ARISTOTLE
NOW YOU KNOW™

205 Pennsylvania Ave., SE
Washington, DC 2003

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

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 it's 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 The Victoria NAL was withdrawn by the CFTC in August of this year with a direction to stop all trading by February 15, 2023.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 2022[5], 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 Awards[8], and whether certain bills will pass[9], 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 programing 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.

---

[12] *See, 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.

<u>Commission Question 10: Broader Questions Regarding Contract Design are Suitable for Rulemaking</u>

---

[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 2006[24] 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 Discovery[26]

As discussed in response to Question 1, 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 2019 4(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 campaigns[41] 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.

<u>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.</u>

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)