is contrary to the public interest, such agreement, contract, or transaction may not “be listed or made available for clearing or trading on or through a registered entity.” *Id.* § 7a-2(c)(5)(C)(ii).

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or references terrorism, assassination, war, gaming, or an **activity** that is unlawful under any State or Federal law; or

(2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references **an activity that is similar to an activity** enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.¹⁶

II. APPLICATION TO KALSHI'S POLITICAL CONTROL CONTRACTS

To help frame the matter, the key question here requires understanding the limitations on the scope of Section 5c(c)(5)(C) and Rule 40.11. Is the scope (1) limited to contracts when the activity underlying the event contract involves one of the enumerated activities or do they (2) include the act of participating in the contract is itself?

Applying the principles of statutory and regulatory construction shows that Section 5c(c)(5)(C) and Rule 40.11 are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation.

A. Section 5c(c)(5)(C) and Rule 40.11 Apply Only To Event Contracts Where The Activity Underlying The Event Contract Is One Of The Enumerated Activities.

The plain text of Section 5c(c)(5)(C) demonstrates that Congress limited the statute's scope to instances where the underlying activity of an event contract is one of the enumerated events. If the activity underlying the event contract does not involve one of the enumerated activities, the listing is outside the scope of the Statute and Rule 40.11, regardless of how the act of *participating* in the event contract itself is classified. An interpretation of the statute that extends the applicable scope to also include contracts where the underlying activity is not one of the enumerated events is overbroad and incorrect.

First, Section 5c(c)(5)(C) limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously acknowledged that Section 5c(c)(5)(C)'s textual focus is on "activities," *i.e.*, the underlying conduct. In describing Section

¹⁶ 17 C.F.R. § 40.11(a) (emphases added).

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5c(c)(5)(C), the Commission stated that the rule applied to contracts that “involve one or more *activities* enumerated in the Dodd-Frank Act.”¹⁷ These “activities” are not the contracts themselves. They are the events that create the basis for the relevant contract.

To give but one straightforward example, in the statute events two through four are terrorism, assassination, and war. The inclusion of these activities clearly demonstrates that the scope of Section 5c(c)(5)(C) and Rule 40.11 includes contracts when the activity underlying the event contract involves one of the enumerated activities. The act of participating in a contract is not itself an act of terrorism, assassination, or war.¹⁸ The same analytical approach, by extension, should apply to each of the items on the list, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C) would be internally inconsistent, contrary to the traditional tools of construction.

Second, Section 5c(c)(5)(C) and Rule 40.11 allow the Commission to prohibit the listing of an event contract only “if the agreements, contracts, or transactions **involve**” any of the enumerated activities that are against the public interest. Event contracts that do not involve any of the enumerated activities may be listed for trading because the special rule would not prohibit the listing of those contracts by a DCM.

Third, Section 5c(c)(5)(C) places an additional, key limitation on the “agreements, contracts, or transactions” within the scope of the text. Those “agreements, contracts, or transactions” must be “in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency.” The reference to “occurrence” or “contingency” can only mean to the underlying event of the contract, not the contract itself. The contract cannot reasonably be described as an occurrence or a contingency. Indeed, the headings of the section—“Special rule for review and approval of event contracts and swap contracts” (Section 5c(c)(5)(C)) and “Event Contracts” (Section 5c(c)(5)(C)(i))—reinforce Congress’ focus on the “event” or occurrence, not the trading

¹⁷ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) (“Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more **activities** enumerated in the Dodd-Frank Act.”) (emphasis added) (“40.11 Proposed Rule”); *see id.* at 67,289 (“If [] the Commission determines that such product may involve an **activity** that is enumerated in 40.11 . . .”) (emphasis added).

¹⁸ To illustrate this point, consider hypothetical contracts on whether a foreign leader will be assassinated, how many Russian planes will be shot down by Ukrainian forces, or how many murders will occur in a given city over a certain time period. Section 5c(c)(5)(C) and Rule 40.11 would apply to these hypothetical contracts because the activities underlying the contracts in these hypothetical examples are the enumerated activities of “assassination,” “war,” and “an activity that is unlawful under Federal or State law.” The purchasing of the contract itself, however, is not “an activity” of “assassination,” “war,” or “an activity that is unlawful under Federal or State law.”

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of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningfully limit the Commission's reach regarding event contracts.

Because the text and structure is clear, there is no need to resort to legislative history. That is a bedrock principle of the traditional tools of statutory construction. Nevertheless, the sparse legislative history regarding Section 5c(c)(5)(C)¹⁹ provides no guidance as to whether Congress intended the Commission to limit the scope of Section 5c(c)(5)(C) to instances where the underlying activity of an event contract is one of the enumerated events.

This reading of Section 5c(c)(5)(C) is consistent with the terms used by the Commission in Rule 40.11. Rule 40.11 borrows heavily from the terms used in the statute, including multiple uses of "activity" in both subsections 40.11(a). The Regulation also uses the same term "involves" which appears in the Statute, but also adds the phrase "relates to, or references" when describing enumerated activities. Because "involves" is the only statutory authority provided by Congress, the Commission cannot expand upon the scope of that term. Thus, the only way to read "relates to, or references" consistent with the Commission's authority is that they are the specific meanings of "involves" that the Commission adopted.²⁰ The terms "relates to" and "references," in turn, clearly describe the underlying activity upon which the event contract is based. It would be nonsensical to interpret "relates to" and "references" as describing the act of participating in the event contract itself.

To be clear, Congress could certainly promulgate a law that covers the *participation* in an event contract. But Section 5c(c)(5)(C) is not that law. Instead, applying the traditional tools of construction, Congress enacted Section 5c(c)(5)(C) to prohibit a narrow group of contracts whose underlying activities are the enumerated activities and the CFTC has determined are contrary to

¹⁹ The only legislative history that has been cited by the Commission regarding Rule 40.11 involves a short colloquy between Senator Feinstein of California and Senator Lincoln of Arkansas on July 15, 2010. *See, e.g.*, 40.11 Final Rule, 76 Fed. Reg. at 44,786 & nn. 34-35; *see also* Nadex Order, Whereas Clauses 2 & 7. This 555-word back-and-forth between two Senators, which takes up less than two columns of one page of the Congressional Record (Volume 156, Issue 105, S5906-5907 (July 15, 2010)), is particularly weak evidence of the intent of Congress as a whole and the meaning of the provision. *See, e.g., NLRB v. SW General, Inc.*, 137 S. Ct. 929, 943 (2017) ("[F]loor statements by individual legislators rank among the least illuminating forms of legislative history."). The text is by far the more probative evidence of Congress' meaning. The Nadex Order's extensive reliance on this sparse legislative history is simply inconsistent with the interpretive approach laid out in *Kisor* and provides an additional reason why Kalshi can self-certify the contracts notwithstanding the Nadex Order. In any event, none of the short legislative history specifically addresses the question about whether Section 5c(c)(5)(C) applies only to the underlying events or the trading of the contracts as well, so it has nothing to add to this analysis.

²⁰ Rule 40.11 cannot exceed the scope of Section 5c(c)(5)(C). Any interpretation of Rule 40.11 that views it as expanding the scope delineated in Section 5c(c)(5)(C) would run afoul of the Constitution's separation of powers and the Administrative Procedure Act.

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the public interest and those limitations apply to Rule 40.11. If the underlying activity of a contract is not an enumerated event, it is outside the scope of Section 5c(c)(5)(C) and Rule 40.11.

B. The Nadex Order Incorrectly Interprets And Applies Section 5c(c)(5)(C) And Rule 40.11 To Apply To Political Control Contracts Like Kalshi's.

As described above, Section 5c(c)(5)(C) and Rule 40.11 apply only to the listing of event contracts whose underlying activity involves one of the six enumerated activities. They do not apply to event contracts whose underlying activity does not involve one of the enumerated activities. This key distinction between the activity itself or a *contract on the activity* is of particular importance for the Kalshi contracts at issue here. The underlying activity of Kalshi's contracts is political control of the chambers of Congress. Political control of Congress is none of the activities identified in Section 5c(c)(5)(C) and, as such, Kalshi's political control contracts are not subject to the special rule.

The Nadex Order's contrary conclusion was incorrectly reasoned and misapplied in several aspects.²¹ First, contrary to the above explanation, the Nadex Order incorrectly expanded the scope of the statute and regulation to include the act of participating in the contract, and not just the underlying activity. Second, the Nadex Order incorrectly includes election contracts in the enumerated activities of illegal under state law and gaming.

The Nadex Order incorrectly expanded the scope of Section 5c(c)(5)(C) and Rule 40.11 to include the act of participating in the contract, and not just the underlying activity. The first enumerated activity of Section 5c(c)(5)(C) is "activity that is unlawful under any Federal or State law." The underlying activity of Kalshi's contracts is political control of the chambers of Congress. There is no Federal or State law that makes political control of Congress illegal. There is also no Federal or State law that prohibits elections or voting in elections which result in the political control of Congress. Accordingly, political control contracts would not fall under the special rule's enumerated act of "illegal activity."

To be sure, 27 states do prohibit, in one form or another, betting on elections. And the Nadex Order (incorrectly) stated that "state gambling definitions of 'wager' and 'bet' are analogous to the act of taking a position in the Political Event Contracts"²² as a justification for prohibiting those contracts' listing. In this regard, however, the Nadex Order overextended. Section 5c(c)(5)(C) is limited to the activity underlying the contract, not the participation in the contract itself.

²¹ As noted previously (*see supra* nn. 4-14), the Commission adopted the Nadex Order prior to the Supreme Court's decision in *Kisor v. Wilkie* and thus the Order did not use the framework now required by the Supreme Court for evaluating the scope and implications of Rule 40.11.

²² Nadex Order at 2.

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The Nadex Order also misapplies the enumerated activity of “gaming.” There are at least two fundamental differences between the relevant state gaming or gambling laws and event contracts. As Commissioner Brian Quintenz described with regards to the withdrawn ErisX sports event contract, trading an event contract with a binary outcome is not automatically considered a gamble.²³ Indeed, if Section 5c(c)(5)(C) had assumed that participating in any event contract involved making a wager or gamble, there would have been no need for Congress to individually enumerate “gaming” as a distinct category of event contracts upon which the Commission could make a public interest determination. The fact that Congress separated “gaming” from other event contracts is a clear indication that Congress did not intend for all event contracts to be considered gaming.

In fact, the statutory definition of “bet” or “wager” used by the Nadex Order itself, in the same statute, clearly indicates that not all CFTC regulated products are gaming. The statute cited by the Nadex Order²⁴ for defining “bet” or “wager” is 31 U.S.C. § 5362(1), a part of the Unlawful Internet Gambling Enforcement Act of 2006. That definition of “bet or wager,” however, includes two relevant exclusions. First, the term “bet or wager” does 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.”²⁵ The term also does not include “any other transaction that is excluded or exempt from regulation under the Commodity Exchange Act.”²⁶ The statute cited by the Nadex Order itself demonstrates that the Nadex Order’s expansive application of Section 5c(c)(5)(C) and Rule 40.11 is incorrect.

The Nadex Order’s broad interpretation of gaming under the statute and rule would result in prohibiting much of the legally registered activity that the CFTC has previously approved. Indeed, many states ban “gambling” not just on elections, but specifically on the outcomes of future events. For example, New Hampshire bans gambling and defines it as “to risk something of value upon a future contingent event not under one’s control or influence”²⁷ while North Carolina includes a

²³ See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>) (last visited May 30, 2022). The many other distinctions between an event contract and a gamble include the fact that betting is a game of pure chance without any economic utility while event contracts are non-chance driven outcomes with economic utility.

²⁴ Nadex Order at 3.

²⁵ 31 U.S.C. § 5362(1)(a)(E)(ii).

²⁶ *Id.* § 5362(1)(a)(E)(iv)(I).

²⁷ NH 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

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wager on an “unknown or contingent event” in its statutory definition of gambling.²⁸ New York defines gambling as staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.²⁹ Other states explicitly prohibit trading on the future delivery of securities and commodities without delivery and which are purely cash-settled, as is normal for products like stock index futures and eurodollar futures.³⁰ In all, 19 states contain provisions in their state codes that prohibit the listing of at least some subset of contracts that the CFTC has approved.³¹

Under the Nadex Order’s reasoning, because Rule 40.11 prohibits the listing of contracts that “involve” “gaming,” laws like these would prohibit *all* event contracts. For example, event contracts on the weather and various economic indicators would be considered “risking something of value upon a future contingent event not under one’s control or influence.” And yet, not only are these event contracts a staple of CFTC regulated DCMs, but the Commission’s Core Principles require that event contracts be specifically outside the control or influence of a market participant and not readily susceptible to manipulation. The Nadex Order’s application of Rule 40.11 would therefore preclude the CFTC from regulating any event contract because event contracts are considered gambling under (some) state laws.³² Because such an interpretation of “gaming” would lead to absurd results, the traditional tools of interpretation and the process required by the

value in the event of a certain outcome”); Or. 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 . . .”).

²⁸ N.C. Gen. Stat. § 16-1.

²⁹ NY Penal Law, Chapter 40, Part 3, Title M, Article 225.

³⁰ For example, the laws of South Carolina, Oklahoma, and Mississippi use the following language: “Any contract of sale for the future delivery of cotton, grain, stocks or other commodities . . . upon which contracts of sale for future delivery are executed and dealt in without any actual bonafide execution and the carrying out or discharge of such contracts upon the floor of such exchange, board of trade, or similar institution in accordance with the rules thereof, shall be null and void and unenforceable in any court of this state, and no action shall lie thereon at the suit of any party thereto.”

³¹ Moreover, the purpose of the CEA, CFMA and other laws was to create clear and consistent national guidelines; a contrary interpretation would lead to the undesirable result that if one state prohibited a specific kind of contract then the Commission could use the special rule to ban that contract in all states.

³² On this point, it seems that at the very least, Rule 40.11 would be an APA violation, or even unconstitutional, if the analysis in Nadex Order was taken to its logical conclusion because of its dramatic impacts on the regulatory scheme. *Cf. Whitman v. American Trucking Ass’ns, Inc.*, 531 U.S. 457, 468 (2001) (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.”).

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Supreme Court in *Kisor* demonstrate that the Nadex Order's view cannot be the correct way to interpret Rule 40.11.³³

Seen in this context, the state laws that prohibit gambling on elections do not and cannot refer to CFTC regulated event contracts. The laws of many states prohibit gambling on event contracts, case-settled commodity futures contracts, and elections as one. Yet, the CFTC clearly continues to regulate and approve of the event contracts and cash-settled commodity futures markets even though it may seem to conflict with those state laws.³⁴ Event contracts relating to elections should be no different. Indeed, just as other event contracts regulated by the CFTC, Kalshi's political control contract should also not be precluded by the gaming provisions of Rule 40.11.

Furthermore, the CFTC's actions and inactions since the Nadex Order indicate that even the Commission has not continued the Nadex Order's reasoning in this regard. Consider, for example, the Small Cannabis Equity Index Futures Contract listed by the Small Exchange. The Cannabis Index involves the stock prices of companies in the cannabis industry that produce and distribute cannabis for consumption—an activity that is unlawful under Federal law and many State laws. The contract is “dependent on the occurrence, nonoccurrence, or the extent of the occurrence” of an event with “potential financial, economic, or commercial consequence,”³⁵ namely the value of the Cannabis Index. The activities of these companies are production and distribution of cannabis for consumption, which are all activities that are “unlawful under Federal and [many] State laws,”

³³ See, e.g., *Tennessee Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2462 (2019) (“reading § 2 [of the Twenty-First Amendment] to prohibit the transportation or importation of alcoholic beverages in violation of *any* state law would lead to absurd results that the provision cannot have been meant to produce”) (emphasis in original). Indeed, the “Commission agrees that the term ‘gaming’ requires further clarification and that the term is not susceptible to easy definition.” *Provisions Common to Registered Entities: Final Rule*, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). In the 40.11 Final Rule, the Commission noted that it had previously sought comments regarding event contracts and gaming in 2008 and that the “Commission continues to consider these comments and may issue a future rulemaking concerning the appropriate regulatory treatment of ‘event contracts,’ including those involving ‘gaming.’” 40.11 Final Rule at 44,785. “In the meantime, the Commission has determined to prohibit contracts based upon the activities enumerated in Section 745 of the Dodd-Frank Act and to consider individual product submissions on a case-by-case basis under 40.2 or 40.3.” *Id.* That process is undermined if the Nadex's Order's approach to “gaming” stands.

³⁴ The CFMA explicitly preempts the application of state gambling statutes when it applies to legal commodity futures contracts and as such there is also a federal preemption argument here that the state gambling statutes should not be considered, regardless of the Nadex Order's misapplication of Rule 40.11. See 7 U.S.C. § 16(e)(2) (“This chapter shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops (other than antifraud provisions of general applicability) in the case of—(A) an electronic trading facility excluded under section 2(e) of this title; and (B) an agreement, contract, or transaction that is excluded from this chapter under section 2(c) or 2(f) of this title or sections 27 to 27f of this title, or exempted under section 6(c) of this title (regardless of whether any such agreement, contract, or transaction is otherwise subject to this chapter).”).

³⁵ See 7 U.S.C. § 1a(19) (definition of excluded commodity).

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and should otherwise fall under the purview of Section 5c(c)(5)(C) and Rule 40.11. Certainly, if Section 5c(c)(5)(C) was given the same broad reading that the Commission gave to it in the Nadex Order, the Cannabis Equity Index would certainly “involve” an enumerated activity and be subject to Section 5c(c)(5)(C) and Rule 40.11. Yet, the Cannabis Index contract was self-certified and the Commission did not invoke Section 5c(c)(5)(C) or Rule 40.11. Therefore, it is clear that the Commission has not maintained the Nadex Order’s overbroad and incorrect reading of the Statute and Rule 40.11.

Even if the proposed Kalshi contracts somehow came within the scope of Section 5c(c)(5)(C) and Rule 40.11, that does not preclude them from being listed. I understand that Kalshi has made submissions to the Commission demonstrating offering the contracts would be in the public interest. A full discussion of those points is outside the scope of this letter. I do note, however, that the Commission is not limited to using an economic purpose test for determining whether a contract is within the public interest. That test is found nowhere in the text of Section 5c(c)(5)(C) or Rule 40.11. One reference to the economic purpose test between two Senators in a brief discussion of what would become Section 5c(c)(5)(C) is insufficient to bind the Commission to that test.³⁶ The Commission recognized as much in the Nadex Order itself, stating “the Commission has the discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest.”³⁷

Furthermore, as a procedural matter, there is nothing in the CEA or Rule 40.11 requiring the Commission to act on Kalshi’s self-certification of the political control contracts discussed in this letter. Both Section 5c(c)(5)(C) and Rule 40.11 speak in terms that the Commission “may determine.”³⁸

At the end of the day, Kalshi has various arguments to justify the self-certification of the contracts described above.

³⁶ See supra note 19 (discussing limitations of floor statements as persuasive evidence of a statute’s meaning).

³⁷ Nadex Order at 4.

³⁸ 7 U.S.C. § 7a-2(c)(5)(C)(i) (“the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest . . .”) (emphasis added); 7 C.F.R. § 40.11(c) (“The Commission **may determine** . . . that a contract . . . be subject to the 90-day review.”) (emphasis added).

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Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml


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APPENDIX G (CONFIDENTIAL) - FEES

As instructed by the Secretariat, the Exchange paid a fee of \$6,000 via the CFTC's pay.gov portal. A copy of the receipt is attached.

KalshiEX LLC - Confidential Treatment Under Regulations 40.8 and 40.9 Requested

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07 2022

Receipt - Commodity Futures Trading Commission(CFTC)Miscellaneous Form

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Receipt

Your payment has been submitted to Pay.gov and the details are below. If you have any questions regarding this payment, please email 9-AMZ-AR-CFTC@faa.gov, please.

Tracking Information

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Agency Tracking ID: 76268019171

Form Name: Commodity Futures Trading Commission(CFTC)Miscellaneous Form

Application Name: Commodity Futures Trading Commission (CFTC) Misc. Form

Payment Information

Payment Type: Debit or credit card

Payment Amount: \$6,000.00

Transaction Date: 07/20/2022 12:09:03 AM EDT


Payment Date: 07/20/2022

Account Information

Cardholder Name: Hadassah Mishory

Card Type: Visa

Card Number: *****7093

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07 2022

Receipt - Commodity Futures Trading Commission(CFTC)Miscellaneous Form

[← Payment Activity](#)

Receipt

Your payment has been submitted to Pay.gov and the details are below. If you have any questions regarding this payment, please email 9-AMZ-AR-CFTC@faa.gov, please.

Tracking Information

Pay.gov Tracking ID: 270UR42L

Agency Tracking ID: 76268019171

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Card Number: *****7093

Kalshi

FOIA CONFIDENTIAL TREATMENT REQUESTED by KalshiEX LLC – Pursuant to 17 C.F.R. §§ 40.8 and 145.9

Assistant Secretary of the Commission
for FOI, Privacy and Sunshine Acts Compliance
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: FOIA Confidential Treatment Request (Detailed Written Justification of FOIA Confidential Treatment Request)

Dear Sir or Madam:

KalshiEX LLC (“Kalshi”) hereby respectfully requests that the Commodity Futures Trading Commission (the “CFTC”) accord confidential treatment under 17 C.F.R. §§ 40.8 and 145.9 to the confidential material transmitted today with this letter that are marked confidential, and all information derived therefrom (collectively, the “Confidential Information”). Pursuant to Commission Regulation 145.9(d)(4), please consider that this cover sheet has been clearly marked “FOIA Confidential Treatment Requested by KalshiEX LLC” and is securely attached to the group of records submitted for which confidential treatment is requested.

This request for confidential treatment is made pursuant to 17 C.F.R. §145.9(d)(1) because Kalshi believes that the Confidential Information is covered by one or more exemptions in the Freedom of Information Act (the “FOIA”) (5 U.S.C. §552(b)) and is therefore exempt from the CFTC’s public disclosure requirements pursuant to 17 C.F.R. §145.5. In particular, 5 U.S.C. §552(b)(4) (“Exemption 4”) and 17 C.F.R. §145.9(d)(1)(ii) exempts disclosure that would reveal the Kalshi’s trade secrets or confidential commercial or financial information. Kalshi believes that the Confidential Information contains confidential commercial and financial information as well as proprietary information regarding its legal and business analyses and research that

should be protected from public disclosure pursuant to this exemption. Confidential treatment is requested for a period of five years.

Judicial analysis of Exemption 4 has found that there is a presumption of confidentiality for commercial information that is (1) provided voluntarily and (2) is of a kind the provider would not customarily make available to the public. See *Critical Mass Energy Project v. Nuclear Regulatory Commission*, 975 F.2d 871, 878 (D.C. Cir. 1992) (en banc); see also *Center for Auto Safety v. National Highway Traffic Safety Administration*, 244 F.3d 144, 147 (D.C. Cir. 2001) (applying the tests detailed in *Critical Mass*). Kalshi provided the Confidential Information to the Commission voluntarily in order to demonstrate to the Commission the Program's compliance with the CEA and the Commission Regulations. Notwithstanding the presumption of confidentiality, the confidential information would still be considered "confidential" because Kalshi would not disclose it to the public and its disclosure would cause substantial harm to Kalshi's competitive position. The information set out in the confidential appendices was developed by Kalshi at significant cost and over a substantial period of time. Further, the Confidential Information is purely internal analyses that Kalshi would not customarily make available to the public. Additionally, the Confidential Information would give Kalshi's competitors insights into Kalshi's processes and proprietary research, which would have the effect of placing Kalshi at a significant competitive disadvantage in light of the time, effort, and capital that Kalshi expended developing that material. Publication of this material would have the deleterious effect of stifling innovation; after all, if registrants are stripped of the benefits of innovation there is no incentive to innovate.

FOIA was enacted to facilitate the disclosure of information to the public, but was clearly not intended to allow business competitors to avail themselves of valuable confidential information, especially when "competition in business turns on the relative costs and opportunities faced by members of the same industry." *Worthington Compressors v. Costle*, 662 F.2d 45, 51 (D.C. Cir. 1981). In *Gulf & Western Industries, Inc. v. United States*, 615 F.2d 527 (D.C. Cir. 1979), the Court of Appeals concluded that information is confidential for purposes of FOIA if (1) it is not of the type normally released to the public by the Kalshi and (2) the information is of the type that would cause substantial competitive harm if released. There is no requirement that "competitive harm" be established by a showing of actual competitive harm. Rather, "actual competition and the likelihood of substantial competitive injury is all that needs to be shown." *Gulf & Western*, 615 F.2d at 530. Thus, in *National Parks and Conservation Association v. Kleppe*, 547 F.2d 673 (D.C. Cir. 1976), the Court of Appeals concluded that the disclosure of certain financial information, including costs and price-related items, was likely to cause substantial harm to the disclosing party's competitive position. When applying the "substantial competitive harm test," courts "[c]onsider how valuable the information will be to the requesting competitors and how much this gain will damage the submitter." *Worthington Compressors*, 662 F.2d at 51. It is clear that the FOIA exemption was intended to prevent the fundamental unfairness that can result from one side having confidential information about the other in a business context. *Cf. National Parks*, 547 F.2d at 678 n.18. The confidential information is valuable commercially because it took significant time and at substantial cost to develop.

If the Commission or its staff transmits any of the Confidential Submission to another federal agency, Kalshi requests that you forward a copy of this letter to any such agency with the Submission and further requests that you advise any such agency that Kalshi has requested that this material be accorded confidential treatment.

The requests set forth in the preceding paragraphs also apply to any memoranda, notes, transcripts or other writings of any sort whatsoever that are made by, or at the request of, any employee of the Commission (or any other federal agency) and which (1) incorporate, include or relate to any aspect of the Confidential Submission; or (2) refer to any conference, meeting, or telephone conversation between Kalshi, its current or former employees, representatives, agents, auditors or counsel on the one hand and employees of the Commission (or any other government agency) on the other, relating to the Confidential Submission.

This request is not to be construed as a waiver of any other protection from disclosure or confidential treatment accorded by law, and Kalshi will rely on and invoke any such confidentiality protection. Kalshi requests that the CFTC advise the undersigned, pursuant to 17 C.F.R. §145.9(e)(1), in advance of any disclosure of the Confidential Information pursuant to the FOIA, so that this request for confidential treatment may be substantiated.

If you should have any questions or comments or require further information, please do not hesitate to contact the undersigned at emishory@kalshi.com or (443) 839-3192.

Yours,

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com



September 25, 2022

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. The Exchange welcomes the opportunity to address the Commission’s questions. This comment addresses the first question and the third question that the Commission asked:

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
2. as described in regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?
3. 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?

This comment is divided into two parts. Part 1 discusses the statute. In particular, Part 1 of the comment addresses section 5c(c)(5)(C) of the Commodity Exchange Act (“CEA”), codified¹ at 7 U.S.C. 7a-2(c)(5)(C).² Of particular importance, Part 1 is based on an analysis of the statute

¹ The CEA section designations do not align with the section designations in the United States Code. Because this is a public comment, the Exchange will generally use citations to the United States Code as opposed to the CEA, which will enhance the public’s ability to research and analyze the issues presented.

² The Exchange will address the applicability of the regulations at 17 C.F.R. 40.11 in a separate comment, and also in the appendix to this comment in the Counsel Analyses. However, the Exchange notes here that the regulation cannot exceed the authority in the statute that the regulation implements. This is axiomatically true even under the *Chevron* deference from *Chevron, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Indeed, step one of *Chevron* is to determine whether Congress expressed intent in the statute and, if so, whether or not the statute’s intent is ambiguous. It is black letter law that if the statute is clear, the regulating agency cannot regulate contrary to the statute. Indeed, earlier this year in *Empire Health*, Justice Kagan, writing for the Court, held that the government’s regulation was valid only because the “regulation correctly construes the statutory language at issue.” *Becerra v. Empire Health Foundation*, 142 S. Ct. 2354 (2022). Had that not been the case, Justice Kagan and the Court would have held the regulation invalid.

Kalshi



irrespective of any rule, including 40.11, which the Commission has issued or may, in the future, promulgate to implement this statutory provision.

As a threshold matter, the Exchange notes that the majority of the Commission’s questions for public comment assume that the Special Rule in CEA 5c(c)(5)(C) (“Special Rule”) applies or can apply to Kalshi’s political control contract (“Contract”), a question that the Commission invites the public to address in questions 1 and 3. If the answers to questions 1 and 3 are no, many of the other questions become moot, at least in regard to the Contract, which is the sole matter under Consideration in this Commission action.³

Part 2 includes analyses from Jonathan Marcus and Dan Davis that directly address Questions 1 and 3. Messrs. Marcus and Davis both served as General Counsel of the Commission prior to assuming their current positions in private practice.

Part 1

Contracts, events, and other important terms

There are several terms that are key to understanding the framework that Congress created for the Special Rule that appear throughout this comment and are helpful to define here:

- “Event Contract”
- The “Event Contract’s Event” (also, referred to as the “contract’s Event”)
- The “contract, considered as a whole” (also, referred to as the “contract, as a whole”, the “contract, itself”, and the “contract itself, considered as a whole”)

An “Event Contract” is a contract that is based on an occurrence, extent of an occurrence, or a contingency. For example, a contract whose terms and conditions specify that the holder of the contract will receive payment based on the occurrence of a hurricane is an Event Contract because it is based on an occurrence, a hurricane. The terms and conditions of Kalshi’s Contract specify that holders of the contract will receive money based on the occurrence of political control over Congress.⁴ It is an event contract because it is based on an occurrence, political control.⁵

A contract’s “Event” refers to the specific occurrence, extent of an occurrence, or contingency on which the contract is based. A hurricane contract’s event is the hurricane. Kalshi’s Contract’s event is political control

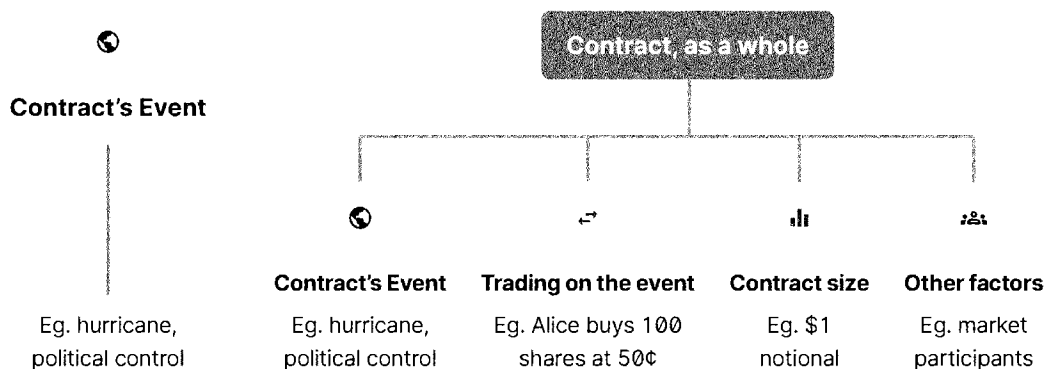
The phrase “contract, considered as a whole” refers to a broad view of a contract and all factors that surround or are a part of the contract. For example, this would include the activity of buying and selling the contract ie. the activity of *trading* the contract, the information embedded in the contract’s pricing, and in the case of an Event Contract, the contract’s Event.

Accordingly, any suggestion that the Commission’s regulation 40.11, which implements the statute at 7 U.S.C. 7a-2(c)(5)(C), applies to a contract to which the statute itself does not apply is specious. If the regulation did, it would be invalid. Regardless, a careful reading of the regulation shows that the regulation does not apply to any contract to which the statute does not apply. We address the regulation in more depth in Part 2.

³ Specifically, if the answers to questions 1 and 3 are no, the following questions would be moot insofar as they would not apply to the Contract: 2, 4, 6, 7, 8, 9, 10, 11, 12, 13, 14, 17. Question 5, which assumes the soundness of the legal reasoning in the Nadex Order, *see infra*, would also be moot.

⁴ Please see the full filing for the full terms and conditions of the Contract.

⁵ Specifically, the contract is based on the party membership of the Speaker of the House and the President Pro Tempore.



The statute

Part 1 of this comment focuses on the correct interpretation of the Special Rule, which is set forth in a statute. The full text of the statute⁶ is included here, for the reader's convenience:

(C) Special rule for review and approval of event contracts and swaps contracts
(i) Event contracts

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve-

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

(ii) Prohibition

No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

General background on the CEA's Special Rule

Under the CEA, contract listing is not a "permission" regime. Contracts do not need Commission approval to be listed, and although the CEA provides a mechanism that exchanges may utilize to put a contract before the Commission for approval, whether or not to utilize that method is solely

⁶ 7 U.S.C. 7A-2(c)(5)(C).



in an exchange’s discretion.⁷ Indeed, the overwhelmingly vast majority of contracts are never presented to the Commission for approval under this mechanism. Even in those rare instances when the Commission is formally presented with a contract for approval, the Commission’s discretion over whether to grant or withhold approval is limited; under the statute and the regulations, the Commission must approve every contract that does not violate the CEA or the regulations.⁸ The Commission was not granted authority to conduct a “is this a contract that I am comfortable with” analysis and the Commission was not granted authority to disapprove a contract because it does not like it.⁹

The Commission was also not granted the authority to prohibit any contract on the grounds that it violates the public interest. There is one exception to this rule, where Congress did give the Commission the authority to prohibit a contract that the Commission determines is contrary to the public interest.¹⁰ This exception is the Special Rule in 5c(c)(5)(C) of the Commodity Exchange Act.¹¹ This Special Rule gives the Commission discretion to consider, for very specific types of contracts, whether a contract is contrary to the public interest.¹²

There are two aspects to the Special Rule. The first is the Special Rule’s eligibility requirements; the Special Rule does not apply to all contracts. It only applies to a specifically defined subset of contracts, identified through a two-step process described below, that are eligible for the Special Rule. If a contract is determined to be eligible for the Special Rule, it is not automatically prohibited. The Special Rule only prohibits contracts that are eligible for the Special Rule if the Commission determines that the contract is contrary to the public interest. The second aspect of the Special Rule thus is determining whether the contract that is eligible for the Special Rule is contrary to the public interest. Congress laid out the process for the Special Rule in three steps.

The three steps of the Special Rule

There are three steps in the Special Rule.

Step one of the Special Rule (“Step One”) is to determine if the contract is eligible for the Special Rule. The statute limits the scope of the Special Rule to contracts that are “based upon [an] occurrence, extent of an occurrence, or contingency” (collectively “Event”). In other words, to be eligible for the Special Rule, a contract must be based on an Event, *i.e.*, the contract must be an Event Contract. If a contract is not an Event Contract, it is not eligible for the Special Rule and the contract fails Step One. The analysis then terminates and the Special Rule does not apply to that contract. If the contract is an Event Contract, the analysis proceeds to step two.

Step two of the Special Rule (“Step Two”) is to determine if the Event Contract’s Event involves¹³ certain activities that were listed by Congress in the Special Rule. These activities are:

1. an activity that is unlawful under any Federal or State law;

⁷ This process is set forth in 17 C.F.R. 40.3, which the Commission titled “*Voluntary* submission of new products for Commission review and approval.”

⁸ 7 U.S.C. 7a-2(c)(5)(B); 17 C.F.R. 40.3(b).

⁹ *Id.*

¹⁰ As explained below and in a second comment letter, even if, *arguendo*, the Special Rule applied to the Contract (which it does not), the Special Rule would still not prohibit the Contract because it is *in* the public interest, and therefore certainly not contrary to the public interest.

¹¹ 7 U.S.C. 7a-2(c)(5)(C).

¹² *Id.*

¹³ Please see *infra* the “A further look at step two of the Special Rule” for more discussion on the correct interpretation of step two and why step two is limited to the contract’s Event.



2. terrorism;
3. assassination;
4. war;
5. gaming;

In addition to these five specific activities, Congress included a sixth activity: “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”¹⁴ This sixth activity gives the Commission discretion to identify other similar activities that are contrary to the public interest. If the Event Contract’s Event does not involve any of the six activities that are listed in the Special Rule, the Event Contract is not eligible for the Special Rule. The analysis terminates and the Special Rule does not apply to prohibit the contract. If the Event Contract’s Event does involve at least one of these activities, the analysis continues to step three.

Step three of the Special Rule (“Step Three”) is for the Commission to determine whether the contract itself, considered as a whole, is contrary to the public interest.¹⁵ If the Commission does not determine that the contract is contrary to the public interest, the contract is not prohibited under the Special Rule. If the Commission determines that the contract is contrary to the public interest, the Special Rule applies and the contract is prohibited.¹⁶

The three steps that the Commission follows in applying the Special Rule are therefore:

Step 1: Is the contract an Event Contract? If no, stop. If yes, continue to step 2.

Step 2: Does the Event Contract’s Event involve an activity that was included by Congress in the Special Rule? If no, stop. If yes, continue to step 3.

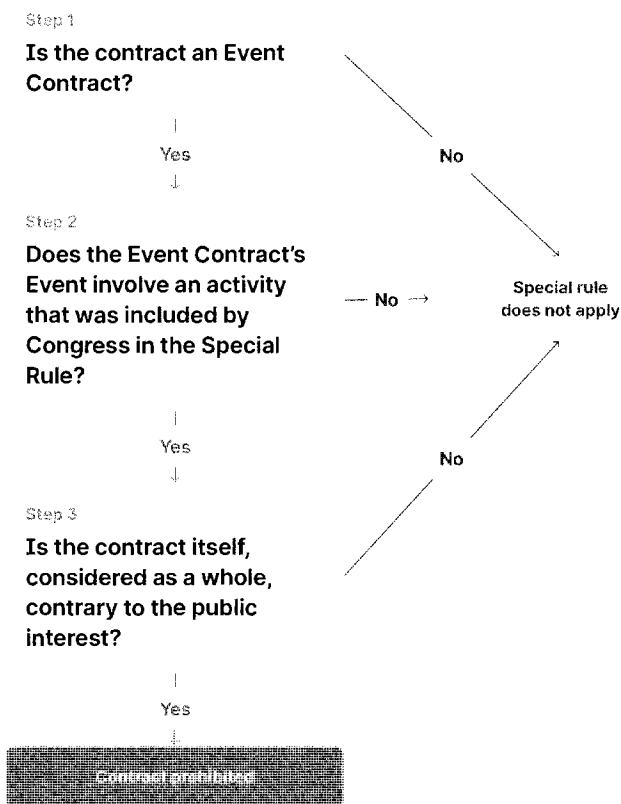
Step 3: Is the contract itself, considered as a whole, contrary to the public interest? If no, the contract is not prohibited. If yes, the contract is prohibited.

Graphically, the flow of the three steps looks like this:

¹⁴ 7 U.S.C. 7a-2(c)(5)(C)(i)(VI).

¹⁵ The phrase “contrary to the public interest” is used three times in the Special Rule. It is used in clause (i) in reference to the sixth activity in the list of activities Congress included in step two of the Special Rule. In this context, it is the *contract’s Event* that is contrary to the public interest, not the *contract itself*. It is also used in clause (i) in step three and in the prohibition in clause (ii) in reference to the *contract itself*.

¹⁶ 7 U.S.C. 7a-2(c)(5)(C)(ii). (“No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.”)



Step One and Step Two limit the scope of contracts to which the Special Rule applies. Step One limits the Special Rule only to Event Contracts. Step Two limits this scope further. Step Two provides that the Special Rule does not apply to *all* Event Contracts, but only to those contracts whose Events involve one of the activities Congress listed in the statute. Step Three provides that even a contract that passes Steps One and Two is not prohibited unless the Commission determines that the contract, considered as a whole, is contrary to the public interest. The following graphic illustrates how each step of the Special Rule functions to narrow the scope of the contracts that are prohibited under the Special Rule.



All Contracts

Step 1 Is the contract an Event Contract?

Step 2 Does the Event Contract's Event involve an activity that was included by Congress in the Special Rule?

Step 3 Is the contract itself, considered as a whole, contrary to the public interest?

To further explain the role of Step Three, Congress did not prohibit an Event Contract whose Event involves an activity listed in the Special Rule.. It is possible that an Event Contract's Event involves an activity listed in the Special Rule but the Commission does not determine that the contract, considered as a whole, is contrary to the public interest. That contract would not be prohibited under the Special Rule. For example, an Event Contract on the invasion of Ukraine would satisfy Steps One and Two because it is an Event Contract (Step One) and the Event Contract's Event involves war, one of the activities that is listed in the Special Rule (Step Two). That does not mean that the contract is prohibited; it moves to step three for the Commission to determine if the Event Contract, considered as a whole, is contrary to the public interest. The Commission may determine that it is contrary to the public interest, in which case the Event Contract would be prohibited by the Special Rule.¹⁷ And the Commission may determine that it is not contrary to the public interest. As Commissioner Johnson recently noted, "Geopolitical events in Europe, specifically, the invasion of Ukraine has led to remarkable disruptions in energy and agriculture markets."¹⁸ Accordingly, the Commission may find that the Event Contract has hedging utility and/or other economic utility or benefits and thus could not determine that the Event Contract is contrary to the public interest. This point, that a contract's event can involve an activity listed in the statute and still be allowed because the contract itself is not contrary to the public interest was made by then-Commissioner Berkovitz in his statement on ErisX's RSBIX contracts.¹⁹

¹⁷ 7 U.S.C. 7a-2(c)(5)(C)(ii).

¹⁸ [Opening Statement of Commissioner Kristin N. Johnson before the Energy and Environmental Markets Advisory Committee | CFTC](#), September 20, 2022.

¹⁹ Commissioner Berkovitz's statement is available here:

<https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>. Commissioner Berkovitz concluded his statement by noting that, "If sporting event contracts with an economic purpose, such as hedging, are allowed to be traded on a DCM, the general public must be able to access and trade those contracts on the exchange. The public cannot be barred from trading a contract listed on a DCM. However, gaming contracts without any economic purpose should not be permitted on a DCM."



A further look at step two of the Special Rule

Once an Event Contract passes Step One, the analysis moves to Step Two of the Special Rule. Step Two is to determine if the Event Contract involves an activity that was listed by Congress in the Special Rule. For the purposes of step two of the Special Rule, an Event Contract only involves an activity if the Event Contract’s *Event* involves that activity.²⁰ For example, an Event Contract can only involve war if the Event Contract’s Event involves war. Conversely, if the Event Contract’s Event does not involve war, then the Event Contract does not involve war. Similarly, an Event Contract will involve gaming only if the Event Contract’s Event involves gaming. For the purposes of Step Two, it is irrelevant if something else surrounding the Event Contract, such as the market activity of trading the contract, involves a listed activity. The only relevant factor for Step Two is whether the Event Contract’s Event involves the listed activity, not whether the Event Contract, considered as a whole, involves the listed activity.

There are many reasons why the analysis of whether an Event Contract involves a listed activity in Step Two is limited to the Event Contract’s Event, and does not include the consideration of the Event Contract as a whole. Many of these reasons are stated in the letters in Part 2 of this comment, as well as by other commenters.²¹ The Exchange provides two reasons here. (For convenience, this comment refers to the incorrect reading that the analysis under Step Two includes the Event Contract, considered as a whole, and is not limited to only the Event Contract’s Event, as the “Contract as a Whole view of Step Two”.)

The Contract as a Whole view of Step Two is wrong. An Event Contract cannot be considered to involve a listed activity based on the Event Contract considered as a whole, and not only the Event Contract’s Event. If step two were so broad, it would (1) defeat Congress’ intended narrowing function, and (2) render the statute internally inconsistent.

The sixth activity illustrates the flaw in applying Step Two broadly, ie. Contract as a whole View of Step Two. Congress included as the sixth activity a “similar activity [to the first five activities, that is] determined by the Commission, by rule or regulation, to be contrary to the public interest.” Under the Contract as a Whole view of Step Two, the sixth activity means that the Commission can determine that any factor that is part of an Event Contract is contrary to the public interest.²² For example, the Commission can determine that *trading* contracts on a certain event is a “similar activity” to the listed activities and is contrary to the public interest. These contracts would satisfy Step Two even though the Event contracts are based on Events that are *not* contrary to the public interest because the *trading* on the contract *is* contrary to the public interest per the Commission’s determination, and trading on the contract is part of the contract when considered as a whole.

The analysis would then move to Step Three. But Step Three calls for a public interest analysis

²⁰ The analysis of the Event Contract in Step Three is different from Step Two. The analysis in Step Three considers the Event Contract as a whole, and is not limited to the Event Contract’s Event. Conversely, the analysis in Step Two is limited to what activities the Event Contract’s Event involves.

²¹ See e.g. the comments of Josh Sterling, Timothy McDermott, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, and Railbird Technologies.

²² This is because under the Contract as a Whole view of Step Two, Step Two is not limited only to looking at the Event Contract’s Event. The analysis in Step Two looks at the Event Contract as a whole. Accordingly, the activities included in the list in Step Two are not confined to the Event Contracts’ Events, and can include anything related to the Event Contract.



of the Event Contract, considered as a whole, where it has already been determined under Step Two that the *trading itself* is contrary to the public interest, i.e. that the Event Contract, considered as a whole, is contrary to the public interest. This results in two consecutive steps that do the exact same thing:

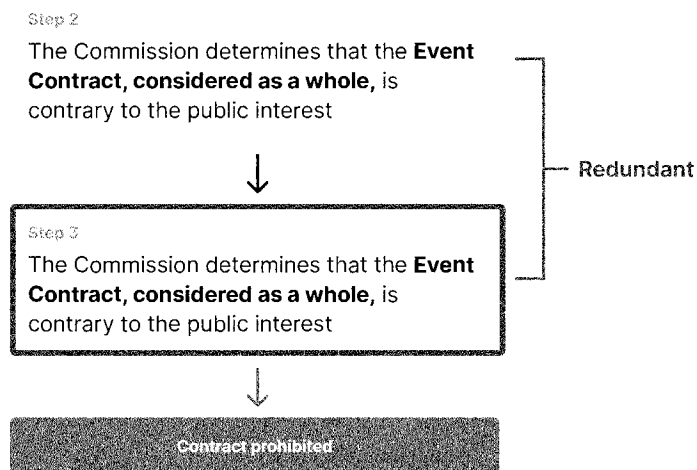
- Step Two: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
- Step Three: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest (*again*)

This illustrates the fundamental flaw in the Contract as a Whole view of Step Two. What Congress clearly designed is a statute that allows the Commission to apply special scrutiny to contracts based on particular events that Congress identified as problematic. Congress did not shut the door to such contracts, but recognized that trading on an Event Contract whose Event is a problematic activity that involves, say, assassination or terrorism might nevertheless have redeeming features (such as hedging utility) that would justify the conclusion that the Event Contract, considered as a whole, is not contrary to the public interest. In this way, Congress clearly differentiated the Event Contract's Event (which may be disfavored), and trading in the Event Contract (permitted where trading on the disfavored activity offers economic and other societal benefits). When trading in the Event Contract *itself* is included in the analysis at Step Two, the distinction Congress sought to draw between the underlying event and trading in the contract is obliterated.²³

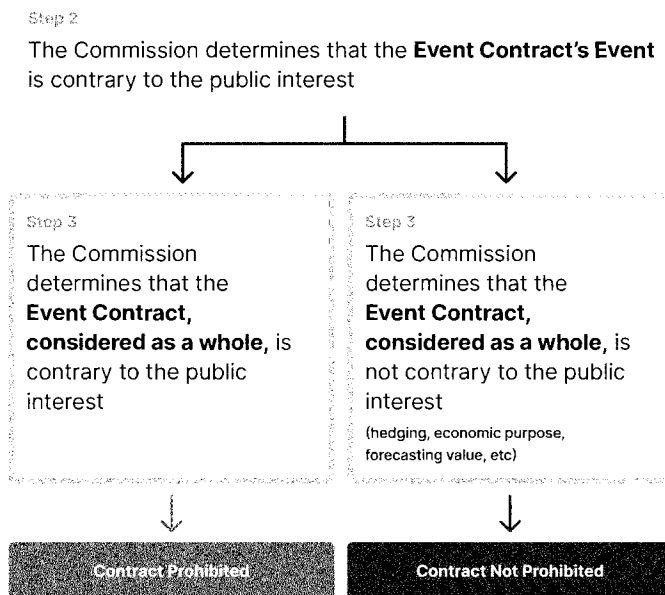
²³ This defect in the statute that emerges from the Contract as a Whole view of Step Two is from the sixth activity. The fact that the defect stems from the sixth activity does not mean that defect is limited to the sixth activity and that the Contract as a Whole View of Step Two is fine with regard to activities one through five. That would misapprehend the way that statutes work. Once it is demonstrated that step two cannot be about the contract, considered as a whole, for even one activity, that view is proven wrong. Therefore, the Contract as a Whole view of Step Two is an incorrect reading of the statute regardless of the activity.



The use of (c)(5)(C)(i)(VI) under the incorrect Contract as a Whole view of Step 2



The use of (c)(5)(C)(i)(VI) under the correct view of Step 2





Additionally, the Contract as a Whole view of Step Two actually renders all of the first five activities in Step Two superfluous. Once a contract passes Step Two, no matter which activity the contract involves, it must pass Step three to be prohibited by the Special Rule. The analysis in Step Three is for the Commission to determine whether the Event Contract, considered as a whole, is contrary to the public interest. *Any* Event Contract that the Commission determines is contrary to the public interest in step three *necessarily* would also satisfy the sixth activity in Step Two. For example, an Event Contract that involves war will pass Step Two. The analysis of the Event Contract will then move to Step Three, and assume that the Commission finds that the contract is contrary to the public interest. At that point, the Event Contract actually involves *two* of the listed activities: (i) it involves the activity of war, and (ii) it *also* involves an activity that the Commission has determined is contrary to the public interest. It is impossible for an Event Contract to pass Step Three and not involve the sixth activity in Step Two. Accordingly, there is no point in the first five activities listed in Step Two, only the sixth activity. In fact, there would be no point in Step Two at all. As noted, the sixth activity in Step Two and Step Three are identical. Accordingly, if the Contract as a Whole view of Step Two is correct, Congress would have just skipped Step Two altogether. The Special Rule would have been a simple six line statute that said only:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest.

The inevitable collapse of all of the Step Two activities into the sixth activity and the collapse of the sixth activity into Step Three under this expansive interpretation of Step Two shows that the Contract as a Whole view of Step Two is wrong. The correct view of Step Two is that it, like Step One, simply describes what the contract is based on, and the analysis in Step Two is limited to the Event Contract's Event. Accordingly, there is a big difference between Step Two, including the sixth activity, and Step Three. Step Two is focused only on the Event Contract's Event. If an Event Contract passes Step Two because the Event Contract's Event involves any of the listed activities, even the sixth activity, the analysis under Step Two will always be different from the analysis under Step Three. The analysis under Step Two will be whether the Event Contract's Event involves the activity. The analysis under Step Three is very different. Step Three does not only consider the Event Contract's Event alone, it considers the Event Contract, considered as a whole. Thus, all of the anomalies that directly stem from the Contract as a Whole view of Step Two disappear under the view that the analysis in Step Two (like Step One) considers only the Event Contract's Event.

The correct reading of the statute is that the analysis in Step Two, like Step One, is limited to the Event Contract's Event. Steps One and Two work in concert to create the eligibility requirements for the *type* of contract that the Special Rule applies to (*i.e.*, an Event Contract whose Event involves a listed activity), and Step Three serves as an independent step whose analysis considers the Event Contract, as a whole. Together, all three steps form a coherent and cohesive statutory rule that implements Congress's intent to have the Commission review a narrow subset of event contracts whose underlying events involve activities (such as terrorism and assassination) Congress did not want to automatically legitimize via futures and swaps trading on them. Congress nevertheless gave the Commission discretion to allow such contracts to be listed if

Kalshi

trading them would not be contrary to the public interest.

The Nadex Order's incorrect reading of the Special Rule

In the Commission's 2012 Nadex Order²⁴ ("*Nadex Order*") (see Question 5), the Commission applied the Special Rule to contracts on the occurrences of political control and the election of the President of the United States. These occurrences do not involve any of the activities in step two of the Special Rule. Despite this, the *Nadex Order* concluded that the Special Rule applied and prohibited the contracts. The *Nadex Order* adopted the Contract as a Whole view of Step Two, and assumed that the analysis in Step Two considers the Event Contract as a whole, not just the Event Contract's Event. The *Nadex Order* found that the election contracts involved the activity of gaming even though the contract's Event did not, because the act of trading on the contract was gaming and therefore, those contracts, considered as a whole, satisfied Step Two.

This Contract as a Whole view of Step Two that the *Nadex Order* adopted is wrong, and should be rejected. As discussed at length, it violates the structure and the framework of the statute, and it leads to absurd results. The correct view of the statute is that Step Two, like Step One, relates to what the contract is based on, or the contract's Event.

The Nadex Order's misreading of the statute would apply to every futures and swap contract on an occurrence

The consequence of the Contract as a Whole view of Step Two that the *Nadex Order* adopted is that the Special Rule applies to *all* futures, commodity options, and swap contracts that are based on an occurrence, extent of an occurrence, or a contingency. The *Nadex Order* found that the contracts at issue there were gaming because the act of trading the contracts would fit within state law and federal law definitions of gaming. That same reasoning would apply to *all* futures, commodity options, and swaps that are based on an occurrence, extent of an occurrence, or contingency, because the act of trading these contracts would also fit within definitions of gaming. For example, the *Nadex Order* cited the law in North Dakota that "'Gambling' means risking any money ... upon ... the happening or outcome of an event, including an election ... over which the person taking the risk has no control."²⁵ The *Nadex Order* also cited the New Hampshire law that "'Wager' means a monetary agreement between 2 or more persons that a sum of money ... shall be paid to one of them on the happening or not happening of an uncertain event."²⁶

The approach the Commission adopted in the *Nadex Order* expands the scope of the Special Rule far beyond what Congress intended. Under the *Nadex Order* and in light of the breadth of some definitions of gaming activity, the Commission could deem the staking of value on any type of future event gaming. Alternatively, the Commission could determine via the authority granted in the Sixth Activity, that trading on any type of future event is similar to the other enumerated activities. The vast breadth of such discretion cannot be squared with the specific enumeration of activities, which Congress clearly designed to cabin the Special Rule's scope.

²⁴ CFTC Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts" (Apr. 2, 2012) available here: [CFTC Issues Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts | CFTC](#).

²⁵ *Nadex Order* fn. 1

²⁶ It is true that the *Nadex Order* also cited state laws that were more tailored to elections specifically, but that does not negate the point that there are also state laws that define gaming broadly that would include trading any futures, commodity options, or swap contracts that pass step one. Picking and choosing which state statutes to consider informative in a manner that is expedient for a desired outcome is not the proper way for the Commission to adopt its definitional framework.



This reality illustrates the *Nadex Order's* flaw in going beyond the event underlying the contract -- elections -- to determine whether the contract was gaming.

This argument is addressed in greater detail in Part 2 of this comment. However, the Exchange notes here that this overbreadth is a problem exclusive to the approach to the Contract as a Whole view of Step Two adopted in the *Nadex Order*. Under the more tailored approach where step two of the Special Rule is limited to the contract's Event, this overbreadth disappears..

Applying the three steps of the Special Rule to Kalshi's Contract

Applying the three steps to Kalshi's contract shows that the contract is not subject to the Special Rule.

Kalshi's Contract passes Step One. It is a contract based on the occurrence of political control. The Contract is an Event Contract, meeting the eligibility requirements in Step One, and the analysis proceeds to Step Two.

Step Two is whether the Event Contract's Event involves an activity that was listed in Step Two. The Contract's Event is political control, specifically the dual occurrences of the party membership of the Speaker of the House and the President Pro Tempore. These do not involve any of the listed activities.

- The occurrence of political control does not involve activity that is illegal under either Federal or State Law.
- The occurrence of political control does not involve the activity of terrorism.
- The occurrence of political control does not involve the activity of assassinations.
- The occurrence of political control does not involve the activity of war.
- The occurrence of political control does not involve the activity of gaming.²⁷
- The occurrence of political control does not involve an activity that the Commission has determined to be contrary to the public interest.

The Contract's Event, therefore, does not involve an activity that was included by Congress in the list of activities in Step Two of the Special Rule, and therefore the contract fails the Step Two eligibility requirements. The analysis therefore terminates and does not proceed to Step Three, and Congress did not authorize the Commission to apply the Special Rule to prohibit the Contract.

Conclusion to Part 1

Congress granted the Commission in the Special Rule the authority to prohibit certain contracts. This grant of authority is subject to the rules that Congress created. Congress included three distinct steps to determine if a contract is prohibited under the Special Rule. The Commission must abide by these rules. Step Two is clear; the analysis only considers whether the Event Contract's Event involves a listed activity, and it does not consider the Event Contract, as a whole. The Kalshi Contract's Event is political control. Political control does not involve any of the activities that Congress included in Step Two. Accordingly, the Contract fails Step Two, and the Special Rule cannot prohibit the Contract.

²⁷ The Commission has never stated, or even implied, that the occurrence of elections involves gaming. In the Commission's Nadex order, the Commission stated that "*taking a position* in a Political Event Contract" is gaming because elections are a "a contest between electoral candidates." See *North American Derivatives Exchange, April 2, 2012 (cftc.gov)*, pg. 3. However, the Commission was careful to not suggest that elections themselves, the very bedrock and foundation of our democracy, are a game.



As required by the CEA in 7 U.S.C. 7a-2(c)(5)(B), the Commission should approve the Contract.



Part 2

The following two letters contain analyses on the Special Rule, as well as the implementing regulations at 17 C.F.R. 40.11. They were originally submitted to the Commission for consideration as part of the original 40.3 submission, and the Exchange includes them now in a public comment for the Commission's further consideration.

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September 21, 2022

Sebastian Pujol Schott
Acting Deputy Director, Product Review Branch
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, DC 20581

Re: Non-Application of Event Contracts Provisions to KalshiEX LLC's Political Control Contracts

Dear Mr. Pujol Schott:

I write to you on behalf of KalshiEX LLC (“Kalshi”) with respect to its intention to self-certify certain political control contracts (the “Contracts”) to be listed for trading on its designated contract market (“DCM”), and to address any outstanding concerns the Commodity Futures Trading Commission (“CFTC” or “Commission”), including the Division of Market Oversight (“DMO”), might have. We greatly appreciate the Commission’s and DMO’s continued willingness to allow Kalshi to highlight the many reasons why the Contracts should be listed, including the demonstrated economic purposes they serve.

In the spirit of building upon that productive dialogue, and in advance of Kalshi’s self-certification of the Contracts, we wanted to elaborate on why Section 5c(c)(5)(C) of the Commodity Exchange Act (“CEA”) and CFTC Regulation 40.11 (together, the “Event Contracts Provisions”) do not provide a legal basis for the staff or the Commission to impede self-certification of the Contracts.

As further explained below, Section 5c(c)(5)(C)(i) of the CEA does not hinder self-certification of the Contracts because the activity on which they are based does not “involve” any of the enumerated event categories in the provision. Although the Commission previously determined

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that other political event contracts that were self-certified by a different exchange, the North American Derivatives Exchange (“Nadex”), were subject to the Event Contracts Provisions, that determination was based on a misinterpretation of the Event Contracts Provisions. Therefore, the Commission’s previous determination on Nadex’s proposed contracts should not be followed here with regards to the Contracts.¹ Under the Event Contracts Provisions, and contrary to the Commission’s order relating to Nadex’s political event contracts (“Nadex Order”), which determined that the *trading* of contracts based on the outcomes of elections constituted gaming activity, the Commission must consider whether the occurrence or contingency *on which the Contracts are based* – elections – involves one of the enumerated activities. And because elections do not fit within any of the enumerated event categories, the Event Contracts Provisions provide no basis to delay self-certification. CFTC Regulation 40.11 calls for the same result. Accordingly, even if, arguendo, CFTC Regulation 40.11 contains language that could be construed to support a different result, the Commission should read CFTC Regulation 40.11 to be consistent with Section 5c(c)(5)(C) and, accordingly, the Contracts should be self-certified without delay or encumbrance.

As explained in greater detail below, because the Event Contracts Provisions do not establish any legal or regulatory basis for impeding the Contracts, the Commission should take no action that would delay Kalshi from self-certifying them pursuant to CFTC Regulation 40.2.

I. SECTION 5C(C)(5)(C) OF THE CEA PROVIDES NO BASIS TO IMPEDE SELF-CERTIFICATION OF KALSHI’S POLITICAL CONTROL CONTRACTS.

Section 5c(c)(5)(C)(i) of the CEA establishes that, in connection with the listing of agreements, contracts, or transactions on “excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency[.]”

the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve[.] (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

Section 5c(c)(5)(C)(ii) further specifies that “[n]o agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.” Thus, the CEA, through this

¹ 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>.

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provision, establishes a clear framework under which the Commission can – but is not obligated to – review an event contract that is based upon an “occurrence, extent of an occurrence, or contingency” that involves one of the enumerated underlying activities in order to determine if those contracts would be contrary to the public interest. A Commission determination that the contract is contrary to the public interest would render its listing prohibited.

In short, through Section 5c(c)(5)(C), Congress granted the Commission the discretion to determine that a given event contract is contrary to the public interest, and thereby prohibited, only when the event underlying that contract involves one of the statute’s specifically enumerated activities. Congress did not grant the Commission the authority to prohibit a contract based upon an event that involves an unenumerated activity on the grounds that it would be contrary to the public interest.²

The plain language and structure of Section 5c(c)(5)(C)(i) make clear that the scope of the Commission’s discretionary review is narrowly focused on the nature of the contract’s underlying event, not of trading in the contract itself. Section 5c(c)(5)(C)(i) begins with the clause: “[i]n connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities *that are based upon the occurrence, extent of an occurrence, or contingency[.]*” (emphasis added). Thus, at the outset of the controlling provision, the statute establishes that the distinguishing feature of the contract is the nature of the occurrence or contingency. The final clause of Section 5c(c)(5)(C)(i), immediately prior to the provision’s enumeration of the covered activities, refers back to the first clause of the provision when it says: “the Commission may determine that *such* agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve” the enumerated activities. (emphasis added). When the clauses are read together, Section 5c(c)(5)(C)(i) grants the Commission only limited authority to review a contract that is “based upon [an] occurrence, extent of an occurrence, or contingency” that “involve[s]” one of the enumerated activities.

The plain language of the enumerated events themselves bolsters this interpretation. As Kalshi has pointed out in previous submissions,³ Section 5c(c)(5)(C)(i)’s first and sixth categories are defined respectively as an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added). The inclusion of the noun “activity” (and the reference in the sixth

² This lack of authority includes the sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), as that provision requires the Commission to conduct a rulemaking to determine that another activity is contrary to the public interest and then only if it is similar to one of the other specified underlying activities (crimes, terrorism, assassination, war, or gaming). See Commission Rulemaking Explained, available at: https://www.cftc.gov/LawRegulation/CommissionRule-makingExplained/index.htm#_ftn1.

³ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to DMO March 28, 2022.

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category to all five preceding “similar activit[ies]”) makes clear that Congress intended the underlying activity, not the contract itself, to be the subject of review and scrutiny and it must be assumed that decision was intentional.⁴

The sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), further highlights that Congress’s intention was for the Commission to analyze the activity underlying the contract rather than trading in the contract itself. This final enumerated activity provides the Commission a sort of catchall to determine whether the event involves “similar activity” to the preceding categories and thus might be inappropriate for listing. Since terrorism, assassination, war, and activity unlawful under state or federal law unquestionably refer to the occurrence or contingency underlying the contract, the sixth catch-all category must be read consistently with the rest of the enumerated list (apples must be compared to apples).⁵

Another reason that Section 5c(c)(5)(C) must be read as focusing on the underlying activity is that such focus is congruent with the nature of event contracts themselves. If Congress was concerned about trading in the contract itself, there is no indication why it would have limited the provision to event contracts rather than establishing a general rule that would have authorized the Commission to prohibit any derivatives contract that the trading in is, for example, unlawful under state law.

In the Nadex Order,⁶ the Commission did not interpret Section 5c(c)(5)(C) as focusing on the underlying activity. Instead, the Commission appears to have read the gaming provision (the fifth enumerated activity) to refer to trading in the contract itself. Accordingly, the Commission determined that the gaming provision applied to Nadex’s political event contracts because the contracts involved “a person staking something of value upon a contest of others.”⁷ The Commission likened this trading activity to activity prohibited by state anti-gambling laws. The Commission’s interpretation in this instance ran counter to the plain language and structure of the statute, as explained above.

⁴ The scant legislative history – a colloquy between Senators Diane Feinstein and Blanche Lincoln during the Senate’s consideration of Dodd-Frank’s regulation of event contracts – does not change the analysis. The colloquy did not address whether the underlying event, rather than trading in the contract itself, is the proper subject of analysis; instead, the Senators discussed the distinction in economic purpose between contracts that serve hedging utility and contracts that are designed predominantly for speculation. *See* 56 Cong. Rec. S5906-07 (July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at: <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. In any event, the language and structure of the statute are clear, so resorting to legislative history is unnecessary.

⁵ We explain below why, notwithstanding the Commission’s Nadex Order, the gaming provision must also refer to the underlying activity and not trading in the contract itself.

⁶ *See supra* note 1.

⁷ Nadex Order at 3 (internal quotation marks omitted).

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Other principles of statutory construction also undercut the application of the Event Contracts Provisions in the Nadex Order. Under the Commission’s interpretation, a person trading a political event contract is engaged in gaming – “staking something of value upon a contest of others.”⁸ By parallel reasoning, a person trading a terrorism contract is engaged in terrorism and a person trading a war contract is engaged in war. That is not a tenable interpretation of the statute. If Congress intended the Commission to focus on the underlying event for some of the enumerated categories, but to focus on trading in the contract itself for others, it would have said so. It certainly cannot be presumed or inferred from silence that Congress intended the Commission to apply disparate analytical approaches to the single list of enumerated activities. When the correct interpretation of Section 5c(c)(5)(C) is applied to the Contracts, the result is clear. Elections are not illegal under state or federal law, are not gaming, and are not similar to any of the enumerated activities – federal or state crimes, terrorism, assassination, war, and gaming – all of which are activities that Congress did not want to legitimize or encourage via event contracts without careful consideration by the Commission. The Commission should therefore not impede Kalshi from self-certifying the Contracts and lacks a legal basis to invoke Section 5c(c)(5)(C) to do so.

While we could stop here, we believe it is worth pointing out that the Nadex Order not only contravenes the language and structure of Section 5c(c)(5)(C), but also threatens to upend the CEA itself. Virtually every futures or swaps contract can be described as staking something of value on the outcome of some future event.⁹ Yet the CFTC’s exclusive jurisdiction over derivatives markets means that the CEA preempts any state law that would attempt to regulate derivatives markets.¹⁰ Therefore, regulated futures and swaps contracts *cannot be* illegal gambling under state law.

In fact, many states ban “gambling” not just on elections, but more generally on the outcomes of future events. These laws would prohibit the entire category of event contracts (at a minimum), which both Congress and the CFTC have expressly permitted to be listed on DCMs. Some of these states provide carve-outs for CFTC-regulated products, or otherwise for activities like commodities and securities trading. However, not all do. New Hampshire, for example, bans gambling and defines it as, “to risk something of value upon a future contingent event not under one’s control or influence.”¹¹ Alaska also bans gambling and defines it similarly as when:

⁸ *Id.*

⁹ This overly broad interpretation of the term “gaming” would threaten to render 5c(c)(5)(C)’s other enumerated provisions superfluous, given that, as explained above, virtually all event contracts could potentially qualify for that categorization. As the Supreme Court has repeatedly observed, there is a “canon against interpreting any statutory provision in a manner that would render another provision superfluous.” *Bilski v. Kappos*, 561 U.S. 593, 607-8 (2010).

¹⁰ *See Am. Agric. Movement v. Bd. of Trade*, 977 F.2d 1147, 1156-57 (7th Cir. 1992) (holding that “When application of state law would directly affect trading on or the operation of a futures market, it would stand ‘as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,’ and hence is preempted.” (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941))).

¹¹ NH Rev Stat § 647:2(II)(d), available at: <https://www.gencourt.state.nh.us/rsa/html/lxii/647/647-2.htm/>.

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...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.¹²

Finally, at least one federal law that addresses gambling specifically carves out regulated derivatives products from their definitions of "bet or wager," highlighting that Congress views the two types of transactions as fundamentally distinct. The Unlawful Internet Gambling Enforcement Act of 2006's ("UIGEA") definition of "bet or wager" specifically "does not include [as relevant here:]"

- (ii) any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act;
- (iii) any over-the-counter derivative instrument;
- (iv) any other transaction that—
 - (I) is excluded or exempt from regulation under the Commodity Exchange Act; or
 - (II) is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.¹³

Notably, the Commission relied upon UIGEA's definition of "bet or wager" in its Nadex Order,¹⁴ but made no mention of the carve out for derivatives products.

All of these various provisions illustrate the flaw in evaluating whether *trading* a futures or swaps contract constitutes gaming or gambling activity, as the Commission did in the Nadex Order, or whether *trading* a futures or swaps contract is unlawful under federal or state law. Instead, to maintain the structural integrity of Section 5c(c)(5)(C) and the CEA itself, the Commission should evaluate whether the Contracts involve an underlying activity – elections – that fits into one of the enumerated categories of activities in Section 5c(c)(5)(C). Because elections do not

¹² AK Stat § 11.66.280(2).

¹³ 31 U.S.C. § 5362(1)(E) (2006).

¹⁴ *Supra* note 1 at 3.

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fit within any of the enumerated activities, the Commission should not impede self-certification of the Contracts.

II. CFTC REGULATION 40.11 CALLS FOR THE SAME RESULT.

A determination that Section 5c(c)(5)(C) does not present an obstacle to Kalshi's self-certification of the Contracts should be dispositive, because CFTC Regulation 40.11, which the CFTC adopted to implement Section 5c(c)(5)(C), should likewise be read to allow only for the Commission's consideration of the contract's underlying activity, rather than its consideration of trading in the contract itself. While the language of the rule is not identical to the statute, there is no reason to read the language of CFTC Regulation 40.11 to require an analysis of trading in the contract rather than the contract's underlying activity that constitutes the event.

The scope of CFTC Regulation 40.11 should not be read to go beyond the scope of the special rule in the statute. By using the words "relates to, or references" in addition to "involves," the regulation only reinforces that the relevant activity is the underlying event, not trading on the underlying event. It would not make sense for a futures contract or swap to "reference" trading in the contract; to the contrary, the word "reference" is a clear direction to focus on the underlying event that the contract "references." Thus, under the regulation, like the statute, the relevant activity for purposes of the Commission's event contract analysis is the activity on which the contract is based (or to which the contract refers) rather than the contract itself.¹⁵ Even if the different words in the regulation could conceivably be read to support a different analysis that would broaden the scope of contracts subject to the statute, courts have held that, even under a standard of review that is highly deferential, an agency interpretation will not stand if "it is contrary to clear congressional intent or frustrates the policy Congress sought to implement."¹⁶

¹⁵ Because the Contracts are not based on an enumerated activity, the Commission does not need to consider undertaking a public interest analysis. If the Commission were to conclude otherwise, however, the Commission could either permit the contracts to be listed (the statute authorizes prohibition only upon a Commission determination that the contract would be contrary to the public interest, a determination that the Commission "may" undertake) or conduct a public interest analysis. CFTC Regulation 40.11 should not be read to constitute a blanket prohibition, as that reading could not be squared with the statute. See Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitz-statement040721> ("if sports event contracts involving gaming are found to have an economic purpose, they should be permitted to be listed on a DCM and retail customers cannot be prohibited from trading those contracts"); Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521> ("Congress [through Section 5c(c)(5)(C) of the CEA] unambiguously provided a default rule that all event contracts, including the enumerated ones, are allowed").

¹⁶ *Garcia Carias v. Holder*, 697 F.3d 257, 271 (5th Cir. 2012); *CHW W. Bay v. Thompson*, 246 F.3d 1218, 1223 (9th Cir. 2001) ("deference is not owed to an agency decision if it construes a statute in a way that is contrary to congressional intent or frustrates congressional policy").

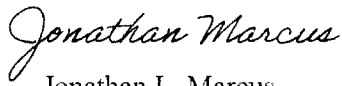
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III. CONCLUSION

For all of the reasons stated above, the Commission has no reason to stay Kalshi's self-certification of the Contracts. We welcome your feedback on this position and would appreciate the opportunity to follow-up on these specific considerations in a conference call or in-person meeting to the extent you have further questions.

Very truly yours,



Jonathan L. Marcus

Cc: Eliezer Mishory
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May 31, 2022

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Re: Political Event Contracts, Section 5c(c)(5)(C) of the CEA, and CFTC Rule 40.11

Dear Mr. Mishory:

This letter is in response to your request for legal advice regarding KalshiEx LLC's ("Kalshi") engagement with the Commodity Futures Trading Commission ("CFTC" or "Commission") about the listing of certain event contracts relating to the partisan makeup of Congress, specifically the political control of Congress. One of the factors that Kalshi considers in listing contracts is ensuring regulatory compliance and, as such, you requested advice on the following question:

Are Kalshi's proposed political control contracts subject to the Commodity Exchange Act's ("CEA's") special rule for event contracts described in Section 5c(c)(5)(C) of the CEA and the implementing regulations at 17 C.F.R. § 40.11?

By way of background, in 2012, Nadex listed similar contracts (although with different characteristics) which the Commission prohibited by order ("Nadex Order"),¹ finding that trading in the Nadex contracts violated the CEA. Specifically, the Nadex Order found that Section 5c(c)(5)(C) of the CEA applied to the Nadex contracts because the Nadex contracts constituted gaming.² The Nadex Order also determined that the Nadex contracts were contrary to the public interest because the Nadex contracts could have an adverse effect on the integrity of elections.³

Section 5c(c)(5)(C) and Rule 40.11, however, are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match

¹ 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 (Apr. 2, 2012) (<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/-documents/ffddocs/nadexorder040212.pdf>) (last visited May 30, 2022).

² Nadex Order at 2-3.

³ *Id.* at 4.

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any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation. In reaching this conclusion, I will first provide some background of principles of interpretation and the relevant text of Section 5c(c)(5)(C) and Rule 40.11. I will then apply those principles to the Kalshi political control contracts and describe how the Nadex Order’s conclusions to the contrary are incorrect.

I. BACKGROUND

A. Principles of Interpretation

Since the Nadex Order, the Supreme Court has significantly modified the method through which regulatory text should be interpreted and the circumstances in which an agency will receive deference for its interpretation of regulatory text. The tools for interpreting regulatory text are similar to those for evaluating statutory text. I first discuss these principles and then use them to evaluate Section 5c(c)(5)(C) and CFTC Rule 40.11 and their application to Kalshi’s political event contracts.

The Supreme Court revamped the process for evaluating regulatory text in the 2019 case of *Kisor v. Wilkie*.⁴ In *Kisor*, the court considered whether to overrule *Auer v. Robbins*⁵ and *Bowles v. Seminole Rock*,⁶ cases which found that an agency was entitled to deference of its interpretation of an agency rule so long as it was not “plainly erroneous or inconsistent with the regulation.”⁷ In *Kisor*, the Court did not overrule *Auer* and *Seminole Rock*, but significantly limited their application: “The deference doctrine we describe is potent in its place, but cabined in its scope.”⁸

In reviewing the meaning of Rule 40.11, according to *Kisor*, one must “exhaust the ‘traditional tools’ of statutory construction.”⁹ “Agency regulations can sometimes make the eyes glaze over. But hard interpretive conundrums, even relating to complex rules, can often be solved.”¹⁰ One must “resort[] to all the standard tools of interpretation,”¹¹ including a careful consideration of

⁴ 139 S. Ct. 2400 (2019).

⁵ 519 U.S. 452 (1996).

⁶ 325 U.S. 410 (1945).

⁷ *Seminole Rock*, 325 U.S. at 414.

⁸ *Kisor*, 139 S. Ct. at 2408.

⁹ *Id.* at 2415 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

¹⁰ *Kisor*, 139 S. Ct. at 2415.

¹¹ *Id.* at 2414.

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“the text, structure, history, and purpose of a regulation”¹² to determine whether a rule has “one reasonable construction of a regulation”¹³ or can “at least establish the outer bounds of reasonable interpretation.”¹⁴ In discussing this approach to regulatory construction, the Supreme Court relied heavily on the principles of statutory construction discussed in *Chevron* and its progeny.

B. The Statute And The Rule

With these key principles in mind, I turn to the statute and rule. This analysis begins, of course, with the statutory text of Section 5c(c)(5)(C) of the CEA, from which the CFTC promulgated Rule 40.11. That section of the CEA states:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon **the occurrence, extent of an occurrence, or contingency** (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest **if** the agreements, contracts, or transactions **involve—**

- (I) **activity** that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) **other similar activity** determined by the Commission, by rule or regulation, to be contrary to the public interest.¹⁵

In relevant part for purposes of this analysis, Rule 40.11(a) states:

A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following:

- (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that **involves, relates to,**

¹² *Id.* at 2415.

¹³ *Id.*

¹⁴ *Id.* at 2416. The *Kisor* court goes on to explain that an agency’s interpretation of an ambiguous regulation may still not receive deference. The Court must then determine if “the character and context of the agency interpretation entitles it to controlling weight.” *Id.*

¹⁵ 7 U.S.C. § 7a-2(c)(5)(C)(i)(I)-(VI) (emphases added). If the Commission determines that such an agreement, contract, or transaction is contrary to the public interest, such agreement, contract, or transaction may not “be listed or made available for clearing or trading on or through a registered entity.” *Id.* § 7a-2(c)(5)(C)(ii).

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or references terrorism, assassination, war, gaming, or an **activity** that is unlawful under any State or Federal law; or

(2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references **an activity that is similar to an activity** enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.¹⁶

II. APPLICATION TO KALSHI'S POLITICAL CONTROL CONTRACTS

To help frame the matter, the key question here requires understanding the limitations on the scope of Section 5c(c)(5)(C) and Rule 40.11. Is the scope (1) limited to contracts when the activity underlying the event contract involves one of the enumerated activities or do they (2) include the act of participating in the contract is itself?

Applying the principles of statutory and regulatory construction shows that Section 5c(c)(5)(C) and Rule 40.11 are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation.

A. Section 5c(c)(5)(C) and Rule 40.11 Apply Only To Event Contracts Where The Activity Underlying The Event Contract Is One Of The Enumerated Activities.

The plain text of Section 5c(c)(5)(C) demonstrates that Congress limited the statute's scope to instances where the underlying activity of an event contract is one of the enumerated events. If the activity underlying the event contract does not involve one of the enumerated activities, the listing is outside the scope of the Statute and Rule 40.11, regardless of how the act of *participating* in the event contract itself is classified. An interpretation of the statute that extends the applicable scope to also include contracts where the underlying activity is not one of the enumerated events is overbroad and incorrect.

First, Section 5c(c)(5)(C) limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously acknowledged that Section 5c(c)(5)(C)'s textual focus is on "activities," *i.e.*, the underlying conduct. In describing Section

¹⁶ 17 C.F.R. § 40.11(a) (emphases added).

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5c(c)(5)(C), the Commission stated that the rule applied to contracts that “involve one or more *activities* enumerated in the Dodd-Frank Act.”¹⁷ These “activities” are not the contracts themselves. They are the events that create the basis for the relevant contract.

To give but one straightforward example, in the statute events two through four are terrorism, assassination, and war. The inclusion of these activities clearly demonstrates that the scope of Section 5c(c)(5)(C) and Rule 40.11 includes contracts when the activity underlying the event contract involves one of the enumerated activities. The act of participating in a contract is not itself an act of terrorism, assassination, or war.¹⁸ The same analytical approach, by extension, should apply to each of the items on the list, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C) would be internally inconsistent, contrary to the traditional tools of construction.

Second, Section 5c(c)(5)(C) and Rule 40.11 allow the Commission to prohibit the listing of an event contract only “if the agreements, contracts, or transactions **involve**” any of the enumerated activities that are against the public interest. Event contracts that do not involve any of the enumerated activities may be listed for trading because the special rule would not prohibit the listing of those contracts by a DCM.

Third, Section 5c(c)(5)(C) places an additional, key limitation on the “agreements, contracts, or transactions” within the scope of the text. Those “agreements, contracts, or transactions” must be “in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency.” The reference to “occurrence” or “contingency” can only mean to the underlying event of the contract, not the contract itself. The contract cannot reasonably be described as an occurrence or a contingency. Indeed, the headings of the section—“Special rule for review and approval of event contracts and swap contracts” (Section 5c(c)(5)(C)) and “Event Contracts” (Section 5c(c)(5)(C)(i))—reinforce Congress’ focus on the “event” or occurrence, not the trading

¹⁷ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) (“Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more **activities** enumerated in the Dodd-Frank Act.”) (emphasis added) (“40.11 Proposed Rule”); *see id.* at 67,289 (“If [] the Commission determines that such product may involve an **activity** that is enumerated in 40.11 . . .”) (emphasis added).

¹⁸ To illustrate this point, consider hypothetical contracts on whether a foreign leader will be assassinated, how many Russian planes will be shot down by Ukrainian forces, or how many murders will occur in a given city over a certain time period. Section 5c(c)(5)(C) and Rule 40.11 would apply to these hypothetical contracts because the activities underlying the contracts in these hypothetical examples are the enumerated activities of “assassination,” “war,” and “an activity that is unlawful under Federal or State law.” The purchasing of the contract itself, however, is not “an activity” of “assassination,” “war,” or “an activity that is unlawful under Federal or State law.”

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of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningfully limit the Commission's reach regarding event contracts.

Because the text and structure is clear, there is no need to resort to legislative history. That is a bedrock principle of the traditional tools of statutory construction. Nevertheless, the sparse legislative history regarding Section 5c(c)(5)(C)¹⁹ provides no guidance as to whether Congress intended the Commission to limit the scope of Section 5c(c)(5)(C) to instances where the underlying activity of an event contract is one of the enumerated events.

This reading of Section 5c(c)(5)(C) is consistent with the terms used by the Commission in Rule 40.11. Rule 40.11 borrows heavily from the terms used in the statute, including multiple uses of "activity" in both subsections 40.11(a). The Regulation also uses the same term "involves" which appears in the Statute, but also adds the phrase "relates to, or references" when describing enumerated activities. Because "involves" is the only statutory authority provided by Congress, the Commission cannot expand upon the scope of that term. Thus, the only way to read "relates to, or references" consistent with the Commission's authority is that they are the specific meanings of "involves" that the Commission adopted.²⁰ The terms "relates to" and "references," in turn, clearly describe the underlying activity upon which the event contract is based. It would be nonsensical to interpret "relates to" and "references" as describing the act of participating in the event contract itself.

To be clear, Congress could certainly promulgate a law that covers the *participation* in an event contract. But Section 5c(c)(5)(C) is not that law. Instead, applying the traditional tools of construction, Congress enacted Section 5c(c)(5)(C) to prohibit a narrow group of contracts whose underlying activities are the enumerated activities and the CFTC has determined are contrary to

¹⁹ The only legislative history that has been cited by the Commission regarding Rule 40.11 involves a short colloquy between Senator Feinstein of California and Senator Lincoln of Arkansas on July 15, 2010. *See, e.g.*, 40.11 Final Rule, 76 Fed. Reg. at 44,786 & nn. 34-35; *see also* Nadex Order, Whereas Clauses 2 & 7. This 555-word back-and-forth between two Senators, which takes up less than two columns of one page of the Congressional Record (Volume 156, Issue 105, S5906-5907 (July 15, 2010)), is particularly weak evidence of the intent of Congress as a whole and the meaning of the provision. *See, e.g.*, *NLRB v. SW General, Inc.*, 137 S. Ct. 929, 943 (2017) ("[F]loor statements by individual legislators rank among the least illuminating forms of legislative history."). The text is by far the more probative evidence of Congress' meaning. The Nadex Order's extensive reliance on this sparse legislative history is simply inconsistent with the interpretive approach laid out in *Kisor* and provides an additional reason why Kalshi can self-certify the contracts notwithstanding the Nadex Order. In any event, none of the short legislative history specifically addresses the question about whether Section 5c(c)(5)(C) applies only to the underlying events or the trading of the contracts as well, so it has nothing to add to this analysis.

²⁰ Rule 40.11 cannot exceed the scope of Section 5c(c)(5)(C). Any interpretation of Rule 40.11 that views it as expanding the scope delineated in Section 5c(c)(5)(C) would run afoul of the Constitution's separation of powers and the Administrative Procedure Act.

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the public interest and those limitations apply to Rule 40.11. If the underlying activity of a contract is not an enumerated event, it is outside the scope of Section 5c(c)(5)(C) and Rule 40.11.

B. The Nadex Order Incorrectly Interprets And Applies Section 5c(c)(5)(C) And Rule 40.11 To Apply To Political Control Contracts Like Kalshi's.

As described above, Section 5c(c)(5)(C) and Rule 40.11 apply only to the listing of event contracts whose underlying activity involves one of the six enumerated activities. They do not apply to event contracts whose underlying activity does not involve one of the enumerated activities. This key distinction between the activity itself or a *contract on the activity* is of particular importance for the Kalshi contracts at issue here. The underlying activity of Kalshi's contracts is political control of the chambers of Congress. Political control of Congress is none of the activities identified in Section 5c(c)(5)(C) and, as such, Kalshi's political control contracts are not subject to the special rule.

The Nadex Order's contrary conclusion was incorrectly reasoned and misapplied in several aspects.²¹ First, contrary to the above explanation, the Nadex Order incorrectly expanded the scope of the statute and regulation to include the act of participating in the contract, and not just the underlying activity. Second, the Nadex Order incorrectly includes election contracts in the enumerated activities of illegal under state law and gaming.

The Nadex Order incorrectly expanded the scope of Section 5c(c)(5)(C) and Rule 40.11 to include the act of participating in the contract, and not just the underlying activity. The first enumerated activity of Section 5c(c)(5)(C) is "activity that is unlawful under any Federal or State law." The underlying activity of Kalshi's contracts is political control of the chambers of Congress. There is no Federal or State law that makes political control of Congress illegal. There is also no Federal or State law that prohibits elections or voting in elections which result in the political control of Congress. Accordingly, political control contracts would not fall under the special rule's enumerated act of "illegal activity."

To be sure, 27 states do prohibit, in one form or another, betting on elections. And the Nadex Order (incorrectly) stated that "state gambling definitions of 'wager' and 'bet' are analogous to the act of taking a position in the Political Event Contracts"²² as a justification for prohibiting those contracts' listing. In this regard, however, the Nadex Order overextended. Section 5c(c)(5)(C) is limited to the activity underlying the contract, not the participation in the contract itself.

²¹ As noted previously (*see supra* nn. 4-14), the Commission adopted the Nadex Order prior to the Supreme Court's decision in *Kisor v. Wilkie* and thus the Order did not use the framework now required by the Supreme Court for evaluating the scope and implications of Rule 40.11.

²² Nadex Order at 2.

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The Nadex Order also misapplies the enumerated activity of “gaming.” There are at least two fundamental differences between the relevant state gaming or gambling laws and event contracts. As Commissioner Brian Quintenz described with regards to the withdrawn ErisX sports event contract, trading an event contract with a binary outcome is not automatically considered a gamble.²³ Indeed, if Section 5c(c)(5)(C) had assumed that participating in any event contract involved making a wager or gamble, there would have been no need for Congress to individually enumerate “gaming” as a distinct category of event contracts upon which the Commission could make a public interest determination. The fact that Congress separated “gaming” from other event contracts is a clear indication that Congress did not intend for all event contracts to be considered gaming.

In fact, the statutory definition of “bet” or “wager” used by the Nadex Order itself, in the same statute, clearly indicates that not all CFTC regulated products are gaming. The statute cited by the Nadex Order²⁴ for defining “bet” or “wager” is 31 U.S.C. § 5362(1), a part of the Unlawful Internet Gambling Enforcement Act of 2006. That definition of “bet or wager,” however, includes two relevant exclusions. First, the term “bet or wager” does 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.”²⁵ The term also does not include “any other transaction that is excluded or exempt from regulation under the Commodity Exchange Act.”²⁶ The statute cited by the Nadex Order itself demonstrates that the Nadex Order’s expansive application of Section 5c(c)(5)(C) and Rule 40.11 is incorrect.

The Nadex Order’s broad interpretation of gaming under the statute and rule would result in prohibiting much of the legally registered activity that the CFTC has previously approved. Indeed, many states ban “gambling” not just on elections, but specifically on the outcomes of future events. For example, New Hampshire bans gambling and defines it as “to risk something of value upon a future contingent event not under one’s control or influence”²⁷ while North Carolina includes a

²³ See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>) (last visited May 30, 2022). The many other distinctions between an event contract and a gamble include the fact that betting is a game of pure chance without any economic utility while event contracts are non-chance driven outcomes with economic utility.

²⁴ Nadex Order at 3.

²⁵ 31 U.S.C. § 5362(1)(a)(E)(ii).

²⁶ *Id.* § 5362(1)(a)(E)(iv)(I).

²⁷ NH 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

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wager on an “unknown or contingent event” in its statutory definition of gambling.²⁸ New York defines gambling as staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.²⁹ Other states explicitly prohibit trading on the future delivery of securities and commodities without delivery and which are purely cash-settled, as is normal for products like stock index futures and eurodollar futures.³⁰ In all, 19 states contain provisions in their state codes that prohibit the listing of at least some subset of contracts that the CFTC has approved.³¹

Under the Nadex Order’s reasoning, because Rule 40.11 prohibits the listing of contracts that “involve” “gaming,” laws like these would prohibit *all* event contracts. For example, event contracts on the weather and various economic indicators would be considered “risking something of value upon a future contingent event not under one’s control or influence.” And yet, not only are these event contracts a staple of CFTC regulated DCMs, but the Commission’s Core Principles require that event contracts be specifically outside the control or influence of a market participant and not readily susceptible to manipulation. The Nadex Order’s application of Rule 40.11 would therefore preclude the CFTC from regulating any event contract because event contracts are considered gambling under (some) state laws.³² Because such an interpretation of “gaming” would lead to absurd results, the traditional tools of interpretation and the process required by the

value in the event of a certain outcome”); Or. 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 . . .”).

²⁸ N.C. Gen. Stat. § 16-1.

²⁹ NY Penal Law, Chapter 40, Part 3, Title M, Article 225.

³⁰ For example, the laws of South Carolina, Oklahoma, and Mississippi use the following language: “Any contract of sale for the future delivery of cotton, grain, stocks or other commodities . . . upon which contracts of sale for future delivery are executed and dealt in without any actual bonafide execution and the carrying out or discharge of such contracts upon the floor of such exchange, board of trade, or similar institution in accordance with the rules thereof, shall be null and void and unenforceable in any court of this state, and no action shall lie thereon at the suit of any party thereto.”

³¹ Moreover, the purpose of the CEA, CFMA and other laws was to create clear and consistent national guidelines; a contrary interpretation would lead to the undesirable result that if one state prohibited a specific kind of contract then the Commission could use the special rule to ban that contract in all states.

³² On this point, it seems that at the very least, Rule 40.11 would be an APA violation, or even unconstitutional, if the analysis in Nadex Order was taken to its logical conclusion because of its dramatic impacts on the regulatory scheme. *Cf. Whitman v. American Trucking Ass’ns, Inc.*, 531 U.S. 457, 468 (2001) (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.”).

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Supreme Court in *Kisor* demonstrate that the Nadex Order's view cannot be the correct way to interpret Rule 40.11.³³

Seen in this context, the state laws that prohibit gambling on elections do not and cannot refer to CFTC regulated event contracts. The laws of many states prohibit gambling on event contracts, case-settled commodity futures contracts, and elections as one. Yet, the CFTC clearly continues to regulate and approve of the event contracts and cash-settled commodity futures markets even though it may seem to conflict with those state laws.³⁴ Event contracts relating to elections should be no different. Indeed, just as other event contracts regulated by the CFTC, Kalshi's political control contract should also not be precluded by the gaming provisions of Rule 40.11.

Furthermore, the CFTC's actions and inactions since the Nadex Order indicate that even the Commission has not continued the Nadex Order's reasoning in this regard. Consider, for example, the Small Cannabis Equity Index Futures Contract listed by the Small Exchange. The Cannabis Index involves the stock prices of companies in the cannabis industry that produce and distribute cannabis for consumption—an activity that is unlawful under Federal law and many State laws. The contract is “dependent on the occurrence, nonoccurrence, or the extent of the occurrence” of an event with “potential financial, economic, or commercial consequence,”³⁵ namely the value of the Cannabis Index. The activities of these companies are production and distribution of cannabis for consumption, which are all activities that are “unlawful under Federal and [many] State laws,”

³³ See, e.g., *Tennessee Wine & Spirits Retailers Ass'n v. Thomas*, 139 S. Ct. 2449, 2462 (2019) (“reading § 2 [of the Twenty-First Amendment] to prohibit the transportation or importation of alcoholic beverages in violation of *any* state law would lead to absurd results that the provision cannot have been meant to produce”) (emphasis in original). Indeed, the “Commission agrees that the term ‘gaming’ requires further clarification and that the term is not susceptible to easy definition.” *Provisions Common to Registered Entities: Final Rule*, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). In the 40.11 Final Rule, the Commission noted that it had previously sought comments regarding event contracts and gaming in 2008 and that the “Commission continues to consider these comments and may issue a future rulemaking concerning the appropriate regulatory treatment of ‘event contracts,’ including those involving ‘gaming.’” 40.11 Final Rule at 44,785. “In the meantime, the Commission has determined to prohibit contracts based upon the activities enumerated in Section 745 of the Dodd-Frank Act and to consider individual product submissions on a case-by-case basis under 40.2 or 40.3.” *Id.* That process is undermined if the Nadex's Order's approach to “gaming” stands.

³⁴ The CFMA explicitly preempts the application of state gambling statutes when it applies to legal commodity futures contracts and as such there is also a federal preemption argument here that the state gambling statutes should not be considered, regardless of the Nadex Order's misapplication of Rule 40.11. See 7 U.S.C. § 16(e)(2) (“This chapter shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops (other than antifraud provisions of general applicability) in the case of—(A) an electronic trading facility excluded under section 2(e) of this title; and (B) an agreement, contract, or transaction that is excluded from this chapter under section 2(c) or 2(f) of this title or sections 27 to 27f of this title, or exempted under section 6(c) of this title (regardless of whether any such agreement, contract, or transaction is otherwise subject to this chapter).”).

³⁵ See 7 U.S.C. § 1a(19) (definition of excluded commodity).

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and should otherwise fall under the purview of Section 5c(c)(5)(C) and Rule 40.11. Certainly, if Section 5c(c)(5)(C) was given the same broad reading that the Commission gave to it in the Nadex Order, the Cannabis Equity Index would certainly “involve” an enumerated activity and be subject to Section 5c(c)(5)(C) and Rule 40.11. Yet, the Cannabis Index contract was self-certified and the Commission did not invoke Section 5c(c)(5)(C) or Rule 40.11. Therefore, it is clear that the Commission has not maintained the Nadex Order’s overbroad and incorrect reading of the Statute and Rule 40.11.

Even if the proposed Kalshi contracts somehow came within the scope of Section 5c(c)(5)(C) and Rule 40.11, that does not preclude them from being listed. I understand that Kalshi has made submissions to the Commission demonstrating offering the contracts would be in the public interest. A full discussion of those points is outside the scope of this letter. I do note, however, that the Commission is not limited to using an economic purpose test for determining whether a contract is within the public interest. That test is found nowhere in the text of Section 5c(c)(5)(C) or Rule 40.11. One reference to the economic purpose test between two Senators in a brief discussion of what would become Section 5c(c)(5)(C) is insufficient to bind the Commission to that test.³⁶ The Commission recognized as much in the Nadex Order itself, stating “the Commission has the discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest.”³⁷

Furthermore, as a procedural matter, there is nothing in the CEA or Rule 40.11 requiring the Commission to act on Kalshi’s self-certification of the political control contracts discussed in this letter. Both Section 5c(c)(5)(C) and Rule 40.11 speak in terms that the Commission “may determine.”³⁸

At the end of the day, Kalshi has various arguments to justify the self-certification of the contracts described above.

³⁶ See supra note 19 (discussing limitations of floor statements as persuasive evidence of a statute’s meaning).

³⁷ Nadex Order at 4.

³⁸ 7 U.S.C. § 7a-2(c)(5)(C)(i) (“the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest . . .”) (emphasis added); 7 C.F.R. § 40.11(c) (“The Commission **may determine** . . . that a contract . . . be subject to the 90-day review.”) (emphasis added).

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Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml

KalshiEX LLC

November 22, 2022

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: KalshiEX LLC – Request for an extension of time under Commission Regulation 40.11(c)(2) with regard to the “Will <party> be in control of the <chamber of Congress>?” contract

Dear Sir or Madam,

Pursuant to section 40.11(c)(2) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi) hereby requests an extension to the Commission’s review period under section 40.11 regarding the “Will <party> be in control of the <chamber of Congress>?” contract until January 23, 2023.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

KalshiEX LLC

KalshiEX LLC

January 6, 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: KalshiEX LLC – Request for an extension of time under Commission Regulation 40.11(c)(2) with regard to the “Will <party> be in control of the <chamber of Congress>?” contract

Dear Sir or Madam,

Pursuant to section 40.11(c)(2) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi) hereby requests an extension to the Commission’s review period under section 40.11 regarding the “Will <party> be in control of the <chamber of Congress>?” contract until March 23, 2023.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

KalshiEX LLC

KalshiEX LLC

March 15, 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: KalshiEX LLC – Request for an extension of time under Commission Regulation 40.11(c)(2) with regard to the “Will <party> be in control of the <chamber of Congress>?” contract

Dear Sir or Madam,

Pursuant to section 40.11(c)(2) of the regulations of the Commodity Futures Trading Commission, KalshiEX LLC (Kalshi) hereby requests an extension to the Commission’s review period under section 40.11 regarding the “Will <party> be in control of the <chamber of Congress>?” contract until May 22, 2023.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

KalshiEX LLC

KalshiEX LLC

May 16, 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: KalshiEX LLC – Withdrawal of the “Will <party> be in control of the <chamber of Congress>?” contract

Dear Sir or Madam,

KalshiEX LLC (Kalshi) hereby notifies the Commodity Futures Trading Commission that it is withdrawing the “Will <party> be in control of the <chamber of Congress>?”.

If you have any questions, please do not hesitate to contact me.

Sincerely,

Eliezer Mishory

Elie Mishory
Chief Regulatory Officer
KalshiEX LLC
emishory@kalshi.com

KalshiEX LLC

I write to voice support for KalshiEX LLC's filing to list political control markets.

For the last 15 years, I have worked at JPMorgan, and I am currently a Managing Director in its private wealth management division. I noticed that one of the questions offered by the CFTC was asking whether elections have sufficiently predictable economic consequences in order to justify risk management products like that which Kalshi is proposing. I have deep experience with this problem in my time working at JPMorgan and I am happy to write detailing that in support of the contract's approval.

I have intimate experience with this. 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. For example, here we detailed how the results of the 2018 midterm cycles impacted financial markets. Here's another example from another bank, Morgan Stanley where they provided a brief guide about how to manage risk before the current midterm elections.

Many banks' research often relies on prediction markets (for an example, check here). However, current prediction markets have a number of constraints that prevent them from operating with the best price accuracy possible. Permitting this contract would improve our and the public's ability to forecast and manage the risks that really matter to them. There is great social value in these products.

Risk stemming from the outcomes of changes in Congressional control (or the lack thereof) imply significant risks for holders of stocks, bonds, derivative products, and recipients of particular cash flows. Congress has broad power to affect changes in tax policy, government benefits, regulations, bureaucratic appointments, foreign and trade policy, immigration policy, and so many other facets that deeply affect industry. Although politicians hardly always keep their promises, markets consistently move based on changes in election expectations and outcomes. Far before policies come into place, deals are made on the basis of future expectations regarding policy, even if those expectations don't always bear fruit (though they frequently do). If the private market is already trading and pricing this risk, it follows that such a risk is sufficiently predictable and a risk management product like Kalshi's would be socially valuable.

Large banks offer these to high networth and ultra rich clients, Kalshi is not the first to wonder how impactful it would be to bring these capabilities to the rest of the population who does not have access to desks at large banks and private wealth management services: we've been thinking about these types of instruments for a long time.

Given my statement, and the large extent of hedging and pricing based on the expected policy outcomes of elections, it would be very strange for the CFTC to find that election contracts do not have regular and predictable hedging use cases. Not a single person in the industry would tell you different.

I encourage the CFTC to swiftly approve Kalshi's contract in order to complete markets and promote effective and innovative risk management tools.

Angelo Lisboa



September 25, 2022

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. The Exchange welcomes the opportunity to address the Commission's questions. This comment addresses the first question and the third question that the Commission asked:

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
2. as described in regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?
3. 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?

This comment is divided into two parts. Part 1 discusses the statute. In particular, Part 1 of the comment addresses section 5c(c)(5)(C) of the Commodity Exchange Act ("CEA"), codified¹ at 7 U.S.C. 7a-2(c)(5)(C).² Of particular importance, Part 1 is based on an analysis of the statute

¹ The CEA section designations do not align with the section designations in the United States Code. Because this is a public comment, the Exchange will generally use citations to the United States Code as opposed to the CEA, which will enhance the public's ability to research and analyze the issues presented.

² The Exchange will address the applicability of the regulations at 17 C.F.R. 40.11 in a separate comment, and also in the appendix to this comment in the Counsel Analyses. However, the Exchange notes here that the regulation cannot exceed the authority in the statute that the regulation implements. This is axiomatically true even under the *Chevron* deference from *Chevron, Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). Indeed, step one of *Chevron* is to determine whether Congress expressed intent in the statute and, if so, whether or not the statute's intent is ambiguous. It is black letter law that if the statute is clear, the regulating agency cannot regulate contrary to the statute. Indeed, earlier this year in *Empire Health*, Justice Kagan, writing for the Court, held that the government's regulation was valid only because the "regulation correctly construes the statutory language at issue." *Becerra v. Empire Health Foundation*, 142 S. Ct. 2354 (2022). Had that not been the case, Justice Kagan and the Court would have held the regulation invalid.

Kalshi



irrespective of any rule, including 40.11, which the Commission has issued or may, in the future, promulgate to implement this statutory provision.

As a threshold matter, the Exchange notes that the majority of the Commission’s questions for public comment assume that the Special Rule in CEA 5c(c)(5)(C) (“Special Rule”) applies or can apply to Kalshi’s political control contract (“Contract”), a question that the Commission invites the public to address in questions 1 and 3. If the answers to questions 1 and 3 are no, many of the other questions become moot, at least in regard to the Contract, which is the sole matter under Consideration in this Commission action.³

Part 2 includes analyses from Jonathan Marcus and Dan Davis that directly address Questions 1 and 3. Messrs. Marcus and Davis both served as General Counsel of the Commission prior to assuming their current positions in private practice.

Part 1

Contracts, events, and other important terms

There are several terms that are key to understanding the framework that Congress created for the Special Rule that appear throughout this comment and are helpful to define here:

- “Event Contract”
- The “Event Contract’s Event” (also, referred to as the “contract’s Event”)
- The “contract, considered as a whole” (also, referred to as the “contract, as a whole”, the “contract, itself”, and the “contract itself, considered as a whole”)

An “Event Contract” is a contract that is based on an occurrence, extent of an occurrence, or a contingency. For example, a contract whose terms and conditions specify that the holder of the contract will receive payment based on the occurrence of a hurricane is an Event Contract because it is based on an occurrence, a hurricane. The terms and conditions of Kalshi’s Contract specify that holders of the contract will receive money based on the occurrence of political control over Congress.⁴ It is an event contract because it is based on an occurrence, political control.⁵

A contract’s “Event” refers to the specific occurrence, extent of an occurrence, or contingency on which the contract is based. A hurricane contract’s event is the hurricane. Kalshi’s Contract’s event is political control

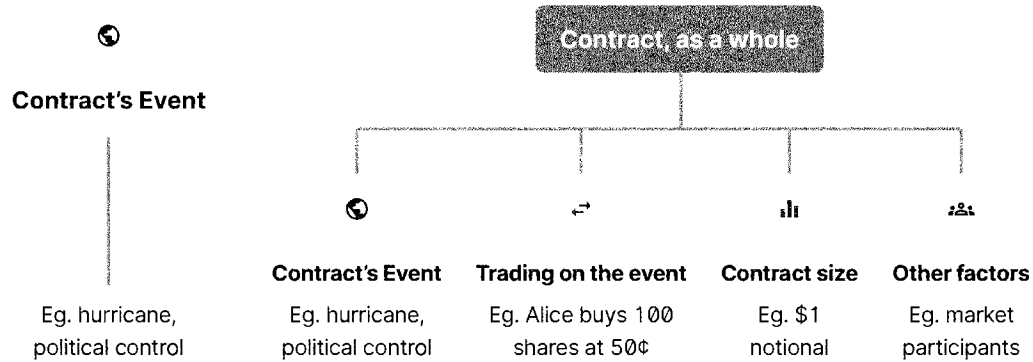
The phrase “contract, considered as a whole” refers to a broad view of a contract and all factors that surround or are a part of the contract. For example, this would include the activity of buying and selling the contract ie. the activity of *trading* the contract, the information embedded in the contract’s pricing, and in the case of an Event Contract, the contract’s Event.

Accordingly, any suggestion that the Commission’s regulation 40.11, which implements the statute at 7 U.S.C. 7a-2(c)(5)(C), applies to a contract to which the statute itself does not apply is specious. If the regulation did, it would be invalid. Regardless, a careful reading of the regulation shows that the regulation does not apply to any contract to which the statute does not apply. We address the regulation in more depth in Part 2.

³ Specifically, if the answers to questions 1 and 3 are no, the following questions would be moot insofar as they would not apply to the Contract: 2, 4, 6, 7, 8, 9, 10, 11, 12, 13, 14, 17. Question 5, which assumes the soundness of the legal reasoning in the Nadex Order, *see infra*, would also be moot.

⁴ Please see the full filing for the full terms and conditions of the Contract.

⁵ Specifically, the contract is based on the party membership of the Speaker of the House and the President Pro Tempore.



The statute

Part 1 of this comment focuses on the correct interpretation of the Special Rule, which is set forth in a statute. The full text of the statute⁶ is included here, for the reader's convenience:

(C) Special rule for review and approval of event contracts and swaps contracts

(i) Event contracts

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve-

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

(ii) Prohibition

No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

General background on the CEA's Special Rule

Under the CEA, contract listing is not a "permission" regime. Contracts do not need Commission approval to be listed, and although the CEA provides a mechanism that exchanges may utilize to put a contract before the Commission for approval, whether or not to utilize that method is solely

⁶ 7 U.S.C. 7A-2(c)(5)(C).



in an exchange’s discretion.⁷ Indeed, the overwhelmingly vast majority of contracts are never presented to the Commission for approval under this mechanism. Even in those rare instances when the Commission is formally presented with a contract for approval, the Commission’s discretion over whether to grant or withhold approval is limited; under the statute and the regulations, the Commission must approve every contract that does not violate the CEA or the regulations.⁸ The Commission was not granted authority to conduct a “is this a contract that I am comfortable with” analysis and the Commission was not granted authority to disapprove a contract because it does not like it.⁹

The Commission was also not granted the authority to prohibit any contract on the grounds that it violates the public interest. There is one exception to this rule, where Congress did give the Commission the authority to prohibit a contract that the Commission determines is contrary to the public interest.¹⁰ This exception is the Special Rule in 5c(c)(5)(C) of the Commodity Exchange Act.¹¹ This Special Rule gives the Commission discretion to consider, for very specific types of contracts, whether a contract is contrary to the public interest.¹²

There are two aspects to the Special Rule. The first is the Special Rule’s eligibility requirements; the Special Rule does not apply to all contracts. It only applies to a specifically defined subset of contracts, identified through a two-step process described below, that are eligible for the Special Rule. If a contract is determined to be eligible for the Special Rule, it is not automatically prohibited. The Special Rule only prohibits contracts that are eligible for the Special Rule if the Commission determines that the contract is contrary to the public interest. The second aspect of the Special Rule thus is determining whether the contract that is eligible for the Special Rule is contrary to the public interest. Congress laid out the process for the Special Rule in three steps.

The three steps of the Special Rule

There are three steps in the Special Rule.

Step one of the Special Rule (“Step One”) is to determine if the contract is eligible for the Special Rule. The statute limits the scope of the Special Rule to contracts that are “based upon [an] occurrence, extent of an occurrence, or contingency” (collectively “Event”). In other words, to be eligible for the Special Rule, a contract must be based on an Event, *i.e.*, the contract must be an Event Contract. If a contract is not an Event Contract, it is not eligible for the Special Rule and the contract fails Step One. The analysis then terminates and the Special Rule does not apply to that contract. If the contract is an Event Contract, the analysis proceeds to step two.

Step two of the Special Rule (“Step Two”) is to determine if the Event Contract’s Event involves¹³ certain activities that were listed by Congress in the Special Rule. These activities are:

1. an activity that is unlawful under any Federal or State law;

⁷ This process is set forth in 17 C.F.R. 40.3, which the Commission titled “*Voluntary* submission of new products for Commission review and approval.”

⁸ 7 U.S.C. 7a-2(c)(5)(B); 17 C.F.R. 40.3(b).

⁹ *Id.*

¹⁰ As explained below and in a second comment letter, even if, *arguendo*, the Special Rule applied to the Contract (which it does not), the Special Rule would still not prohibit the Contract because it is *in* the public interest, and therefore certainly not contrary to the public interest.

¹¹ 7 U.S.C. 7a-2(c)(5)(C).

¹² *Id.*

¹³ Please see *infra* the “A further look at step two of the Special Rule” for more discussion on the correct interpretation of step two and why step two is limited to the contract’s Event.



2. terrorism;
3. assassination;
4. war;
5. gaming;

In addition to these five specific activities, Congress included a sixth activity: “other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”¹⁴ This sixth activity gives the Commission discretion to identify other similar activities that are contrary to the public interest. If the Event Contract’s Event does not involve any of the six activities that are listed in the Special Rule, the Event Contract is not eligible for the Special Rule. The analysis terminates and the Special Rule does not apply to prohibit the contract. If the Event Contract’s Event does involve at least one of these activities, the analysis continues to step three.

Step three of the Special Rule (“Step Three”) is for the Commission to determine whether the contract itself, considered as a whole, is contrary to the public interest.¹⁵ If the Commission does not determine that the contract is contrary to the public interest, the contract is not prohibited under the Special Rule. If the Commission determines that the contract is contrary to the public interest, the Special Rule applies and the contract is prohibited.¹⁶

The three steps that the Commission follows in applying the Special Rule are therefore:

Step 1: Is the contract an Event Contract? If no, stop. If yes, continue to step 2.

Step 2: Does the Event Contract’s Event involve an activity that was included by Congress in the Special Rule? If no, stop. If yes, continue to step 3.

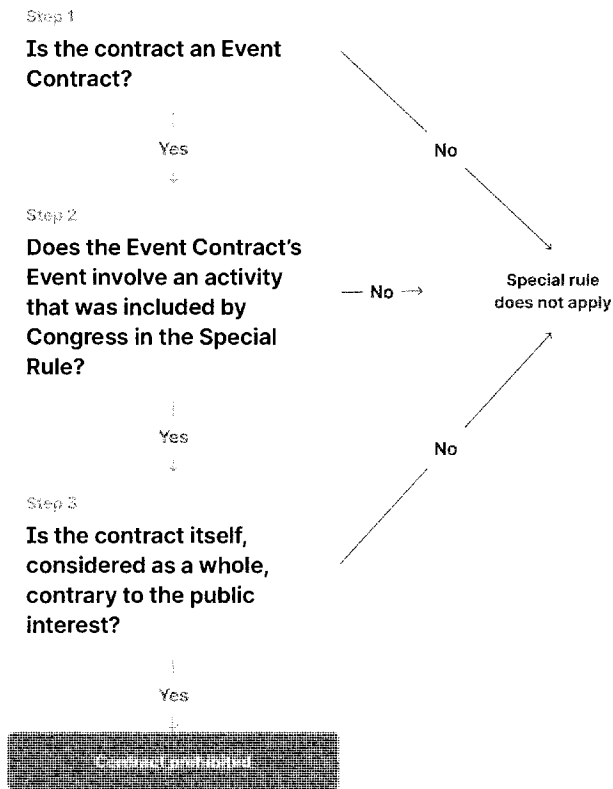
Step 3: Is the contract itself, considered as a whole, contrary to the public interest? If no, the contract is not prohibited. If yes, the contract is prohibited.

Graphically, the flow of the three steps looks like this:

¹⁴ 7 U.S.C. 7a-2(c)(5)(C)(i)(VI).

¹⁵ The phrase “contrary to the public interest” is used three times in the Special Rule. It is used in clause (i) in reference to the sixth activity in the list of activities Congress included in step two of the Special Rule. In this context, it is the *contract’s Event* that is contrary to the public interest, not the *contract itself*. It is also used in clause (i) in step three and in the prohibition in clause (ii) in reference to the *contract itself*.

¹⁶ 7 U.S.C. 7a-2(c)(5)(C)(ii). (“No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.”)



Step One and Step Two limit the scope of contracts to which the Special Rule applies. Step One limits the Special Rule only to Event Contracts. Step Two limits this scope further. Step Two provides that the Special Rule does not apply to *all* Event Contracts, but only to those contracts whose Events involve one of the activities Congress listed in the statute. Step Three provides that even a contract that passes Steps One and Two is not prohibited unless the Commission determines that the contract, considered as a whole, is contrary to the public interest. The following graphic illustrates how each step of the Special Rule functions to narrow the scope of the contracts that are prohibited under the Special Rule.

Kalshi

All Contracts

Step 1 Is the contract an Event Contract?

Step 2 Does the Event Contract's Event involve an activity that was included by Congress in the Special Rule?

Step 3 Is the contract itself, considered as a whole, contrary to the public interest?

To further explain the role of Step Three, Congress did not prohibit an Event Contract whose Event involves an activity listed in the Special Rule.. It is possible that an Event Contract's Event involves an activity listed in the Special Rule but the Commission does not determine that the contract, considered as a whole, is contrary to the public interest. That contract would not be prohibited under the Special Rule. For example, an Event Contract on the invasion of Ukraine would satisfy Steps One and Two because it is an Event Contract (Step One) and the Event Contract's Event involves war, one of the activities that is listed in the Special Rule (Step Two). That does not mean that the contract is prohibited; it moves to step three for the Commission to determine if the Event Contract, considered as a whole, is contrary to the public interest. The Commission may determine that it is contrary to the public interest, in which case the Event Contract would be prohibited by the Special Rule.¹⁷ And the Commission may determine that it is not contrary to the public interest. As Commissioner Johnson recently noted, "Geopolitical events in Europe, specifically, the invasion of Ukraine has led to remarkable disruptions in energy and agriculture markets."¹⁸ Accordingly, the Commission may find that the Event Contract has hedging utility and/or other economic utility or benefits and thus could not determine that the Event Contract is contrary to the public interest. This point, that a contract's event can involve an activity listed in the statute and still be allowed because the contract itself is not contrary to the public interest was made by then-Commissioner Berkovitz in his statement on ErisX's RSBIX contracts.¹⁹

¹⁷ 7 U.S.C. 7a-2(c)(5)(C)(ii).

¹⁸ Opening Statement of Commissioner Kristin N. Johnson before the Energy and Environmental Markets Advisory Committee | CFTC, September 20, 2022.

¹⁹ Commissioner Berkovitz's statement is available here:

<https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721>. Commissioner Berkovitz concluded his statement by noting that, "If sporting event contracts with an economic purpose, such as hedging, are allowed to be traded on a DCM, the general public must be able to access and trade those contracts on the exchange. The public cannot be barred from trading a contract listed on a DCM. However, gaming contracts without any economic purpose should not be permitted on a DCM."



A further look at step two of the Special Rule

Once an Event Contract passes Step One, the analysis moves to Step Two of the Special Rule. Step Two is to determine if the Event Contract involves an activity that was listed by Congress in the Special Rule. For the purposes of step two of the Special Rule, an Event Contract only involves an activity if the Event Contract’s *Event* involves that activity.²⁰ For example, an Event Contract can only involve war if the Event Contract’s Event involves war. Conversely, if the Event Contract’s Event does not involve war, then the Event Contract does not involve war. Similarly, an Event Contract will involve gaming only if the Event Contract’s Event involves gaming. For the purposes of Step Two, it is irrelevant if something else surrounding the Event Contract, such as the market activity of trading the contract, involves a listed activity. The only relevant factor for Step Two is whether the Event Contract’s Event involves the listed activity, not whether the Event Contract, considered as a whole, involves the listed activity.

There are many reasons why the analysis of whether an Event Contract involves a listed activity in Step Two is limited to the Event Contract’s Event, and does not include the consideration of the Event Contract as a whole. Many of these reasons are stated in the letters in Part 2 of this comment, as well as by other commenters.²¹ The Exchange provides two reasons here. (For convenience, this comment refers to the incorrect reading that the analysis under Step Two includes the Event Contract, considered as a whole, and is not limited to only the Event Contract’s Event, as the “Contract as a Whole view of Step Two”.)

The Contract as a Whole view of Step Two is wrong. An Event Contract cannot be considered to involve a listed activity based on the Event Contract considered as a whole, and not only the Event Contract’s Event. If step two were so broad, it would (1) defeat Congress’ intended narrowing function, and (2) render the statute internally inconsistent.

The sixth activity illustrates the flaw in applying Step Two broadly, ie. Contract as a whole View of Step Two. Congress included as the sixth activity a “similar activity [to the first five activities, that is] determined by the Commission, by rule or regulation, to be contrary to the public interest.” Under the Contract as a Whole view of Step Two, the sixth activity means that the Commission can determine that any factor that is part of an Event Contract is contrary to the public interest.²² For example, the Commission can determine that *trading* contracts on a certain event is a “similar activity” to the listed activities and is contrary to the public interest. These contracts would satisfy Step Two even though the Event contracts are based on Events that are *not* contrary to the public interest because the *trading* on the contract *is* contrary to the public interest per the Commission’s determination, and trading on the contract is part of the contract when considered as a whole.

The analysis would then move to Step Three. But Step Three calls for a public interest analysis

²⁰ The analysis of the Event Contract in Step Three is different from Step Two. The analysis in Step Three considers the Event Contract as a whole, and is not limited to the Event Contract’s Event. Conversely, the analysis in Step Two is limited to what activities the Event Contract’s Event involves.

²¹ See e.g. the comments of Josh Sterling, Timothy McDermott, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, and Railbird Technologies.

²² This is because under the Contract as a Whole view of Step Two, Step Two is not limited only to looking at the Event Contract’s Event. The analysis in Step Two looks at the Event Contract as a whole. Accordingly, the activities included in the list in Step Two are not confined to the Event Contracts’ Events, and can include anything related to the Event Contract.



of the Event Contract, considered as a whole, where it has already been determined under Step Two that the *trading itself* is contrary to the public interest, i.e. that the Event Contract, considered as a whole, is contrary to the public interest. This results in two consecutive steps that do the exact same thing:

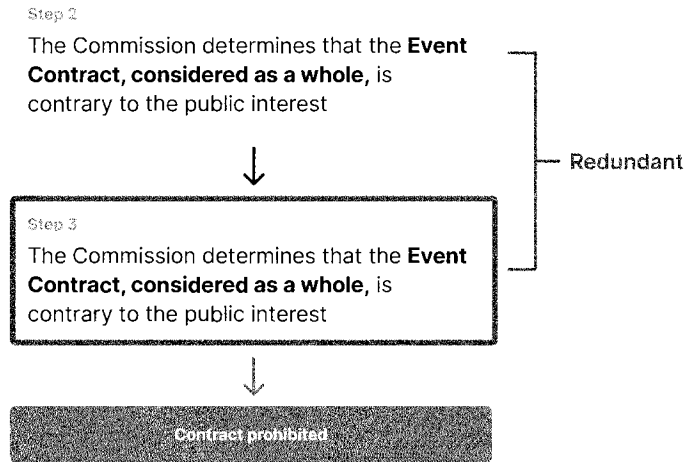
- Step Two: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest
- Step Three: the Commission determines that the Event Contract, considered as a whole, is contrary to the public interest (*again*)

This illustrates the fundamental flaw in the Contract as a Whole view of Step Two. What Congress clearly designed is a statute that allows the Commission to apply special scrutiny to contracts based on particular events that Congress identified as problematic. Congress did not shut the door to such contracts, but recognized that trading on an Event Contract whose Event is a problematic activity that involves, say, assassination or terrorism might nevertheless have redeeming features (such as hedging utility) that would justify the conclusion that the Event Contract, considered as a whole, is not contrary to the public interest. In this way, Congress clearly differentiated the Event Contract's Event (which may be disfavored), and trading in the Event Contract (permitted where trading on the disfavored activity offers economic and other societal benefits). When trading in the Event Contract *itself* is included in the analysis at Step Two, the distinction Congress sought to draw between the underlying event and trading in the contract is obliterated.²³

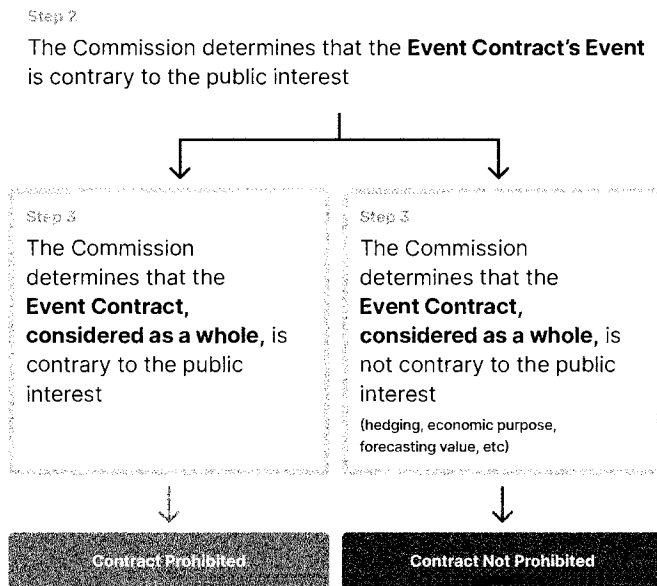
²³ This defect in the statute that emerges from the Contract as a Whole view of Step Two is from the sixth activity. The fact that the defect stems from the sixth activity does not mean that defect is limited to the sixth activity and that the Contract as a Whole View of Step Two is fine with regard to activities one through five. That would misapprehend the way that statutes work. Once it is demonstrated that step two cannot be about the contract, considered as a whole, for even one activity, that view is proven wrong. Therefore, the Contract as a Whole view of Step Two is an incorrect reading of the statute regardless of the activity.



The use of (c)(5)(C)(i)(VI) under the incorrect Contract as a Whole view of Step 2



The use of (c)(5)(C)(i)(VI) under the correct view of Step 2



Kalshi

Additionally, the Contract as a Whole view of Step Two actually renders all of the first five activities in Step Two superfluous. Once a contract passes Step Two, no matter which activity the contract involves, it must pass Step three to be prohibited by the Special Rule. The analysis in Step Three is for the Commission to determine whether the Event Contract, considered as a whole, is contrary to the public interest. *Any* Event Contract that the Commission determines is contrary to the public interest in step three *necessarily* would also satisfy the sixth activity in Step Two. For example, an Event Contract that involves war will pass Step Two. The analysis of the Event Contract will then move to Step Three, and assume that the Commission finds that the contract is contrary to the public interest. At that point, the Event Contract actually involves *two* of the listed activities: (i) it involves the activity of war, and (ii) it *also* involves an activity that the Commission has determined is contrary to the public interest. It is impossible for an Event Contract to pass Step Three and not involve the sixth activity in Step Two. Accordingly, there is no point in the first five activities listed in Step Two, only the sixth activity. In fact, there would be no point in Step Two at all. As noted, the sixth activity in Step Two and Step Three are identical. Accordingly, if the Contract as a Whole view of Step Two is correct, Congress would have just skipped Step Two altogether. The Special Rule would have been a simple six line statute that said only:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) of this title), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest.

The inevitable collapse of all of the Step Two activities into the sixth activity and the collapse of the sixth activity into Step Three under this expansive interpretation of Step Two shows that the Contract as a Whole view of Step Two is wrong. The correct view of Step Two is that it, like Step One, simply describes what the contract is based on, and the analysis in Step Two is limited to the Event Contract's Event. Accordingly, there is a big difference between Step Two, including the sixth activity, and Step Three. Step Two is focused only on the Event Contract's Event. If an Event Contract passes Step Two because the Event Contract's Event involves any of the listed activities, even the sixth activity, the analysis under Step Two will always be different from the analysis under Step Three. The analysis under Step Two will be whether the Event Contract's Event involves the activity. The analysis under Step Three is very different. Step Three does not only consider the Event Contract's Event alone, it considers the Event Contract, considered as a whole. Thus, all of the anomalies that directly stem from the Contract as a Whole view of Step Two disappear under the view that the analysis in Step Two (like Step One) considers only the Event Contract's Event.

The correct reading of the statute is that the analysis in Step Two, like Step One, is limited to the Event Contract's Event. Steps One and Two work in concert to create the eligibility requirements for the *type* of contract that the Special Rule applies to (*i.e.*, an Event Contract whose Event involves a listed activity), and Step Three serves as an independent step whose analysis considers the Event Contract, as a whole. Together, all three steps form a coherent and cohesive statutory rule that implements Congress's intent to have the Commission review a narrow subset of event contracts whose underlying events involve activities (such as terrorism and assassination) Congress did not want to automatically legitimize via futures and swaps trading on them. Congress nevertheless gave the Commission discretion to allow such contracts to be listed if



trading them would not be contrary to the public interest.

The Nadex Order’s incorrect reading of the Special Rule

In the Commission’s 2012 Nadex Order²⁴ (“*Nadex Order*”) (see Question 5), the Commission applied the Special Rule to contracts on the occurrences of political control and the election of the President of the United States. These occurrences do not involve any of the activities in step two of the Special Rule. Despite this, the *Nadex Order* concluded that the Special Rule applied and prohibited the contracts. The *Nadex Order* adopted the Contract as a Whole view of Step Two, and assumed that the analysis in Step Two considers the Event Contract as a whole, not just the Event Contract’s Event. The *Nadex Order* found that the election contracts involved the activity of gaming even though the contract’s Event did not, because the act of trading on the contract was gaming and therefore, those contracts, considered as a whole, satisfied Step Two.

This Contract as a Whole view of Step Two that the *Nadex Order* adopted is wrong, and should be rejected. As discussed at length, it violates the structure and the framework of the statute, and it leads to absurd results. The correct view of the statute is that Step Two, like Step One, relates to what the contract is based on, or the contract’s Event.

The Nadex Order’s misreading of the statute would apply to every futures and swap contract on an occurrence

The consequence of the Contract as a Whole view of Step Two that the *Nadex Order* adopted is that the Special Rule applies to *all* futures, commodity options, and swap contracts that are based on an occurrence, extent of an occurrence, or a contingency. The *Nadex Order* found that the contracts at issue there were gaming because the act of trading the contracts would fit within state law and federal law definitions of gaming. That same reasoning would apply to *all* futures, commodity options, and swaps that are based on an occurrence, extent of an occurrence, or contingency, because the act of trading these contracts would also fit within definitions of gaming. For example, the *Nadex Order* cited the law in North Dakota that “‘Gambling’ means risking any money ... upon ... the happening or outcome of an event, including an election ... over which the person taking the risk has no control.”²⁵ The *Nadex Order* also cited the New Hampshire law that “‘Wager’ means a monetary agreement between 2 or more persons that a sum of money ... shall be paid to one of them on the happening or not happening of an uncertain event.”²⁶

The approach the Commission adopted in the *Nadex Order* expands the scope of the Special Rule far beyond what Congress intended. Under the *Nadex Order* and in light of the breadth of some definitions of gaming activity, the Commission could deem the staking of value on any type of future event gaming. Alternatively, the Commission could determine via the authority granted in the Sixth Activity, that trading on any type of future event is similar to the other enumerated activities. The vast breadth of such discretion cannot be squared with the specific enumeration of activities, which Congress clearly designed to cabin the Special Rule’s scope.

²⁴ CFTC Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts” (Apr. 2, 2012) available here: [CFTC Issues Order Prohibiting North American Derivatives Exchange’s Political Event Derivatives Contracts | CFTC](#).

²⁵ *Nadex Order* fn. 1

²⁶ It is true that the *Nadex Order* also cited state laws that were more tailored to elections specifically, but that does not negate the point that there are also state laws that define gaming broadly that would include trading any futures, commodity options, or swap contracts that pass step one. Picking and choosing which state statutes to consider informative in a manner that is expedient for a desired outcome is not the proper way for the Commission to adopt its definitional framework.



This reality illustrates the *Nadex Order's* flaw in going beyond the event underlying the contract -- elections -- to determine whether the contract was gaming.

This argument is addressed in greater detail in Part 2 of this comment. However, the Exchange notes here that this overbreadth is a problem exclusive to the approach to the Contract as a Whole view of Step Two adopted in the *Nadex Order*. Under the more tailored approach where step two of the Special Rule is limited to the contract's Event, this overbreadth disappears..

Applying the three steps of the Special Rule to Kalshi's Contract

Applying the three steps to Kalshi's contract shows that the contract is not subject to the Special Rule.

Kalshi's Contract passes Step One. It is a contract based on the occurrence of political control. The Contract is an Event Contract, meeting the eligibility requirements in Step One, and the analysis proceeds to Step Two.

Step Two is whether the Event Contract's Event involves an activity that was listed in Step Two. The Contract's Event is political control, specifically the dual occurrences of the party membership of the Speaker of the House and the President Pro Tempore. These do not involve any of the listed activities.

- The occurrence of political control does not involve activity that is illegal under either Federal or State Law.
- The occurrence of political control does not involve the activity of terrorism.
- The occurrence of political control does not involve the activity of assassinations.
- The occurrence of political control does not involve the activity of war.
- The occurrence of political control does not involve the activity of gaming.²⁷
- The occurrence of political control does not involve an activity that the Commission has determined to be contrary to the public interest.

The Contract's Event, therefore, does not involve an activity that was included by Congress in the list of activities in Step Two of the Special Rule, and therefore the contract fails the Step Two eligibility requirements. The analysis therefore terminates and does not proceed to Step Three, and Congress did not authorize the Commission to apply the Special Rule to prohibit the Contract.

Conclusion to Part 1

Congress granted the Commission in the Special Rule the authority to prohibit certain contracts. This grant of authority is subject to the rules that Congress created. Congress included three distinct steps to determine if a contract is prohibited under the Special Rule. The Commission must abide by these rules. Step Two is clear; the analysis only considers whether the Event Contract's Event involves a listed activity, and it does not consider the Event Contract, as a whole. The Kalshi Contract's Event is political control. Political control does not involve any of the activities that Congress included in Step Two. Accordingly, the Contract fails Step Two, and the Special Rule cannot prohibit the Contract.

²⁷ The Commission has never stated, or even implied, that the occurrence of elections involves gaming. In the Commission's Nadex order, the Commission stated that "*taking a position* in a Political Event Contract" is gaming because elections are a "a contest between electoral candidates." See *North American Derivatives Exchange, April 2, 2012* (cfic.gov), pg. 3. However, the Commission was careful to not suggest that elections themselves, the very bedrock and foundation of our democracy, are a game.



As required by the CEA in 7 U.S.C. 7a-2(c)(5)(B), the Commission should approve the Contract.



Part 2

The following two letters contain analyses on the Special Rule, as well as the implementing regulations at 17 C.F.R. 40.11. They were originally submitted to the Commission for consideration as part of the original 40.3 submission, and the Exchange includes them now in a public comment for the Commission’s further consideration.

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Confidential Treatment Requested by KalshiEX LLC

September 21, 2022

Sebastian Pujol Schott
Acting Deputy Director, Product Review Branch
Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, DC 20581

Re: Non-Application of Event Contracts Provisions to KalshiEX LLC's Political Control Contracts

Dear Mr. Pujol Schott:

I write to you on behalf of KalshiEX LLC ("Kalshi") with respect to its intention to self-certify certain political control contracts (the "Contracts") to be listed for trading on its designated contract market ("DCM"), and to address any outstanding concerns the Commodity Futures Trading Commission ("CFTC" or "Commission"), including the Division of Market Oversight ("DMO"), might have. We greatly appreciate the Commission's and DMO's continued willingness to allow Kalshi to highlight the many reasons why the Contracts should be listed, including the demonstrated economic purposes they serve.

In the spirit of building upon that productive dialogue, and in advance of Kalshi's self-certification of the Contracts, we wanted to elaborate on why Section 5c(c)(5)(C) of the Commodity Exchange Act ("CEA") and CFTC Regulation 40.11 (together, the "Event Contracts Provisions") do not provide a legal basis for the staff or the Commission to impede self-certification of the Contracts.

As further explained below, Section 5c(c)(5)(C)(i) of the CEA does not hinder self-certification of the Contracts because the activity on which they are based does not "involve" any of the enumerated event categories in the provision. Although the Commission previously determined

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that other political event contracts that were self-certified by a different exchange, the North American Derivatives Exchange (“Nadex”), were subject to the Event Contracts Provisions, that determination was based on a misinterpretation of the Event Contracts Provisions. Therefore, the Commission’s previous determination on Nadex’s proposed contracts should not be followed here with regards to the Contracts.¹ Under the Event Contracts Provisions, and contrary to the Commission’s order relating to Nadex’s political event contracts (“Nadex Order”), which determined that the *trading* of contracts based on the outcomes of elections constituted gaming activity, the Commission must consider whether the occurrence or contingency *on which the Contracts are based* – elections – involves one of the enumerated activities. And because elections do not fit within any of the enumerated event categories, the Event Contracts Provisions provide no basis to delay self-certification. CFTC Regulation 40.11 calls for the same result. Accordingly, even if, arguendo, CFTC Regulation 40.11 contains language that could be construed to support a different result, the Commission should read CFTC Regulation 40.11 to be consistent with Section 5c(c)(5)(C) and, accordingly, the Contracts should be self-certified without delay or encumbrance.

As explained in greater detail below, because the Event Contracts Provisions do not establish any legal or regulatory basis for impeding the Contracts, the Commission should take no action that would delay Kalshi from self-certifying them pursuant to CFTC Regulation 40.2.

I. SECTION 5c(c)(5)(C) OF THE CEA PROVIDES NO BASIS TO IMPEDE SELF-CERTIFICATION OF KALSHI’S POLITICAL CONTROL CONTRACTS.

Section 5c(c)(5)(C)(i) of the CEA establishes that, in connection with the listing of agreements, contracts, or transactions on “excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency[.]”

the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve[:] (I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

Section 5c(c)(5)(C)(ii) further specifies that “[n]o agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.” Thus, the CEA, through this

¹ 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>.

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provision, establishes a clear framework under which the Commission can – but is not obligated to – review an event contract that is based upon an “occurrence, extent of an occurrence, or contingency” that involves one of the enumerated underlying activities in order to determine if those contracts would be contrary to the public interest. A Commission determination that the contract is contrary to the public interest would render its listing prohibited.

In short, through Section 5c(c)(5)(C), Congress granted the Commission the discretion to determine that a given event contract is contrary to the public interest, and thereby prohibited, only when the event underlying that contract involves one of the statute’s specifically enumerated activities. Congress did not grant the Commission the authority to prohibit a contract based upon an event that involves an unenumerated activity on the grounds that it would be contrary to the public interest.²

The plain language and structure of Section 5c(c)(5)(C)(i) make clear that the scope of the Commission’s discretionary review is narrowly focused on the nature of the contract’s underlying event, not of trading in the contract itself. Section 5c(c)(5)(C)(i) begins with the clause: “[i]n connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities *that are based upon the occurrence, extent of an occurrence, or contingency[.]*” (emphasis added). Thus, at the outset of the controlling provision, the statute establishes that the distinguishing feature of the contract is the nature of the occurrence or contingency. The final clause of Section 5c(c)(5)(C)(i), immediately prior to the provision’s enumeration of the covered activities, refers back to the first clause of the provision when it says: “the Commission may determine that *such* agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve” the enumerated activities. (emphasis added). When the clauses are read together, Section 5c(c)(5)(C)(i) grants the Commission only limited authority to review a contract that is “based upon [an] occurrence, extent of an occurrence, or contingency” that “involve[s]” one of the enumerated activities.

The plain language of the enumerated events themselves bolsters this interpretation. As Kalshi has pointed out in previous submissions,³ Section 5c(c)(5)(C)(i)’s first and sixth categories are defined respectively as an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added). The inclusion of the noun “activity” (and the reference in the sixth

² This lack of authority includes the sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), as that provision requires the Commission to conduct a rulemaking to determine that another activity is contrary to the public interest and then only if it is similar to one of the other specified underlying activities (crimes, terrorism, assassination, war, or gaming). See Commission Rulemaking Explained, available at: https://www.cftc.gov/LawRegulation/CommissionRulemakingExplained/index.htm#_ftn1.

³ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to DMO March 28, 2022.

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category to all five preceding “similar activit[ies]”) makes clear that Congress intended the underlying activity, not the contract itself, to be the subject of review and scrutiny and it must be assumed that decision was intentional.⁴

The sixth enumerated activity (“other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest”), further highlights that Congress’s intention was for the Commission to analyze the activity underlying the contract rather than trading in the contract itself. This final enumerated activity provides the Commission a sort of catchall to determine whether the event involves “similar activity” to the preceding categories and thus might be inappropriate for listing. Since terrorism, assassination, war, and activity unlawful under state or federal law unquestionably refer to the occurrence or contingency underlying the contract, the sixth catch-all category must be read consistently with the rest of the enumerated list (apples must be compared to apples).⁵

Another reason that Section 5c(c)(5)(C) must be read as focusing on the underlying activity is that such focus is congruent with the nature of event contracts themselves. If Congress was concerned about trading in the contract itself, there is no indication why it would have limited the provision to event contracts rather than establishing a general rule that would have authorized the Commission to prohibit any derivatives contract that the trading in is, for example, unlawful under state law.

In the Nadex Order,⁶ the Commission did not interpret Section 5c(c)(5)(C) as focusing on the underlying activity. Instead, the Commission appears to have read the gaming provision (the fifth enumerated activity) to refer to trading in the contract itself. Accordingly, the Commission determined that the gaming provision applied to Nadex’s political event contracts because the contracts involved “a person staking something of value upon a contest of others.”⁷ The Commission likened this trading activity to activity prohibited by state anti-gambling laws. The Commission’s interpretation in this instance ran counter to the plain language and structure of the statute, as explained above.

⁴ The scant legislative history – a colloquy between Senators Diane Feinstein and Blanche Lincoln during the Senate’s consideration of Dodd-Frank’s regulation of event contracts – does not change the analysis. The colloquy did not address whether the underlying event, rather than trading in the contract itself, is the proper subject of analysis; instead, the Senators discussed the distinction in economic purpose between contracts that serve hedging utility and contracts that are designed predominantly for speculation. *See* 56 Cong. Rec. S5906-07 (July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln), available at: <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>. In any event, the language and structure of the statute are clear, so resorting to legislative history is unnecessary.

⁵ We explain below why, notwithstanding the Commission’s Nadex Order, the gaming provision must also refer to the underlying activity and not trading in the contract itself.

⁶ *See supra* note 1.

⁷ Nadex Order at 3 (internal quotation marks omitted).

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Other principles of statutory construction also undercut the application of the Event Contracts Provisions in the Nadex Order. Under the Commission’s interpretation, a person trading a political event contract is engaged in gaming – “staking something of value upon a contest of others.”⁸ By parallel reasoning, a person trading a terrorism contract is engaged in terrorism and a person trading a war contract is engaged in war. That is not a tenable interpretation of the statute. If Congress intended the Commission to focus on the underlying event for some of the enumerated categories, but to focus on trading in the contract itself for others, it would have said so. It certainly cannot be presumed or inferred from silence that Congress intended the Commission to apply disparate analytical approaches to the single list of enumerated activities. When the correct interpretation of Section 5c(c)(5)(C) is applied to the Contracts, the result is clear. Elections are not illegal under state or federal law, are not gaming, and are not similar to any of the enumerated activities – federal or state crimes, terrorism, assassination, war, and gaming – all of which are activities that Congress did not want to legitimize or encourage via event contracts without careful consideration by the Commission. The Commission should therefore not impede Kalshi from self-certifying the Contracts and lacks a legal basis to invoke Section 5c(c)(5)(C) to do so.

While we could stop here, we believe it is worth pointing out that the Nadex Order not only contravenes the language and structure of Section 5c(c)(5)(C), but also threatens to upend the CEA itself. Virtually every futures or swaps contract can be described as staking something of value on the outcome of some future event.⁹ Yet the CFTC’s exclusive jurisdiction over derivatives markets means that the CEA preempts any state law that would attempt to regulate derivatives markets.¹⁰ Therefore, regulated futures and swaps contracts *cannot be* illegal gambling under state law.

In fact, many states ban “gambling” not just on elections, but more generally on the outcomes of future events. These laws would prohibit the entire category of event contracts (at a minimum), which both Congress and the CFTC have expressly permitted to be listed on DCMs. Some of these states provide carve-outs for CFTC-regulated products, or otherwise for activities like commodities and securities trading. However, not all do. New Hampshire, for example, bans gambling and defines it as, “to risk something of value upon a future contingent event not under one’s control or influence.”¹¹ Alaska also bans gambling and defines it similarly as when:

⁸ *Id.*

⁹ This overly broad interpretation of the term “gaming” would threaten to render 5c(c)(5)(C)’s other enumerated provisions superfluous, given that, as explained above, virtually all event contracts could potentially qualify for that categorization. As the Supreme Court has repeatedly observed, there is a “canon against interpreting any statutory provision in a manner that would render another provision superfluous.” *Bilski v. Kappos*, 561 U.S. 593, 607-8 (2010).

¹⁰ *See Am. Agric. Movement v. Bd. of Trade*, 977 F.2d 1147, 1156-57 (7th Cir. 1992) (holding that “When application of state law would directly affect trading on or the operation of a futures market, it would stand ‘as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress,’ and hence is preempted.” (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941))).

¹¹ NH Rev Stat § 647:2(II)(d), available at: <https://www.gencourt.state.nh.us/rsa/html/lxii/647/647-2.htm/>.

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...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.¹²

Finally, at least one federal law that addresses gambling specifically carves out regulated derivatives products from their definitions of "bet or wager," highlighting that Congress views the two types of transactions as fundamentally distinct. The Unlawful Internet Gambling Enforcement Act of 2006's ("UIGEA") definition of "bet or wager" specifically "does not include [as relevant here:]"

- (ii) any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act;
- (iii) any over-the-counter derivative instrument;
- (iv) any other transaction that—
 - (I) is excluded or exempt from regulation under the Commodity Exchange Act; or
 - (II) is exempt from State gaming or bucket shop laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.¹³

Notably, the Commission relied upon UIGEA's definition of "bet or wager" in its Nadex Order,¹⁴ but made no mention of the carve out for derivatives products.

All of these various provisions illustrate the flaw in evaluating whether *trading* a futures or swaps contract constitutes gaming or gambling activity, as the Commission did in the Nadex Order, or whether *trading* a futures or swaps contract is unlawful under federal or state law. Instead, to maintain the structural integrity of Section 5c(c)(5)(C) and the CEA itself, the Commission should evaluate whether the Contracts involve an underlying activity – elections – that fits into one of the enumerated categories of activities in Section 5c(c)(5)(C). Because elections do not

¹² AK Stat § 11.66.280(2).

¹³ 31 U.S.C. § 5362(1)(E) (2006).

¹⁴ *Supra* note 1 at 3.

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fit within any of the enumerated activities, the Commission should not impede self-certification of the Contracts.

II. CFTC REGULATION 40.11 CALLS FOR THE SAME RESULT.

A determination that Section 5c(c)(5)(C) does not present an obstacle to Kalshi's self-certification of the Contracts should be dispositive, because CFTC Regulation 40.11, which the CFTC adopted to implement Section 5c(c)(5)(C), should likewise be read to allow only for the Commission's consideration of the contract's underlying activity, rather than its consideration of trading in the contract itself. While the language of the rule is not identical to the statute, there is no reason to read the language of CFTC Regulation 40.11 to require an analysis of trading in the contract rather than the contract's underlying activity that constitutes the event.

The scope of CFTC Regulation 40.11 should not be read to go beyond the scope of the special rule in the statute. By using the words "relates to, or references" in addition to "involves," the regulation only reinforces that the relevant activity is the underlying event, not trading on the underlying event. It would not make sense for a futures contract or swap to "reference" trading in the contract; to the contrary, the word "reference" is a clear direction to focus on the underlying event that the contract "references." Thus, under the regulation, like the statute, the relevant activity for purposes of the Commission's event contract analysis is the activity on which the contract is based (or to which the contract refers) rather than the contract itself.¹⁵ Even if the different words in the regulation could conceivably be read to support a different analysis that would broaden the scope of contracts subject to the statute, courts have held that, even under a standard of review that is highly deferential, an agency interpretation will not stand if "it is contrary to clear congressional intent or frustrates the policy Congress sought to implement."¹⁶

¹⁵ Because the Contracts are not based on an enumerated activity, the Commission does not need to consider undertaking a public interest analysis. If the Commission were to conclude otherwise, however, the Commission could either permit the contracts to be listed (the statute authorizes prohibition only upon a Commission determination that the contract would be contrary to the public interest, a determination that the Commission "may" undertake) or conduct a public interest analysis. CFTC Regulation 40.11 should not be read to constitute a blanket prohibition, as that reading could not be squared with the statute. See Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitz-statement040721> ("if sports event contracts involving gaming are found to have an economic purpose, they should be permitted to be listed on a DCM and retail customers cannot be prohibited from trading those contracts"); Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, available at: <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521> ("Congress [through Section 5c(c)(5)(C) of the CEA] unambiguously provided a default rule that all event contracts, including the enumerated ones, are allowed").

¹⁶ *Garcia Carias v. Holder*, 697 F.3d 257, 271 (5th Cir. 2012); *CHW W. Bay v. Thompson*, 246 F.3d 1218, 1223 (9th Cir. 2001) ("deference is not owed to an agency decision if it construes a statute in a way that is contrary to congressional intent or frustrates congressional policy").

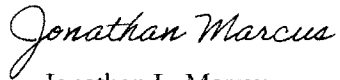
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III. CONCLUSION

For all of the reasons stated above, the Commission has no reason to stay Kalshi's self-certification of the Contracts. We welcome your feedback on this position and would appreciate the opportunity to follow-up on these specific considerations in a conference call or in-person meeting to the extent you have further questions.

Very truly yours.



Jonathan L. Marcus

Cc: Eliezer Mishory
Chief Regulatory Officer and Counsel, Kalshi

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Confidential Treatment Requested by KalshiEX LLC

May 31, 2022

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Re: Political Event Contracts, Section 5c(c)(5)(C) of the CEA, and CFTC Rule 40.11

Dear Mr. Mishory:

This letter is in response to your request for legal advice regarding KalshiEx LLC's ("Kalshi") engagement with the Commodity Futures Trading Commission ("CFTC" or "Commission") about the listing of certain event contracts relating to the partisan makeup of Congress, specifically the political control of Congress. One of the factors that Kalshi considers in listing contracts is ensuring regulatory compliance and, as such, you requested advice on the following question:

Are Kalshi's proposed political control contracts subject to the Commodity Exchange Act's ("CEA's") special rule for event contracts described in Section 5c(c)(5)(C) of the CEA and the implementing regulations at 17 C.F.R. § 40.11?

By way of background, in 2012, Nadex listed similar contracts (although with different characteristics) which the Commission prohibited by order ("Nadex Order"),¹ finding that trading in the Nadex contracts violated the CEA. Specifically, the Nadex Order found that Section 5c(c)(5)(C) of the CEA applied to the Nadex contracts because the Nadex contracts constituted gaming.² The Nadex Order also determined that the Nadex contracts were contrary to the public interest because the Nadex contracts could have an adverse effect on the integrity of elections.³

Section 5c(c)(5)(C) and Rule 40.11, however, are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match

¹ 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 (Apr. 2, 2012) (<https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>) (last visited May 30, 2022).

² Nadex Order at 2-3.

³ *Id.* at 4.

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any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation. In reaching this conclusion, I will first provide some background of principles of interpretation and the relevant text of Section 5c(c)(5)(C) and Rule 40.11. I will then apply those principles to the Kalshi political control contracts and describe how the Nadex Order's conclusions to the contrary are incorrect.

I. BACKGROUND

A. Principles of Interpretation

Since the Nadex Order, the Supreme Court has significantly modified the method through which regulatory text should be interpreted and the circumstances in which an agency will receive deference for its interpretation of regulatory text. The tools for interpreting regulatory text are similar to those for evaluating statutory text. I first discuss these principles and then use them to evaluate Section 5c(c)(5)(C) and CFTC Rule 40.11 and their application to Kalshi's political event contracts.

The Supreme Court revamped the process for evaluating regulatory text in the 2019 case of *Kisor v. Wilkie*.⁴ In *Kisor*, the court considered whether to overrule *Auer v. Robbins*⁵ and *Bowles v. Seminole Rock*,⁶ cases which found that an agency was entitled to deference of its interpretation of an agency rule so long as it was not "plainly erroneous or inconsistent with the regulation."⁷ In *Kisor*, the Court did not overrule *Auer* and *Seminole Rock*, but significantly limited their application: "The deference doctrine we describe is potent in its place, but cabined in its scope."⁸

In reviewing the meaning of Rule 40.11, according to *Kisor*, one must "exhaust the 'traditional tools' of statutory construction."⁹ "Agency regulations can sometimes make the eyes glaze over. But hard interpretive conundrums, even relating to complex rules, can often be solved."¹⁰ One must "resort[] to all the standard tools of interpretation,"¹¹ including a careful consideration of

⁴ 139 S. Ct. 2400 (2019).

⁵ 519 U.S. 452 (1996).

⁶ 325 U.S. 410 (1945).

⁷ *Seminole Rock*, 325 U.S. at 414.

⁸ *Kisor*, 139 S. Ct. at 2408.

⁹ *Id.* at 2415 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

¹⁰ *Kisor*, 139 S. Ct. at 2415.

¹¹ *Id.* at 2414.

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“the text, structure, history, and purpose of a regulation”¹² to determine whether a rule has “one reasonable construction of a regulation”¹³ or can “at least establish the outer bounds of reasonable interpretation.”¹⁴ In discussing this approach to regulatory construction, the Supreme Court relied heavily on the principles of statutory construction discussed in *Chevron* and its progeny.

B. The Statute And The Rule

With these key principles in mind, I turn to the statute and rule. This analysis begins, of course, with the statutory text of Section 5c(c)(5)(C) of the CEA, from which the CFTC promulgated Rule 40.11. That section of the CEA states:

In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon **the occurrence, extent of an occurrence, or contingency** (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i) [2] of this title), by a designated contract market or swap execution facility, the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest **if** the agreements, contracts, or transactions **involve—**

- (I) **activity** that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) **other similar activity** determined by the Commission, by rule or regulation, to be contrary to the public interest.¹⁵

In relevant part for purposes of this analysis, Rule 40.11(a) states:

A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following:

- (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that **involves, relates to,**

¹² *Id.* at 2415.

¹³ *Id.*

¹⁴ *Id.* at 2416. The *Kisor* court goes on to explain that an agency’s interpretation of an ambiguous regulation may still not receive deference. The Court must then determine if “the character and context of the agency interpretation entitles it to controlling weight.” *Id.*

¹⁵ 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI) (emphases added). If the Commission determines that such an agreement, contract, or transaction is contrary to the public interest, such agreement, contract, or transaction may not “be listed or made available for clearing or trading on or through a registered entity.” *Id.* § 7a-2(c)(5)(C)(ii).

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or references terrorism, assassination, war, gaming, or an **activity** that is unlawful under any State or Federal law; or

(2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references **an activity that is similar to an activity** enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.¹⁶

II. APPLICATION TO KALSHI'S POLITICAL CONTROL CONTRACTS

To help frame the matter, the key question here requires understanding the limitations on the scope of Section 5c(c)(5)(C) and Rule 40.11. Is the scope (1) limited to contracts when the activity underlying the event contract involves one of the enumerated activities or do they (2) include the act of participating in the contract is itself?

Applying the principles of statutory and regulatory construction shows that Section 5c(c)(5)(C) and Rule 40.11 are limited to only the underlying activity (not participating in the contract itself) and, because Kalshi's political control contracts do not match any of the enumerated activities which the statute is expressly limited to, those contracts are not subject to the statute and implementing regulation.

A. Section 5c(c)(5)(C) and Rule 40.11 Apply Only To Event Contracts Where The Activity Underlying The Event Contract Is One Of The Enumerated Activities.

The plain text of Section 5c(c)(5)(C) demonstrates that Congress limited the statute's scope to instances where the underlying activity of an event contract is one of the enumerated events. If the activity underlying the event contract does not involve one of the enumerated activities, the listing is outside the scope of the Statute and Rule 40.11, regardless of how the act of *participating* in the event contract itself is classified. An interpretation of the statute that extends the applicable scope to also include contracts where the underlying activity is not one of the enumerated events is overbroad and incorrect.

First, Section 5c(c)(5)(C) limits the scope of the Commission's authority to "activities" and activities only. The Commission only has discretion to take action on (1) an "activity" that is unlawful under federal or state law; (2) one of four specifically listed "activities" (terrorism, assassination, war, or gaming); or (3) other similar "activity" determined by the Commission to be contrary to the public interest. The Commission itself has previously acknowledged that Section 5c(c)(5)(C)'s textual focus is on "activities," *i.e.*, the underlying conduct. In describing Section

¹⁶ 17 C.F.R. § 40.11(a) (emphases added).

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5c(c)(5)(C), the Commission stated that the rule applied to contracts that “involve one or more *activities* enumerated in the Dodd-Frank Act.”¹⁷ These “activities” are not the contracts themselves. They are the events that create the basis for the relevant contract.

To give but one straightforward example, in the statute events two through four are terrorism, assassination, and war. The inclusion of these activities clearly demonstrates that the scope of Section 5c(c)(5)(C) and Rule 40.11 includes contracts when the activity underlying the event contract involves one of the enumerated activities. The act of participating in a contract is not itself an act of terrorism, assassination, or war.¹⁸ The same analytical approach, by extension, should apply to each of the items on the list, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C) would be internally inconsistent, contrary to the traditional tools of construction.

Second, Section 5c(c)(5)(C) and Rule 40.11 allow the Commission to prohibit the listing of an event contract only “if the agreements, contracts, or transactions **involve**” any of the enumerated activities that are against the public interest. Event contracts that do not involve any of the enumerated activities may be listed for trading because the special rule would not prohibit the listing of those contracts by a DCM.

Third, Section 5c(c)(5)(C) places an additional, key limitation on the “agreements, contracts, or transactions” within the scope of the text. Those “agreements, contracts, or transactions” must be “in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency.” The reference to “occurrence” or “contingency” can only mean to the underlying event of the contract, not the contract itself. The contract cannot reasonably be described as an occurrence or a contingency. Indeed, the headings of the section—“Special rule for review and approval of event contracts and swap contracts” (Section 5c(c)(5)(C)) and “Event Contracts” (Section 5c(c)(5)(C)(i))—reinforce Congress’ focus on the “event” or occurrence, not the trading

¹⁷ *Provisions Common to Registered Entities: Proposed Rule*, 75 Fed. Reg. 67,282, 67,283 (Nov. 2, 2010) (“Section 745 of the Dodd-Frank Act also authorizes the Commission to prohibit the listing of event contracts based on certain excluded commodities if such contracts involve one or more **activities** enumerated in the Dodd-Frank Act.”) (emphasis added) (“40.11 Proposed Rule”); *see id.* at 67,289 (“If [] the Commission determines that such product may involve an **activity** that is enumerated in 40.11 . . .”) (emphasis added).

¹⁸ To illustrate this point, consider hypothetical contracts on whether a foreign leader will be assassinated, how many Russian planes will be shot down by Ukrainian forces, or how many murders will occur in a given city over a certain time period. Section 5c(c)(5)(C) and Rule 40.11 would apply to these hypothetical contracts because the activities underlying the contracts in these hypothetical examples are the enumerated activities of “assassination,” “war,” and “an activity that is unlawful under Federal or State law.” The purchasing of the contract itself, however, is not “an activity” of “assassination,” “war,” or “an activity that is unlawful under Federal or State law.”

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of the contract. Thus, the text and structure of Section 5c(c)(5)(C) clearly and meaningfully limit the Commission's reach regarding event contracts.

Because the text and structure is clear, there is no need to resort to legislative history. That is a bedrock principle of the traditional tools of statutory construction. Nevertheless, the sparse legislative history regarding Section 5c(c)(5)(C)¹⁹ provides no guidance as to whether Congress intended the Commission to limit the scope of Section 5c(c)(5)(C) to instances where the underlying activity of an event contract is one of the enumerated events.

This reading of Section 5c(c)(5)(C) is consistent with the terms used by the Commission in Rule 40.11. Rule 40.11 borrows heavily from the terms used in the statute, including multiple uses of "activity" in both subsections 40.11(a). The Regulation also uses the same term "involves" which appears in the Statute, but also adds the phrase "relates to, or references" when describing enumerated activities. Because "involves" is the only statutory authority provided by Congress, the Commission cannot expand upon the scope of that term. Thus, the only way to read "relates to, or references" consistent with the Commission's authority is that they are the specific meanings of "involves" that the Commission adopted.²⁰ The terms "relates to" and "references," in turn, clearly describe the underlying activity upon which the event contract is based. It would be nonsensical to interpret "relates to" and "references" as describing the act of participating in the event contract itself.

To be clear, Congress could certainly promulgate a law that covers the *participation* in an event contract. But Section 5c(c)(5)(C) is not that law. Instead, applying the traditional tools of construction, Congress enacted Section 5c(c)(5)(C) to prohibit a narrow group of contracts whose underlying activities are the enumerated activities and the CFTC has determined are contrary to

¹⁹ The only legislative history that has been cited by the Commission regarding Rule 40.11 involves a short colloquy between Senator Feinstein of California and Senator Lincoln of Arkansas on July 15, 2010. *See, e.g.*, 40.11 Final Rule, 76 Fed. Reg. at 44,786 & nn. 34-35; *see also* Nadex Order, Whereas Clauses 2 & 7. This 555-word back-and-forth between two Senators, which takes up less than two columns of one page of the Congressional Record (Volume 156, Issue 105, S5906-5907 (July 15, 2010)), is particularly weak evidence of the intent of Congress as a whole and the meaning of the provision. *See, e.g.*, *NLRB v. SW General, Inc.*, 137 S. Ct. 929, 943 (2017) ("[F]loor statements by individual legislators rank among the least illuminating forms of legislative history."). The text is by far the more probative evidence of Congress' meaning. The Nadex Order's extensive reliance on this sparse legislative history is simply inconsistent with the interpretive approach laid out in *Kisor* and provides an additional reason why Kalshi can self-certify the contracts notwithstanding the Nadex Order. In any event, none of the short legislative history specifically addresses the question about whether Section 5c(c)(5)(C) applies only to the underlying events or the trading of the contracts as well, so it has nothing to add to this analysis.

²⁰ Rule 40.11 cannot exceed the scope of Section 5c(c)(5)(C). Any interpretation of Rule 40.11 that views it as expanding the scope delineated in Section 5c(c)(5)(C) would run afoul of the Constitution's separation of powers and the Administrative Procedure Act.

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the public interest and those limitations apply to Rule 40.11. If the underlying activity of a contract is not an enumerated event, it is outside the scope of Section 5c(c)(5)(C) and Rule 40.11.

B. The Nadex Order Incorrectly Interprets And Applies Section 5c(c)(5)(C) And Rule 40.11 To Apply To Political Control Contracts Like Kalshi's.

As described above, Section 5c(c)(5)(C) and Rule 40.11 apply only to the listing of event contracts whose underlying activity involves one of the six enumerated activities. They do not apply to event contracts whose underlying activity does not involve one of the enumerated activities. This key distinction between the activity itself or a *contract on the activity* is of particular importance for the Kalshi contracts at issue here. The underlying activity of Kalshi's contracts is political control of the chambers of Congress. Political control of Congress is none of the activities identified in Section 5c(c)(5)(C) and, as such, Kalshi's political control contracts are not subject to the special rule.

The Nadex Order's contrary conclusion was incorrectly reasoned and misapplied in several aspects.²¹ First, contrary to the above explanation, the Nadex Order incorrectly expanded the scope of the statute and regulation to include the act of participating in the contract, and not just the underlying activity. Second, the Nadex Order incorrectly includes election contracts in the enumerated activities of illegal under state law and gaming.

The Nadex Order incorrectly expanded the scope of Section 5c(c)(5)(C) and Rule 40.11 to include the act of participating in the contract, and not just the underlying activity. The first enumerated activity of Section 5c(c)(5)(C) is "activity that is unlawful under any Federal or State law." The underlying activity of Kalshi's contracts is political control of the chambers of Congress. There is no Federal or State law that makes political control of Congress illegal. There is also no Federal or State law that prohibits elections or voting in elections which result in the political control of Congress. Accordingly, political control contracts would not fall under the special rule's enumerated act of "illegal activity."

To be sure, 27 states do prohibit, in one form or another, betting on elections. And the Nadex Order (incorrectly) stated that "state gambling definitions of 'wager' and 'bet' are analogous to the act of taking a position in the Political Event Contracts"²² as a justification for prohibiting those contracts' listing. In this regard, however, the Nadex Order overextended. Section 5c(c)(5)(C) is limited to the activity underlying the contract, not the participation in the contract itself.

²¹ As noted previously (*see supra* nn. 4-14), the Commission adopted the Nadex Order prior to the Supreme Court's decision in *Kisor v. Wilkie* and thus the Order did not use the framework now required by the Supreme Court for evaluating the scope and implications of Rule 40.11.

²² Nadex Order at 2.

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The Nadex Order also misapplies the enumerated activity of “gaming.” There are at least two fundamental differences between the relevant state gaming or gambling laws and event contracts. As Commissioner Brian Quintenz described with regards to the withdrawn ErisX sports event contract, trading an event contract with a binary outcome is not automatically considered a gamble.²³ Indeed, if Section 5c(c)(5)(C) had assumed that participating in any event contract involved making a wager or gamble, there would have been no need for Congress to individually enumerate “gaming” as a distinct category of event contracts upon which the Commission could make a public interest determination. The fact that Congress separated “gaming” from other event contracts is a clear indication that Congress did not intend for all event contracts to be considered gaming.

In fact, the statutory definition of “bet” or “wager” used by the Nadex Order itself, in the same statute, clearly indicates that not all CFTC regulated products are gaming. The statute cited by the Nadex Order²⁴ for defining “bet” or “wager” is 31 U.S.C. § 5362(1), a part of the Unlawful Internet Gambling Enforcement Act of 2006. That definition of “bet or wager,” however, includes two relevant exclusions. First, the term “bet or wager” does 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.”²⁵ The term also does not include “any other transaction that is excluded or exempt from regulation under the Commodity Exchange Act.”²⁶ The statute cited by the Nadex Order itself demonstrates that the Nadex Order’s expansive application of Section 5c(c)(5)(C) and Rule 40.11 is incorrect.

The Nadex Order’s broad interpretation of gaming under the statute and rule would result in prohibiting much of the legally registered activity that the CFTC has previously approved. Indeed, many states ban “gambling” not just on elections, but specifically on the outcomes of future events. For example, New Hampshire bans gambling and defines it as “to risk something of value upon a future contingent event not under one’s control or influence”²⁷ while North Carolina includes a

²³ See Statement of Commission Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts (Mar. 25, 2021) (available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>) (last visited May 30, 2022). The many other distinctions between an event contract and a gamble include the fact that betting is a game of pure chance without any economic utility while event contracts are non-chance driven outcomes with economic utility.

²⁴ Nadex Order at 3.

²⁵ 31 U.S.C. § 5362(1)(a)(E)(ii).

²⁶ *Id.* § 5362(1)(a)(E)(iv)(I).

²⁷ NH 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

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wager on an “unknown or contingent event” in its statutory definition of gambling.²⁸ New York defines gambling as staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under his control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome.²⁹ Other states explicitly prohibit trading on the future delivery of securities and commodities without delivery and which are purely cash-settled, as is normal for products like stock index futures and eurodollar futures.³⁰ In all, 19 states contain provisions in their state codes that prohibit the listing of at least some subset of contracts that the CFTC has approved.³¹

Under the Nadex Order’s reasoning, because Rule 40.11 prohibits the listing of contracts that “involve” “gaming,” laws like these would prohibit *all* event contracts. For example, event contracts on the weather and various economic indicators would be considered “risking something of value upon a future contingent event not under one’s control or influence.” And yet, not only are these event contracts a staple of CFTC regulated DCMs, but the Commission’s Core Principles require that event contracts be specifically outside the control or influence of a market participant and not readily susceptible to manipulation. The Nadex Order’s application of Rule 40.11 would therefore preclude the CFTC from regulating any event contract because event contracts are considered gambling under (some) state laws.³² Because such an interpretation of “gaming” would lead to absurd results, the traditional tools of interpretation and the process required by the

value in the event of a certain outcome”); Or. 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 . . .”).

²⁸ N.C. Gen. Stat. § 16-1.

²⁹ NY Penal Law, Chapter 40, Part 3, Title M, Article 225.

³⁰ For example, the laws of South Carolina, Oklahoma, and Mississippi use the following language: “Any contract of sale for the future delivery of cotton, grain, stocks or other commodities . . . upon which contracts of sale for future delivery are executed and dealt in without any actual bonafide execution and the carrying out or discharge of such contracts upon the floor of such exchange, board of trade, or similar institution in accordance with the rules thereof, shall be null and void and unenforceable in any court of this state, and no action shall lie thereon at the suit of any party thereto.”

³¹ Moreover, the purpose of the CEA, CFMA and other laws was to create clear and consistent national guidelines; a contrary interpretation would lead to the undesirable result that if one state prohibited a specific kind of contract then the Commission could use the special rule to ban that contract in all states.

³² On this point, it seems that at the very least, Rule 40.11 would be an APA violation, or even unconstitutional, if the analysis in Nadex Order was taken to its logical conclusion because of its dramatic impacts on the regulatory scheme. *Cf. Whitman v. American Trucking Ass’ns, Inc.*, 531 U.S. 457, 468 (2001) (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions—it does not, one might say, hide elephants in mouseholes.”).

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Supreme Court in *Kisor* demonstrate that the Nadex Order’s view cannot be the correct way to interpret Rule 40.11.³³

Seen in this context, the state laws that prohibit gambling on elections do not and cannot refer to CFTC regulated event contracts. The laws of many states prohibit gambling on event contracts, case-settled commodity futures contracts, and elections as one. Yet, the CFTC clearly continues to regulate and approve of the event contracts and cash-settled commodity futures markets even though it may seem to conflict with those state laws.³⁴ Event contracts relating to elections should be no different. Indeed, just as other event contracts regulated by the CFTC, Kalshi’s political control contract should also not be precluded by the gaming provisions of Rule 40.11.

Furthermore, the CFTC’s actions and inactions since the Nadex Order indicate that even the Commission has not continued the Nadex Order’s reasoning in this regard. Consider, for example, the Small Cannabis Equity Index Futures Contract listed by the Small Exchange. The Cannabis Index involves the stock prices of companies in the cannabis industry that produce and distribute cannabis for consumption—an activity that is unlawful under Federal law and many State laws. The contract is “dependent on the occurrence, nonoccurrence, or the extent of the occurrence” of an event with “potential financial, economic, or commercial consequence,”³⁵ namely the value of the Cannabis Index. The activities of these companies are production and distribution of cannabis for consumption, which are all activities that are “unlawful under Federal and [many] State laws,”

³³ See, e.g., *Tennessee Wine & Spirits Retailers Ass’n v. Thomas*, 139 S. Ct. 2449, 2462 (2019) (“reading § 2 [of the Twenty-First Amendment] to prohibit the transportation or importation of alcoholic beverages in violation of *any* state law would lead to absurd results that the provision cannot have been meant to produce”) (emphasis in original). Indeed, the “Commission agrees that the term ‘gaming’ requires further clarification and that the term is not susceptible to easy definition.” *Provisions Common to Registered Entities: Final Rule*, 76 Fed. Reg. 44,776, 44,785 (July 27, 2011). In the 40.11 Final Rule, the Commission noted that it had previously sought comments regarding event contracts and gaming in 2008 and that the “Commission continues to consider these comments and may issue a future rulemaking concerning the appropriate regulatory treatment of ‘event contracts,’ including those involving ‘gaming.’” 40.11 Final Rule at 44,785. “In the meantime, the Commission has determined to prohibit contracts based upon the activities enumerated in Section 745 of the Dodd-Frank Act and to consider individual product submissions on a case-by-case basis under 40.2 or 40.3.” *Id.* That process is undermined if the Nadex’s Order’s approach to “gaming” stands.

³⁴ The CFMA explicitly preempts the application of state gambling statutes when it applies to legal commodity futures contracts and as such there is also a federal preemption argument here that the state gambling statutes should not be considered, regardless of the Nadex Order’s misapplication of Rule 40.11. See 7 U.S.C. § 16(e)(2) (“This chapter shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops (other than antifraud provisions of general applicability) in the case of—(A) an electronic trading facility excluded under section 2(e) of this title; and (B) an agreement, contract, or transaction that is excluded from this chapter under section 2(c) or 2(f) of this title or sections 27 to 27f of this title, or exempted under section 6(c) of this title (regardless of whether any such agreement, contract, or transaction is otherwise subject to this chapter).”).

³⁵ See 7 U.S.C. § 1a(19) (definition of excluded commodity).

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and should otherwise fall under the purview of Section 5c(c)(5)(C) and Rule 40.11. Certainly, if Section 5c(c)(5)(C) was given the same broad reading that the Commission gave to it in the Nadex Order, the Cannabis Equity Index would certainly “involve” an enumerated activity and be subject to Section 5c(c)(5)(C) and Rule 40.11. Yet, the Cannabis Index contract was self-certified and the Commission did not invoke Section 5c(c)(5)(C) or Rule 40.11. Therefore, it is clear that the Commission has not maintained the Nadex Order’s overbroad and incorrect reading of the Statute and Rule 40.11.

Even if the proposed Kalshi contracts somehow came within the scope of Section 5c(c)(5)(C) and Rule 40.11, that does not preclude them from being listed. I understand that Kalshi has made submissions to the Commission demonstrating offering the contracts would be in the public interest. A full discussion of those points is outside the scope of this letter. I do note, however, that the Commission is not limited to using an economic purpose test for determining whether a contract is within the public interest. That test is found nowhere in the text of Section 5c(c)(5)(C) or Rule 40.11. One reference to the economic purpose test between two Senators in a brief discussion of what would become Section 5c(c)(5)(C) is insufficient to bind the Commission to that test.³⁶ The Commission recognized as much in the Nadex Order itself, stating “the Commission has the discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest.”³⁷

Furthermore, as a procedural matter, there is nothing in the CEA or Rule 40.11 requiring the Commission to act on Kalshi’s self-certification of the political control contracts discussed in this letter. Both Section 5c(c)(5)(C) and Rule 40.11 speak in terms that the Commission “may determine.”³⁸

At the end of the day, Kalshi has various arguments to justify the self-certification of the contracts described above.

³⁶ See supra note 19 (discussing limitations of floor statements as persuasive evidence of a statute’s meaning).

³⁷ Nadex Order at 4.

³⁸ 7 U.S.C. § 7a-2(c)(5)(C)(i) (“the Commission **may determine** that such agreements, contracts, or transactions are contrary to the public interest . . .”) (emphasis added); 7 C.F.R. § 40.11(c) (“The Commission **may determine** . . . that a contract . . . be subject to the 90-day review.”) (emphasis added).

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Please let me know if you need anything further.

Sincerely,

Daniel J. Davis

Daniel J. Davis

DJD:dml

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CERTIFICATE OF SERVICE

I hereby certify that on October 16, 2024, the foregoing Joint Appendix was electronically filed with the Clerk of the Court for the United States Court of Appeals for the District of Columbia using the CM/ECF system. I also certify that I caused 7 paper copies to be delivered to the Clerk's Office.

Service was accomplished on counsel of record by the CM/ECF system, with one paper copy also dispatched by overnight service to lead counsel.

/s/ Margaret P. Aisenbrey