BETTER MARKETS

By Electronic Submission

September 25, 2022

Christopher Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: KalshiEx, LLC's Proposed Political Event Contract

Dear Mr. Kirkpatrick:

Better Markets[1] appreciates the opportunity to comment on the Commission's review of KalshiEX, LLC's proposed congressional control contract under CFTC Regulation 40.11.[2]

In its proposal to the CFTC, KalshiEX, LLC ("Kalshi") seeks to introduce a new binary event contract relating to the partisan control of Congress, allowing traders to "bet" on the outcome of congressional elections. This contract should not be approved based on a number of legal and policy grounds, as 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, 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.

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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* (Aug. 26, 2022), https://www.cftc.gov/PressRoom/PressReleases/8578-22.

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 contract. However, on the current record, meager though it is, the Commission must conclude that the contract would pose a serious threat to investors and fail to serve the legitimate hedging and price discovery functions of the commodities markets. Moreover, as a legal matter, Kalshi's event contract involves, or is at the very least similar to, "gaming" and relates to activity that is unlawful in numerous states across the country. That factor should bear heavily on the Commission's decision and indeed prove dispositive. Put differently, the wrong decision by the CFTC here could de facto preempt innumerable state laws in ways that Congress clearly did not intend. In addition, the contract is susceptible to manipulation, further endangering investors and the integrity of the markets.

This proposed contract 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, justified 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,[3] 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. 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 proposal.

BACKGROUND

On July 19, 2022, KalshiEX, LLC submitted a proposal 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." According to the CFTC, an event contract is "a derivative contract whose payoff is based on a specified event, occurrence, or value such as the value of a macroeconomic indicator . . . ."[4] Kalshi's proposed contract is a binary (all-or-nothing) option contract whose payout is contingent on whether a particular political party will control Congress at a particular time.

Legal Context

Under the Commodity Exchange Act ("CEA"), binary event contracts such as Kalshi's are considered "excluded commodities."[5] Under the CEA, the term "excluded commodity" includes

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[3] *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).

[4] U.S. COMMODITY FUTURES TRADING COMMISSION, *Contracts & Products*, https://www.cftc.gov/IndustryOversight/ContractsProducts/index.htm.

[5] 7 U.S.C. § 1a(19). The Commodities Exchange Act (CEA) is codified at 7 U.S.C. § 1 *et seq*.

"an occurrence, extent of an occurrence, or contingency . . . that is (I) beyond the control of the parties to the relevant contract . . . ; and (II) associated with a financial, commercial, or economic consequence."[6] As explained in further detail below, Section 5c(c)(S)(C) of the CEA expressly authorizes the Commission to prohibit the listing of contracts on excluded commodities that are contrary to the public interest because they involve gaming or similar activity.

CFTC Regulation 40.11(a)(1), which pertains to excluded commodities, prohibits event contracts that "involve, relate to, or reference" (1) terrorism, (2) assassination, (3) war, (4) gaming, or (5) an activity that is unlawful under any State or Federal law. Because not all undesirable contracts may strictly meet the formal definition of the categories listed above, CFTC Regulation 40.11(a)(2) includes a catch-all provision, which prohibits event contracts involving an activity that is "similar to" the activities enumerated above, so long as the Commission determines the contract to be "contrary to the public interest."[7]

Prior Commission Approaches

Historically, the CFTC has permitted binary event contracts only under conditions more 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 University of Iowa's Tippie College of Business in conjunction with several other universities.[8] 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 no-action letter allowed the IEM to continue offering its political event contracts, but with several restrictions. First, the Commission's approval 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

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6 7 U.S.C. § 1a(19); *see also* COMMODITY FUTURES TRADING COMMISSION, *Concept Release on the Appropriate Regulatory Treatment of Event Contracts*, 73 Fed. Reg. 25669, 25672 (May 7, 2008), https://www.federalregister.gov/documents/2008/05/07/E8-9981/concept-release-on-the-appropriate-regulatory-treatment-of-event-contracts; Andrew S. Goldberg, *Political Prediction Markets: A Better Way to Conduct Campaigns and Run Government*, 8 CARDOZO PUB. L. POL'Y & ETH. J. 421 (2010) ("A political prediction market contract arguably fits squarely within this definition of an excluded commodity. After all, a political prediction contract, such as whether Sarah Palin will be the Republican nominee for President in 2012, is precisely an investment in a future 'occurrence' that is 'beyond the control of the parties' involved.").

7 17 C.F.R. § 40.11.

8 CFTC No-Action Letter, CFTCLTR No. 93-66, 1993 WL 595741 (June 18, 1993), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/93-66.pdf.

control of the United States Congress and the Presidency.[9] On April 2, 2012, the CFTC issued an order prohibiting NADEX from listing its proposed political event contracts.[10] 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."[11]

In 2014, the CFTC 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 certain conditions were met. 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;

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9 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.

10 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/ifdocs/nadexorder040212.pdf.

11 *Id.*

- 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 informed PredictIt that it had violated the no-action letter and instructed the company to wind down its operation of the political event contracts by February 2023.[12]

The Kalshi Contract

Like NADEX's contracts, Kalshi's proposed event contract would similarly hinge on the outcome of U.S. congressional elections. Kalshi states in its submission that its current intention is to impose a position limit of $25,000 for the proposed contract. Kalshi's submission provides little information on the fees and commissions it 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."

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.

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.[13] While limited speculation is permitted to provide additional liquidity necessary to enable derivatives markets to

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[12] 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.

[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.

perform their important historic functions, the markets overseen by the CFTC are not — and never were — intended as casinos or predominantly speculative vehicles.[14] 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 concern in the 17 questions it posed for public comment.[15] We hope our comments assist the Commission as it reviews this proposal.

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 submission from Kalshi is grossly deficient. It is largely opaque, providing remarkably scant detail about 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.

Kalshi's submission 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.[16] The submission offers the most skeletal description of the way in which margin will be handled under the contract, stating only that participant funds will be "safeguarded" at a DCO operating under core principles.

The submission goes to some lengths to tout the robust trading in supposedly similar political event contracts in the past, detailing the number of those contracts traded since 2018. Yet the submission fails to provide any detail regarding the trading venue that hosted those contracts or the no-action letter and limitations under which those contracts were based. More significantly, the submission 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, Kalshi's terms of service reserve it the right to unilaterally change its policies as it sees fit at any point in the future. Thus, notwithstanding Kalshi's representations, as deficient and

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14 *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).

15 COMMODITIES FUTURES TRADING COMMISSION, *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.

16 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.

incomplete as they are, Kalshi could seek to materially change any term, policy, or practice after receiving Commission approval of its contract.[17]

While we believe that there is ample basis for the Commission to reject this submission, if the Commission were to decide otherwise, it must require Kalshi to submit additional material information so that the Commission has a minimally adequate record on which to base a decision. The Commission should also require the disclosure of all additional information for the benefit of all public stakeholders who seek to comment. And although the Commission has stated that it plans to issue its decision by October 28, 2022, we respectfully suggest that such a deadline would be inappropriate given the deficient record. We therefore urge the Commission to take the time necessary to fully and adequately develop the record and review the proposal. The Commission should feel no obligation to resolve Kalshi's proposal before the upcoming November elections given that its primary mission is to apply the law while protecting the public and the markets it is mandated to oversee. The financial interests of market participants seeking to capitalize on a new financial instrument—especially one of such questionable legality and dubious merit—should not drive the timeline for the Commission's consideration or decision.

II. The Commission should prohibit trading of the 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 proposed contract because it contravenes the spirit of the Commodity Exchange Act, the letter of 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—
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> (I) activity that is unlawful under any Federal or State law;
> (II) terrorism;

[17] 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.

(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.

This provision reflects Congress's fundamental concern about the threat to the public interest posed by event contracts unrelated to commodities. Following these Dodd-Frank amendments to the CEA, the Commission promulgated Rule 40.11,[18] 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.

[18] 17 C.F.R. § 40.11.

A. <u>The proposed Contract involves, or is similar to, gaming, which is disfavored under the CEA, prohibited under the Commission's rules, and outlawed in several states.</u>

The submission is substantially similar in all material respects to the NADEX contracts, which the Commission appropriately denied because they involved 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." [19] Here too, Kalshi's virtually identical political event contract involves or is "similar to" gaming within the meaning of CEA § 5c(c)(5)(C)(i)(V) 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,[20] 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 contract, and the NADEX contract before it, involve or are similar to "gaming" follows from an analysis of both federal and state law. [21] 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.[22] The Unlawful Internet Gambling Enforcement Act defines the terms "bet or wager" as:

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19 *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.

20 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).

21 For a discussion of prior CFTC consideration and analysis of event contracts and "gaming," *see id.*, at 71–86.

22 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.*

> "***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]

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*."[24] Although neither the Unlawful Internet Gambling Enforcement Act nor the Commodity Exchange 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.'**"[25]

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."[26]

This is no less true now than it was in 2012, and there is no reason why the Commission should now find otherwise.

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[23] 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).

[24] Relatedly, the traditional common law definition of "gambling" 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).

[25] THE CAMBRIDGE ENGLISH DICTIONARY, *Contest* (emphasis added), https://dictionary.cambridge.org/us/dictionary/english/contest.

[26] 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.

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 involves — or is at least similar to — "gaming" for purposes of the CEA.[27]

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).[28] Placing a bet or wager on the outcome of an election is civilly or criminally unlawful in well over a dozen states nationwide.[29] For decades, states have long asserted their right to protect

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27 *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).

28 *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 o f 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 . . . .").

29 *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.

the integrity of their elections by prohibiting placing wagers on the outcome of an election.[30] In the absence of a compelling justification, 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."[31]

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.[32] 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."[33]

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

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30 *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).

31 *See* COMMODITIES FUTURES TRADING COMMISSION, *Designated Contract Markets (DCMs)*, https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm.

32 *See* Alex Altman, *Political Betting Market Raises Questions About Insider Trading*, TIME (Oct. 6 2015), https://time.com/4062628/fantasy-sports-predictit-political-forecasting/.

33 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).

> 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.'[34]

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.[35]

Kalshi's submission (or at least the part available to the public) does not explain how it will identify and address manipulation risks. Given the many ways one could conceivably influence or manipulate a prediction market to their advantage,[36] the Commission should not allow the adoption of political event contracts as Kalshi proposes.

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34 Rebecca Haw Allensworth, *Prediction Markets and Law: A Skeptical Account*, 122 HARV. L. REV. 1217 (2009).

35 Deck, *infra* n. 36, at 61.

36 *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 Hunstman: 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/ecis2017rip/47; Cary Deck, Shengle Lin, & David Porter, *Affecting Policy by Manipulating Prediction Markets: Experimental Evidence*, 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.").

2. Kalshi's proposed 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 approval of the Kalshi submission. Those other platforms were readily distinguishable and were subject to multiple important limitations and conditions. Unlike the Iowa Electronic Markets[37] — and, until recently, PredictIt[38] — Kalshi is a for-profit entity motivated solely by financial gain. In addition, while the Iowa Electronic Markets generates useful data for researchers,[39] the data generated by Kalshi's trading platform would remain in its own hands, free from public scrutiny or access. 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. Kalshi's submission proposal provides little assurance that it will not do so, outlining no specific details regarding its fees and commissions policies.

In contrast, the conditions of the no-action letter granted to the Iowa Electronic Markets states 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.[40] These contracts are a far cry from Kalshi's proposed offering. 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 model 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.

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

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37 *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/@lrlettergeneral/documents/letter/93-66.pdf.

38 *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/no-future-regulator-orders-political-betting-market-to-shut-down-in-u-s-00050238.

39 *See generally* IOWA ELECTRONIC MARKETS, *Research Employing IEM Data*, https://iemweb.biz.uiowa.edu/archive/references.html; Saul Levmore, *Simply Efficient Markets and the Role of Regulation: Lessons from the Iowa Electronic Markets and the Hollywood Stock Exchange*, 28 J. OF CORP. LAW 589 (2003).

40 *See* Declan Harty, *Washington Weighs Plan to Let Americans Wager on Elections*, POLITICO (Sep. 5, 2022), https://www.politico.com/news/2022/09/05/voters-betting-elections-trading-00054723.

little if any economic purpose, just like traditional gambling.[41] Such markets prey on unwary traders and typically serve to enrich the few at the expense of the many.[42] What is more, this speculative market runs contrary to the fundamental and historical purposes underlying the derivatives market — namely, to hedge risk and assist in price discovery. Indeed, if anything, these markets 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 cast serious doubt on the wisdom of this proposal.

That CFTC Regulation 40.11(a)(2) includes a very important catch-all provision empowering the Commission to prohibit event contracts deemed to be against the public interest serves as clear recognition that there are simply some types of trading that society can and must consider off limits. If mass gambling upon the outcome of our federal elections is not one such example, we cannot fathom what is. Just as we would not allow traders to place bets on when they believe the next school shooting will occur, so too must we protect our elections by refusing to allow the commercialization and commodification of our democratic process.

III. **The Submission cannot and will not serve a meaningful hedging or price discovery function.**

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.

41 *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.").

42 *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/predictit-gambling-political-prediction-markets/.

For one, as the Commission itself observed in its previous review of NADEX's political event contracts,[43] 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 necessarily 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 enact their desired tax reforms.[44] 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.

The burden of proof is on Kalshi to 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 faces — such as a sector-specific fund, for example — are inferior to Kalshi's proposed contract. Ultimately, political risk itself must ultimately disaggregate into other, more specific 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 contract.

The limited details in Kalshi's proposal also raise serious questions about its platform's ability to maintain sufficient liquidity for Kalshi's contract to be an effective hedging instrument at scale. Moreover, the (currently claimed) size of Kalshi's $25,000 position limits, although arguably an important restriction from an investor protection standpoint – forecloses such a vehicle from serving as a meaningful hedging instrument for all but the smallest of commercial enterprises.

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.[45] 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 this increasingly common pattern, everyday consumers and investors are lured into new financial

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[43] 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.

[44] *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/.

[45] *See supra* notes 13–14, 41 and accompanying text.

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.[46]

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.[47] There is no credible evidence that Kalshi's proposed 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

Stephen W. Hall
Legal Director and Securities Specialist

Brady Williams
Legal Counsel

Better Markets, Inc.
1825 K Street, NW
Suite 1080
Washington, DC 20006
(202) 618-6464

dkelleher@bettermarkets.org

46 *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).

47 *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).

shall@bettermarkets.org
bwilliams@bettermarkets.org

http://www.bettermarkets.org