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January 26, 2021

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

Re: CFTC Rule 40.11 Review of Proposed RSBIX NFL Futures Contracts

Dear CFTC:

In summary:

- The proposed ErisX contracts are in the public interest and should be approved without delay.
- The contracts do not involve “activity that is unlawful under any State or Federal law.”
- The ErisX contracts will help legal sports betting markets function better by providing risk management for legal sports betting operations.
- Congress has already decided to let sports betting go forth. It is not up to the CFTC to override Congress’ decision.

¹ All opinions are strictly my own and do not necessarily represent those of Georgetown University or anyone else. 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, and law firms. I’ve also visited over 75 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.

- Better functioning legal sports betting markets will reduce illegal activity and associated corruption.
- The restrictions on participation are too strict and should be loosened.

Background

The Eris Exchange, LLC (ErisX), a CFTC-regulated designated contract market (DCM), has self-certified futures contracts based on the outcomes of NFL games. It is highly likely that ErisX will in the future self-certify contracts on other sporting events as well. Trading in these contracts will be limited to entities with economic exposure to the outcomes of these events, along with market makers. These entities include licensed sport books, merchandise vendors, and stadium operators.

The contracts themselves are fully collateralized, and thus simpler than the usual futures contracts. This means that there is no need for the complexities of margin accounts.

The CFTC has requested comment on the legality of the proposed contracts and what factors should be considered in determining whether the proposed contracts are in the public interest. Indeed, the CFTC has authority to provide exemptions to its own regulations and the Commodity Exchange Act when it serves the public interest.

The contracts do not involve “activity that is unlawful under any State or Federal law.”

The Commission asks for comment with respect to whether the contracts are related to “activity that is unlawful under any State or Federal law.” Just because one state bans an activity, it does not violate that state’s laws to perform the same activity in another state where it is legal. Thus, the operation of legal sports books in states where such activities are legal does not violate the laws of states where it is not legal. Operating a casino in Nevada does not violate the laws of Utah. Therefore, the ErisX contracts are not supporting any “activity that is unlawful under any State or Federal law.”

The regulation of credit card interest provides a precedent for the use of CFTC-regulated futures.

Gaming laws, like many other laws, vary from state to state. Activities that are perfectly legal in one jurisdiction can result in fines or jail time in others. Sports betting is legal in 25 states.

Some state usury laws impose price controls on credit card interest rates. However, some other states such as Delaware and South Dakota, do not. Consequently, many credit card banks are located in these states because their laws do not cap credit card interest rates. Nevertheless, these credit card banks can make use of our national financial markets to fund their credit card operations and manage their interest rate risk. This is despite the fact that what they can do legally in South Dakota would be deemed illegal in a less liberal state. Thus, there is ample precedent for the use of financial products that support an activity

that is legal in one state but not another. These financial products include CFTC-regulated interest rate futures products.

Market participants have legitimate risk management needs.

Licensed sport books provide lawful entertainment in the jurisdictions where they do business. They take the other sides of the bets their customers wish to place, whether to win or lose. However, their business model is not to take big risks on a team winning or losing. Instead, they wish to act have a matched books of win or lose bets so that they make a profit no matter which team wins. They are more like market makers in the option markets, who take on whatever positions their customers want and then hedge their positions to lock in a profit.

To prevent their books from being too unbalanced between win or lose, some sports bets are based not on whether the team wins or loses, but whether the team beats a particular point spread. In the following example, a bet on the Steelers will only pay off if they beat the Browns by more than 9.5 points:

The screenshot shows a betting interface for a game on 01/03 at 01:00 PM. The title is "SPREAD". It lists two teams: Pittsburgh Steelers and Cleveland Browns. For the Steelers, the spread is +9½ and the odds are -110. For the Browns, the spread is -9½ and the odds are -110.

Team	Spread	Odds
Pittsburgh Steelers	+9½	-110
Cleveland Browns	-9½	-110

However, even with the point system, a particular sports book may wind up with an imbalance between win and lose bets. This can create a huge risk for the licensed sports betting operation.

Better risk management will promote better prices for customers.

Sports books generally charge a commission, or “vig” to cover their costs and ensure a profit. These costs include the risk of expected losses if they wind up with an unbalanced book. By providing cost-effective risk management solutions, the ErisX contracts will allow market participants to reduce their expected losses and thus reduce their cost of operations. Competition can be counted on to pass this lower operating cost onto consumers.

Other entities have important risk management considerations.

Bookies are not the only entities with serious risk management problems around sporting events. Merchandise vendors, for example, have to order their inventory long in advance. If a team does not do

well, the vendor will be stuck with unsalable inventory. The ErisX futures will provide opportunities for these legitimate businesses to hedge their exposure.

It is not the jurisdiction of the CFTC to decide if licensed sports betting is in the public interest.

Congress has left it up to the states to decide whether various forms of gaming are legal. It is not up to the CFTC to override Congress' decision. The CFTC should not try to ban the ErisX contract because it thinks gaming is bad, but instead promote the use of futures contracts to support the risk management needs of legal businesses.

Approval of these contracts will not increase incentives to affect outcomes of sporting events.

There have always been, and always will be, incentives for bad actors to attempt to "fix" the outcomes of sporting events by illegally corrupting players or referees in order to win bets. Approval of the ErisX contracts will not increase these incentives, but will more likely decrease them.

The public demand for this activity is so great that many ignore legal restrictions. Where it is illegal, organized crime develops in ways that further corrupt the citizenry and law enforcement. For this and other reasons, many states have legalized sports gambling so that it can be regulated and taxed. However, extensive betting on sporting events exists even in places where there is legal sports betting.²

Underground sports bookies have incentives to attempt to "fix" games because of difficulties they face in managing the risk of their underground operations. When faced with an unbalanced book of business, one possibility for managing their risk is to manipulate the outcome of a game rather than try to hedge elsewhere.

A transparent sports betting system can make it easier to detect aberrant betting behavior associated with attempts to fix sporting events because of a better audit trail of betting activity. The more smoothly and efficiently the legal sports betting market, less activity will occur in underground sports betting markets. By making it easier for legitimate licensed sports betting operations to manage their risk, such legal enterprises will be in a better position to compete with the underground operations. Thus, more activity will take place in the legitimate sports betting channels relative to the underground channels run by dishonest mobsters more likely to attempt to fix games.

² <https://www.forbes.com/sites/andrewsilver/2020/04/07/legal-sports-betting-still-faces-competition-from-illegal-market-low-state-taxes-could-turn-the-tide/?sh=502f0dc223e3>

The restrictions on participation are too restrictive. Effective futures contracts require speculators as well as hedgers.

I am concerned that the restrictions on participation may be too restrictive. It is well known that futures markets work better when they allow speculators as well as hedgers to participate. Speculators help markets by bringing in additional information, thus making market prices more reflective of true supply and demand. More importantly, they bring in important risk bearing capacity and effectively act as insurance companies bearing the risk that the hedgers are willing to pay to get rid of.

There are likely to be times when total bets on various popular teams are likely to be one-sided and more than the other natural hedgers are willing to bear. For this reason, I would suggest that the restrictions be loosened to allow more participants to bring in additional liquidity to the markets.

Respectfully submitted,

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