Commodity Futures Trading Commission ("CFTC", "Commission")
Three Lafayette Center
1155 21st Street NW
Washington, DC 20581

September 25, 2022

Re: KalshiEX LLC - Commission Regulation 40.3(a), Voluntary submission of new products for Commission review and approval, regarding the "Will be in control of the ?" Contract ("Kalshi Congressional Control Contract")

Submitted electronically

The Institute for Agriculture and Trade Policy ("IATP")[1] appreciates the opportunity to comment on the Kalshi proposal[2] of July 19 and to respond to a few of the Commission's questions[3] about it. Kalshi has requested a Commission determination by October 28 for its Congressional Control Contract to begin trading prior to the November 8 elections. Kalshi's decision to submit this contract for Commission review so close to the national election date should not be allowed to impede a thorough review of the Kalshi proposal, extending beyond October 28, as the Commission deems it necessary.

In our view, the terms this application are not consistent with the Commodity Exchange Act (CEA) and CEA authorized rules. Kalshi LLC should take a hint from this footnote to the Commission's August 26 letter: "This request [that Kalshi not trade the Congressional Control Contract while the Commission reviews the application] does not prevent Kalshi from withdrawing its submission."[4]

[1] IATP is a nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minnesota, with offices in Washington, D.C. and Berlin, Germany. IATP participated in the Commodity Markets Oversight Coalition (CMOC) from 2009 to 2015, and the Derivatives Task Force of Americans for Financial Reform since 2010.

[2] https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm001.pdf

[3] https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexpublicquestions220829.pdf

[4] https://www.cftc.gov/sites/default/files/filings/documents/2022/orgkexkalshicongressco220829.pdf

Prior to responding to a few of the Commission's questions, we wish outline a few topline concerns:

- Kalshi's proposal argues that "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." (2) A staff No-Action letter sets no legal precedent for the Commission's response to the current submission. It is odd that Kalshi neither cites the No-Action Letter nor names the unregistered trading venue, at least in the application's non-confidential information. The number of contracts alleged to have been traded under the No-Action Letter should have no bearing on the Commission's deliberations.
- The underlying asset is the election results that gives control of the Senate and/or the House to the Democratic Party or the Republican Party. However, "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." (p. 4) The Source Agency providing the underlying information for this political event futures contract is "congress.gov." (p. 6) Leave aside the legal question about whether Kalshi's alternative "objective and verifiable" Source Agency is authoritative. When has the Commission ever allowed an exchange to change the specifications of a contract during a trading session for that contract?
- Kalshi claims that the design of the Contract anticipates and claims to manage the risks that the timing of the control of Congress by the Democrats or Republicans may not be decided in an orderly and predictable fashion: "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." (p. 5) However, the expiration date may not allow for enough time to settle election disputes between the time that new Members of Congress take their oaths of office and the expiration date of the contract, which is February 1. (p. 10) These contingencies go beyond the elections whose margin of victory is so small as to trigger an automatic recount. The Washington Post reported that a dozen Republican candidates for Governor and the U.S. Senate are refusing to commit to accept the results of their elections. Furthermore, " "**[m]ore than half of all Republican nominees** for federal and statewide office with powers over election administration **have embraced unproven claims that fraud tainted**

> **Biden's win**, according to a Washington Post tally."[5] (**Bold** in the original). These nominees may characterize their election losses as the result of fraud. Because of the likelihood that disputes over election results, even after hand recounts, would be settled by courts, there is no certainty that these disputes will be settled by February 1. The Commission has never allowed into trade a futures, options or swaps contract whose expiration date could be extended after the first day of trading.

Responses to a few Commission questions about the Kalshi Congressional Control Proposal

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?

Whether a wager is offered in traditional gaming venue that is similar to the Congressional Control Proposal does not offer the Commission a CEA basis for approving the Kalshi proposal, sets no legal precedent for the Commission, and is irrelevant to the Commission's approval or disapproval of this Proposal.

4. Are the contracts substantively different than 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.

The Nadex proposed contracts covered the results of presidential elections and were presented under rules governing exchange self-certification of new products. The Kalshi Congressional Control Proposal does not include presidential elections and is presented under rules governing the Commission's review, approval or disapproval of new products. Otherwise, the proposed contracts are not substantively different.

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.

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[5] https://www.washingtonpost.com/politics/2022/09/19/meet-republicans-who-might-not-accept-defeat-november/

The Kalshi contracts do not serve a hedging function. The election information that is the contract's underlying does not correspond in anyway to the deliverable supply of a physical commodity for which hedging serves to manage price risk in a well-functioning derivatives market. No commercial hedger would buy or sell a contract in which the underlying could change during a trading session because of a decision by the exchange to change the underlying of the contract offered for trading.

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?

Settled prices in the Kalshi contracts do not perform a price benchmarking function. A wheat futures contract can be used by grain elevators to help set a forward contract price for wheat. An oil futures contract can be used to benchmark the price of a oil product derivative, such as diesel fuel or jet fuel. An interest rate futures contract can help benchmark the price of mortgage interest rates. The settled price of a Kalshi contract will not benchmark the price of a political advertising buy or the bidding price of a political consultant's contract.

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

Although the binary design of the contracts enables a very primitive form of price discovery, that price discovery does not serve a hedging or price benchmarking function. The maximum loss exposure of the contracts is $25,000 USD, indicating that the contracts will be marketed to retail, rather than institutional investors. Contracts overseen by the Commission are usually used by commercial hedgers and large institutional investors that understand the underlying assets of their corresponding futures, swaps and options contracts. The CEA does not provide the Commission with authorities oriented to protect retail investors. For all these reasons and more, the proposed contracts are not in the public interest.

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?

It is unlikely that candidate campaign committees or political action committees would attempt to manipulate the contracts by using non-public polling data to take the large number of positions that would be required to manipulate the contract price. Such trading "whales" should be spotted if Kalshi has robust trade data surveillance software. However, it is not inconceivable that chat room rumors could create herd behaviors from many "piranhas" that could result in 'pump and dump' trading.

IATP thanks the Commission for Its consideration of our top-line concerns and answers to Commission questions.

Respectfully,

Steve Suppan
Senior Policy Analyst
Institute for Agriculture and Trade Policy