September 23, 2022

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Via Electronic Submission

Re: CFTC Review of Public Comment Period of KalshiEx Proposed Congressional Control Under CFTC Regulation 40.11 (Industry Filing 22-002)

Dear Mr. Kirkpatrick:

We thank the Commodity Futures Trading Commission (CFTC) for the chance to submit our perspectives. The Center for Effective Altruism's Long Term Future Fund, which supports our research, aims to influence the long-term trajectory of civilization by making grants that address global catastrophic risks. An important way that we can make progress on problems affecting the future is by making and gaining better access to accurate predictions. The Fund has made grants to a number of emerging prediction platforms that aggregate and refine predictions about future events, including Metaculus and Foretold, with the aim of systematically improving our ability to disseminate good judgments about the future.

Prediction markets in general—and the proposed contracts specifically—have unique hedging and price basing functions, allowing nonprofits to efficiently allocate resources and manage political risks associated with Future Impact projects. Additionally, we see prediction markets as an advanced forecasting and social consensus building mechanism still in its nascency. With time and space to mature, they can help humanity navigate an uncertain future.

Anticipating that the CFTC would solicit comments on this issue, we have, since June 2022, reviewed literature and interviewed a wide array of experts and stakeholders in the political prediction market space, including current and former CFTC staff, lawyers, forecasters, academics, industry leaders, platform operators and traders.

Our core finding is that the proposed election contracts specifically and prediction markets generally can serve the public interest under a reasonable regulatory regime. We hope the CFTC will develop efficient, fair and transparent regulations of event contracts that manage risks associated with these markets while allowing a competitive industry for prediction markets to develop that serves the public good.

We are available to support, discuss and clarify any of the content in our comments with the CFTC.

Signed,
Pratik Chougule, Principal, Chougule Strategies; Contributor, Star Spangled Gamblers; Consultant, Insight Prediction
Solomon Sia

With
Ozzie Gooen, President, Quantified Uncertainty Research Institute
Nuño Sempere, Researcher, Quantified Uncertainty Research Institute; Forecaster, Samotsvety Forecasting
Flip Pidot, founder and managing director, Sharp Square Capital, LLC
James Grugett, Cofounder & CEO, Manifold Markets
Stephen Grugett, Cofounder, Manifold Markets
Austin Chen, Cofounder, Manifold Markets
Linchuan Zhang, Research Manager, Rethink Priorities

1-4 Do the Contracts Involve Gaming

1. Do these contracts involve, relate to, or reference gaming as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act, or in the alternative, involve, relate to, or reference an activity that is similar to gaming as described in regulation 40.11(a)(2) or section 5c(c)(5)(C) of the Commodity Exchange Act?

2. Should the Commission consider whether similar offerings are available in traditional gaming venues such as casinos or sports books and/or whether taking a position on elections or congressional control is defined as gaming under state or federal law?

3. Do these contracts involve, relate to, or reference "an activity that is unlawful under any State or Federal law" as described in Commission regulation 40.11(a)(1) and section 5c(c)(5)(C) of the Commodity Exchange Act?

4. In determining whether any of these contracts involves an activity that is unlawful under any State or Federal law, should the Commission be influenced by whether state laws permit betting on the outcome of elections or other political outcomes and/or by the prohibition of interstate betting under Federal law?

Meaningfully distinct from pure gaming

During the 40.11 rulemaking comment period, the Commission agreed that the term "gaming" "requires further clarification and that the term is not susceptible to easy definition."[1]

We believe the proposed contracts have important characteristics that distinguish them from clear cases of gaming.

First, skill and knowledge predominate over chance in predicting party control of Congress over the long-run, which indicates that these contracts are distinct from games of pure chance. We know this through our long association, collaboration, and interviews with leading forecasters in existing political prediction markets—in some cases dating back to the Intrade markets. Academic models of prediction markets, such as *Learning Performance of Prediction Markets with Kelly Bettors*[2] also support that prediction markets will differentially reward participants with the most accurate hypotheses.

Second, election markets differ meaningfully from skill based gaming markets such as poker or sports betting because of their economic purpose, either as a hedge or for price basing. These arguments are discussed below in responses to questions 6 through 11.

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[1] 76 Fed. Reg. at 44785.
[2] Alina Beygelzimer, John Langford, and David M. Pennock. Learning performance of prediction markets with Kelly bettors. In International Conference on Autonomous Agents and Multiagent Systems, pages 1317–1318, 2012.

Third, unlike most traditional gaming markets, election markets provide benefits to the public interest even to non market participants. These include: improved forecasting capacity, trust, aggregation, and information dissemination effects, which are discussed below in responses to questions 12 and 17.

Notably, the proposed contracts are similar to offerings that exist in traditional gaming venues in other countries today. For example, online gambling sites Betfair.com (in mainland Europe) and Smarkets (in the United Kingdom) currently offer political betting that is similar to Kalshi's proposal.[3] The presence of similar offerings does not negate that political betting is meaningfully distinct from traditional gaming—for the reasons discussed above—and should not be a factor in the Commission's decision.

Instead, we believe speculators, disinterested gamblers and retail interests are part of a normal and healthy market. The speculation that exists on political event platforms today serves as liquidity provisioning that enables a hedging and price basing platform.

Exempt from state and federal gaming laws

Under an expansive reading of state and federal laws, most if not all financial instruments and event contracts currently allowed on Designated Contract Markets (DCMs) would be considered unlawful gaming activity. However, we believe that these political event contracts are not unlawful. We support former commissioner Dan Berkovitz's statement that "contracts involving gaming should be permitted to be traded on a DCM if they have an economic purpose."[4]

As discussed in a paper by ex-CFTC attorneys Dave Aron and Matt Jones, "The UIGEA Exclusions in a federal gambling statute appears to indicate that Congress recognized that sports bets bear more than a passing resemblance to financial products that are regulated by the CFTC … and sought to ensure the preeminence of the CFTC regulatory scheme for derivatives over other federal and state regulation, even when that scheme called for an exclusion or exemption."[5]

The Unlawful Internet Gaming Enforcement Act, which would ordinarily define political event contracts as an unlawful bet or wager, specifically excludes from its definition any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act; or any transaction that is exempt from State gaming or bucket shop

[3] See e.g. betfair.com - political betting on majority control of U.S. House and Senate: https://www.betfair.com/exchange/plus/politics/market/1.179673535

[4] Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts, Commodity Futures Trading Commission (April 7, 2021), https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721

[5] Dave Aron & Matt Jones, States' Big Gamble on Sports Betting, 12 UNLV GAMING L.J. 53 (2021).

laws under section 12(e) of the Commodity Exchange Act or section 28(a) of the Securities Exchange Act of 1934.[6]

Therefore, we do not believe that the contracts, taken as a whole, involve, relate to, or reference "an activity that is unlawful under any State."

Plain reading of the regulation

In a dissenting statement, Commissioner Pham put forth an argument whereby, based on plain reading of the regulation: buying or selling the contracts may be gaming, but the contracts, which are defined around control of the House and Senate, do not involve, relate to or reference gaming nor are similar to gaming.[7]

An alternate interpretation was used in the 2012 Nadex decision where the contracts and activity on the contracts were considered as a whole,[8] based on Congressional intent,[9] to grant the CFTC the power to restrict gaming that does not have an economic purpose.

Congressional intent is measured in several ways, the most important being the words of the statute. The words of the statute are unambiguous and the 2012 Nadex interpretation is potentially valid only given the legislative history represented by the colloquy, which is generally less probative.

Given the change in legal, economic, and social landscape since the colloquy and the 2012 decision—as detailed in the response to question 5–we prefer Commissioner Pham's proposed interpretation.

5. Historical Precedent

5. Are the contracts substantively different from Nadex's previously proposed contracts such that the Commission's analysis should be different? For reference, please see "CFTC Order Prohibiting North American Derivatives Exchange's Political Event Derivatives Contracts" (Apr. 2, 2012) available at https://www.cftc.gov/PressRoom/PressReleases/6224-12.

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[6] 31 U.S.C. § 5362(1)(E).

[7] Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts, Commodity Futures Trading Commission (April 7, 2021), https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement082622

[8] Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts

[9] https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf "WHEREAS, the legislative history of CEA Section 5c(c)(5)(C) indicates that the relevant question for the Commission in determining whether a contract involves one of the activities enumerated in CEA Section 5c(c)(5)(C)(i) is whether the contract, considered as a whole, involves one of those activities"

Although prior decisions and congressional intent are natural starting points for analysis, we believe that the CFTC should also remain flexible as circumstances change. This is necessary to fulfill the CFTC's mandate to protect customers and encourage a well regulated market.

The contracts put forward by Kalshi are not substantively different from Nadex's previously proposed contracts. However, the legal, social and technological context has changed since the Nadex decision in three major ways that, independently or collectively, should encourage a reassessment of the 2012 decision.

A transformed legal, social and economic landscape

The legal landscape regarding gambling has changed since the Nadex decision. As former Commissioner Berkovitz noted in 2021, the sports betting landscape today is "dramatically different from when Congress enacted the gaming provision and the Commission promulgated Regulation 40.11" due, among other things, to rapid expansion as well as increase in the dollar amounts being wagered.

The CFTC should base their interpretation of Congress's intent in the context of the new legal and economic landscape, where many forms of gaming are no longer illegal under the PASPA, and therefore have a different analysis than the Nadex decision.

Public perception of gaming has changed since the Nadex decision. A 2020 Gallup poll, found that 71 percent of Americans consider gambling to be morally acceptable, the highest level of registered since Gallup started polling the question in 2003. News media regarding prediction markets specifically has also shifted towards a more positive tone, highlighting prediction markets' value as a source of truth.[10]

Additionally, the forecasting industry and community has grown and matured significantly since the Nadex decision. Although blogs such as overcomingbias.com, marginalrevolution.com and lesswrong.com have existed since the 2000s, the rationalist community has grown since 2012 alongside increased attention to the value of prediction aggregators. Metaculus.com, a reputation based prediction platform hosting over a million forecasts, was founded in 2015. Replication Markets, a research replication prediction market, was founded in 2019. Google created an

[10] See e.g. Holman Jenkins, "A Betting Man With a Plan for America," *Wall Street Journal*, 9 September 2022, https://www.wsj.com/articles/a-betting-man-with-a-plan-to-save-america-poker-odds-school-choice-war-climate-policy-donor-markets-prediction-invest-11662755750; Harry Crane and Koleman Strumpf, "Political prediction markets are an antidote to degraded public discourse", 6 September 2022, https://www.chicagotribune.com/opinion/commentary/ct-opinion-political-prediction-markets-public-discourse-20220906-lfuvziy3fnfkfgw33lzhsno4h4-story.html; Rational Animations, *Prediction markets: can betting be good for the world*>. YouTube. https://www.youtube.com/watch?v=xA27x7GRMZQ&ab_channel=RationalAnimations

internal prediction market in 2022.[11] Nonprofit organizations interested in maximizing their long term impact such as Rethink Priorities, Open Philanthropy, and Effective Altruism Funds—none of which existed prior to 2017—are today collectively managing multibillion dollar budgets.

Mainstream acceptance of gaming coupled with increased awareness of the value of prediction markets increases the likelihood that the hedging, price basing and other positive social benefits of the proposed contracts will be realized. The CFTC should consider whether the proposed contracts pass the economic purpose test or are contrary to the public interest in the context of this new social landscape.

Finally, a variety of election markets have proliferated since the Nadex decision, creating a new regulatory landscape with unique dilemmas. PredictIt started operating with the benefit of a No Action letter after the Nadex decision in 2014. Congressional control markets on the site provide a highly relevant test case for considering theoretical concerns as well as the public interest implications of Kalshi's request.

Due to blockchain and other decentralized technologies, traders are using offshore and unregulated exchanges that feature election contracts with significant liquidity. An example of such a market is Augur which open sourced their code and whose decentralized design may allow it to sidestep regulatory difficulties. Soon after the platform launched, users had created death pools — or assassination markets — on famous people. Retail traders are leveraging VPNs with little evident fear of legal consequences. The extent to which these markets can be and will be regulated with meaningful sanctions and enforcement remains uncertain.

We feel strongly that the public would benefit from having these products traded on a well-regulated exchange. The lack of a regulated exchange will not prevent the risks posed by political event contracts; rather, it will push users towards less well regulated markets where it is harder to safeguard their interests. Prediction markets may, as a consequence, lose their value as a trust and aggregation.

The CFTC should consider whether these proposed contracts pass the economic purpose test or are contrary to the public interest against the backdrop of proliferating unregulated prediction markets. This analysis, in our view, points to different conclusions from the Nadex decision.

6-10 Hedging

6. Do the contracts serve a hedging function? Are the economic consequences of congressional control predictable enough for a contract based on that control to serve a hedging function?

[11] Dan Schwarz and Lindsay Taylor, "Creating a prediction market on Google Cloud", Google Cloud, https://cloud.google.com/blog/topics/solutions-how-tos/design-patterns-in-googles-prediction-market-on-google-cloud

Please provide tangible examples of commercial activity that can be hedged directly by the contracts or economic analysis that demonstrates the hedging utility of the contracts.

7. Are there unique economic risks tied to the outcome of congressional control that cannot be hedged via derivative products on equities, debt, interest rates, tax rates, asset values, and other commodity prices?

8. What standard should the Commission use in reviewing the contract's hedging function? Is it sufficient that a contract could theoretically be used for hedging or, should an exchange provide evidence of demonstrated need by likely hedgers in the market? How often must a contract be used for hedging or what percentage of market participants or open interest must represent hedging use?

9. Should the Commission consider contract and position sizes and the exchange's intended customer base to help assess whether a product is likely to be used for hedging in at least some cases? Are very small dollar value contracts targeted at individual retail customers likely to have hedging utility for such customers when the contracts offer positions on macro level national political events? Does whether contracts are margined or fully collateralized affect this analysis?

10. Should the Commission consider the contract design and payout when trying to assess the economic utility of the contract? For example, are binary contracts useful for hedging nonbinary economic events?

Reasonable expectation of hedging on a more than occasional basis

There is significant unhedged political risk today, and political event contracts can reasonably be expected to serve as a broad economic hedge against economic consequences on more than an occasional basis. A hedging function is sufficient, but not necessary for the proposed contracts to pass the economic purpose test. Price basing, as covered in the response to question 11, is also sufficient to pass the economic purpose test.

We favor a standard that the election contracts could theoretically be used for hedging. Based on the wording of the economic purpose test, either theoretical use for hedging or proven prior use for hedging is sufficient. We also believe that the theoretical standard best fits the standard the CFTC has used on similar proposals in the past.

The comments the CFTC has already received speak to the hedging utility of these political event contracts. In previous event contracts submissions such as ErisX sports betting and MDEX box office futures, prominent industry leaders explicitly declared that they would not use these markets for hedging to any meaningful degree,[12] which influenced CFTC decision-making. However, the proposed contracts serve as a broad economic hedge for so many conceivable interests that it is unlikely that a similar hedging boycott is plausible. On the contrary, the comments file contains a variety of industry and retail interests coming forward to declare their intent to use the proposed contracts as an economic hedge.

In addition to the possibility that election contracts may provide a more correlated hedge for an umbrella of risks than traditional derivative products, election contracts may over time democratize hedging by making available a method more intuitive to retail and other classes of traders who cannot easily open spread accounts.

We believe retail customers are currently not well-educated on the hedging utility of election contracts, which helps account for why hedging in these markets is relatively rare. However, should the Commission approve these contracts on the condition that hedging (or price basing) will be demonstrated on a more than occasional basis, we believe Kalshi would embark on an educational campaign regarding the hedging utility of election contracts for an array of market entrants, including retail customers. Given the amount of unhedged economic risk today, such an educational effort could lead to a notable increase in hedging using election contracts.

Theoretical hedging - broad based economic risks

The Center for Effective Altruism (CEA) makes grants that seek to address global catastrophic risks through technical research, policy analysis, advocacy, and/or demonstration projects. Congressional control contracts are among the most predictable ways to hedge such risks because of the large number of relevant issues that are sources of partisan division. Examples include policy approaches to divisive issues related to pandemics, nuclear safety, and climate change.

If a party with an unfavorable stance from the perspective of global risk reduction should gain congressional control, it would have unique, tangible and predictable economic implications to CEA. More funding for research, analysis, advocacy and/or demonstration projects would be necessary to counteract these political headwinds. The proposed contracts would allow for the construction of a hedge against such political risks.

Even when issues are not front and center in a political campaign, Congressional control markets are a way of hedging myriad factors such as who will serve on relevant committees where

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[12] See e.g. Shaun Raviv, "Box Office Bomb: The Short Life of Popcorn Prediction Markets", *The Ringer*, 15 November 2018, https://www.theringer.com/movies/2018/11/15/18091620/box-office-futures-dodd-frank-mpaa-recession; AGA Comment Letter at 2, available at https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=64800&SearchText=

political agendas are set, hearings are convened, and millions of dollars in appropriations can be allocated.

Theoretical hedging - policy analysis and advocacy

CEA grants include policy analysis and advocacy. The effectiveness of these individual grants and the value of the fund's overall grant portfolio are uniquely, tangibly and predictably tied to the economic event of congressional control. If the fund is overexposed with respect to its advocacy grants towards a specific political party, the proposed contracts would allow for the construction of a hedge against such political risks.

Many of the economic risks that concern CEA are tied far more directly to the outcome of congressional control than any derivative products on equities, debt, interest rates, tax rates, asset values, and other commodity prices.

Examples of hedging on prediction markets

We conducted a review of hedging on existing prediction markets. Few prediction markets today have high enough volume and liquidity (several million) to allow for meaningful hedging. Even relatively unregulated election markets in the UK appear not to be used to a significant degree for hedging, in part because these markets tend not to draw enough liquidity.

We did, however, identify notable exceptions. FTX recently saw an individual actor placing programmatic bets summing to more than $100K on a $931K volume prediction market on the Tokyo Olympics[13]—behavior consistent with a large actor hedging against the risk of the Tokyo Olympics being canceled.[14] UK markets on Brexit drew enough liquidity to attract participation indicative of hedging, albeit less so than currency markets. Finally, Star Spangled Gamblers, a political betting podcast, has featured retail investors using Kalshi to hedge their student loan payments.[15]

Impact of contract size and design

Contract and position sizes will have a significant impact on whether a product is likely to be used for hedging. The proposed contracts have artificially low position limits that will constrain the hedging use case. In comparison, traditional commodity futures have minimal contract sizes that are multiples of the maximum of the proposed contracts, for example, hundreds of thousands of dollars on fund futures.

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[13] See snapshot of FTX Tokyo Olympics market with volume traded of $931K: https://twitter.com/5egKS9lUrwVOqWX/status/1402456266321002499

[14] See https://twitter.com/brianluidog/status/1374555912828985348, which details the bot's behavior of persistently making 'no' hedges and keeping the probability of the Olympics at 75% despite strong evidence from superforecasters and other prediction markets that the probability of the olympics was higher.

[15] https://twitter.com/SSGamblers/status/1530217569348636675

Very small dollar value contracts targeted at individual retail customers are unlikely to have practical hedging utility for all but a small minority of customers when the contracts offer positions on macro level national political events. Even if such hedging were to occur, the economic benefit would be minimal. This is an inherent mismatch, and we recommend higher position limits so hedging becomes feasible on an institutional scale.

In the same vein, we recommend margined contracts which naturally allow for greater hedging potential. We expect margined contracts and possibly even interest generating contracts[16] will provide institutional users greater liquidity with which to hedge their political risk exposure.

We do not find issues with the proposed contract design. The economic event - whether <party> will control the <house or senate> - can be modeled as a binary event, so the binary contract design matches the binary economic event and is not an impediment to hedging.

More generally, contract design and payout are not major impediments to hedging. For example, a sufficient spread of binary contracts may be used to create a basis for hedging nonbinary economic events. Furthermore, subsequent proposed event contracts need not be binary, and there will be appropriate nonbinary event contracts to hedge nonbinary economic events.

11 Price Basing

11. Do the contracts serve a price-basing function? For example, could they form the basis of pricing a commercial transaction in a physical commodity, financial asset, or service?

The political event contracts can reasonably be expected to serve a price-basing function on a more than occasional basis. Furthermore, we understand that serving a price-basing function is sufficient but not necessary for the political event contracts to pass the economic purpose test.

Contrary to the CFTC's findings in the 2012 Nadex Ruling, we believe from our experience with post-2012 prediction market platforms such as PredictIt, Polymarket, Insight Prediction, and Manifold Markets that there are reasonable situations in which the proposed contracts' prices could form the basis for the pricing of a commercial transaction involving a physical commodity, financial asset or service.

Prediction markets provide value by forecasting the future

Election markets are a valuable source of insight when operating alongside current forecasting platforms. The core social value proposition of efficient prediction markets is the production of

[16] See e.g. https://manifold.markets/home which gives interest payoffs to users holding long term positions to grant forecasters liquidity to maintain long term predictions, or the "no loss" contracts pioneered by Hedgehog Markets (https://hedgehog.markets/no-loss/).

accurate, calibrated and useful probabilities. The CEA acknowledges the potential for prediction markets to disseminate insight with trust, aggregation and clarity.[17]

In 2008, a group of 22 academics called for loosened regulations in an open letter to *Science*, describing a "virtually limitless" range of applications for government policy, business and public health. Four Nobel laureates were among the signatories, including 2013 economics co-winner Robert Shiller. Since the Nadex prohibition in 2012, play money and reputation-based prediction markets such as Metaculus and Replication Markets have tested and proven prediction markets' potential for actionable insight in a wide range of applications.

Prediction markets provide strong incentives for accuracy and timeliness by working according to the efficient market hypothesis. They incentivize participants to seek information that would give them an edge and aggregate insights from other forecasters. Market participants are also incentivized to integrate news quickly into a prediction market, leading to timely predictions. In addition, because prediction markets have a resolution date set in stone beforehand, dynamics where "the market stays irrational longer than you can stay solvent" arise to a much lesser degree, since a correct contrarian can simply buy the correct side and hold it until resolution.

In a review of corporate prediction markets Misha Yagudin, Nuño Sempere, and Eli Lifland noted that Google, Yandex, and Goldman Sachs, among others, had previously or currently run prediction markets.[18] The outcome of these prediction markets were used by the companies to estimate the price of investments, broker acquisitions and set strategic direction. Ultimately the research found lower levels of corporate uptake, which the researchers hypothesized may have been due to the significant investments in effort and employee hours required to run an internal prediction market. Nevertheless, there are strong theoretical reasons why public prediction markets would be more cost effective in delivering forecasting value, as the information would be more relevant to a larger population of users. This is perhaps why Google has invested anew in their own internal prediction market, which has seen "over 175,000 predictions from over 10,000 Google employees"[19].

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[17] See 2008 Event Contract Concept Release, supra note 40, at 25,672 ("As demonstrated by the [Iowa Electronic Markets ("IEM")], innovative event markets have the capacity to facilitate the discovery of information, and thereby provide potential benefits to the public.").

[18] Nuño Sempere, Misha Yagudin, and Eli Lifland, "Prediction Markets in the Corporate Setting", Effective Altruism Forum, 31 December 20201, https://forum.effectivealtruism.org/posts/dQhjwHA7LhfE8YpYF/prediction-markets-in-the-corporate-setting#Value_proposition

[19] https://cloud.google.com/blog/topics/solutions-how-tos/design-patterns-in-googles-prediction-market-on-google-cloud

Political event contracts have a price basing function

Efficient and well run markets on political event contracts provide many signals upon which to base prices for services. Examples of valuable signals include the likelihood of either parties' control of the House and Senate, the extent of that control, and the implied volatility of the outcome. These outcomes materially affect the strategic decisions of companies whose outcomes depend on these events.

Political prediction markets have become an important part of the political risk industry guiding private sector decision-making. Rethink Priorities CEO Peter Wildeford told us that political event contracts on Betfair and Predictit are the first thing his organization checks to forecast outcomes of elections—information used to steer the strategic direction of the nonprofit. The strong incentives to integrate accurate and timely information makes the markets, in his view, a unique resource.

Besides setting strategic direction, the signals also have a direct price basing function for physical commodities, financial assets or services. We will use for illustration the price basing function on investments for public good. As public good fund managers become more politically conscious, they increasingly consider two factors in their investing strategy. First, the impact that political parties have on investments; second, the expected return of direct investment in political parties.

An example is the impact that Democrat/Republican control of the House or Senate has on pandemic preparedness funding initiatives.[20] In addition to investments in forecasting, CEA also considers investments in pandemic preparedness. Republican/Democrat control of the House or Senate will directly influence the impact of the Biden administration's proposed Pandemic Preparedness bill, which in turn influences the relative value of funding provided for independent pandemic preparedness initiatives.

As another example, the Center For Election Science advocates for use of approval voting, instead of the "first-past-the-post" system implemented in most of the US right now. Approval voting would favor more centrist candidates which have appeal across party lines, and would avoid problems such as "spoiler" candidates. Because their advocacy might see differential success depending on which party is in power, funders deciding whether to donate to the Center for Election Science can use forecasts of election outcomes as an input into their decision-making.

Additionally, as institutions and individuals consider directly investing in political causes for the public good, signals from political event contracts influence the price they should pay for

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[20] "Pandemic preparedness", Effective Altruism Forum,
https://forum.effectivealtruism.org/topics/pandemic-preparedness

services such as lobbying and campaign management. Sam Bankman-Fried, for example, cited the risk of Trump winning the 2020 election as a direct influence on his political spending decisions.[21]

Current examples of price basing

Below are select practical examples of other prediction markets being used as price basing for physical commodities, financial assets and services today.

We considered the effectiveness of effort and money invested in developing a public comment to the CFTC. As part of our considerations, we reviewed an event contract by Insight Prediction structured around the likelihood of Kalshi offering U.S. election markets by October 25th.[22] As the numbers leaned towards 50%, the expectation that such a public comment could influence the outcome increased, which forms a price basis for services to craft that letter. Based on the implied probabilities from that prediction market, which was 30% at the time of writing, we based the price we were willing to pay for expert and legal services to help us draft this comment letter.

Other prediction markets that exist today can reasonably be expected to have a price basing function. For example, a market on Manifold Markets at the time of writing estimates the probability that Elon Musk will buy Twitter this year at 28%.[23] This can easily be used as a price basing function for Twitter stock, which is a financial asset.

As another example, effective forecasts on the coronavirus pandemic such as those at the prediction platform pandemic.metaculus.com have a price basing function across a wide range of physical commodities, financial assets and services related to healthcare, tourism and commercial activity.

Finally, price basing for physical commodities may be more directly served by a future on the physical commodity rather than an event contract. However, the implied probabilities from an event contract may nevertheless be used as a basis for the price of such commodities. A theoretical example is a prediction market structured around Democrat or Senate control of Congress having a price basing function on corn or wheat.[24]

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[21] Elena Schneider, "How the newest megadonor wants to change Washington", *Politico*, 4 August 2022, https://www.politico.com/news/2022/08/04/democratic-megadonor-sam-bankman-fried-00049048

[22] https://insightprediction.com/m/18609/will-kalshi-offer-a-us-election-market-by-october-25th

[23] https://manifold.markets/SG/will-elon-musk-buy-twitter-this-year

[24] See e.g. David Rogers, "Senate Passes Democrat-Backed Bill To Raise Target Commodities Prices", 14 February 2022, https://www.wsj.com/articles/SB1013625367351156440

13-16 Election Integrity

13. Could the trading of these or other political control or election-based contracts affect the integrity of elections or elections within the chamber of Congress? Could it affect the perception of the integrity of elections within the chamber of Congress?

We analyzed the historical and theoretical adverse effects of prediction systems on election integrity. We also interviewed traders and platform operators of existing election-based markets to understand election manipulation risks specific to election markets.

Our response considers the following integrity risks:

1. Prediction markets may serve as a mechanism to sway election outcomes through self-fulfilling (or self-defeating prophecies). This includes manipulating markets to sway voter sentiment and hence election outcomes and vote buying.
2. Prediction markets may serve as a direct financial incentive to manipulate elections (by means other than prediction markets).
3. Prediction markets may be subject to manipulation for profit, e.g. via the publication of false polls, which manipulates election outcomes as a byproduct.
4. Prediction markets may affect the perception of election integrity.
5. Prediction markets may facilitate violations of campaign finance laws.
6. Election insiders may manipulate outcomes to create profits on the market or trade on insider information.

Ultimately we believe the risk of election-based contracts on election integrity is negligible relative to the risks that already exist. Further, these risks are mitigated by effective regulatory oversight of these markets, and small relative to the economic and social utility of these contracts.

Self-fulfilling prophecies

One category of risk is the self fulfilling prophecy—or its inverse, the self defeating prophecy—where knowledge of the prediction affects the result.[25] The 2016 US presidential election offers plausible evidence for the self-defeating theory, where overconfident win predictions for Hillary Clinton, including in the prediction markets, may have lowered turnout enough to tip the election.[26]

[25] Herbert Simon, Bandwagon and Underdog Effects and the Possibility of Election Predictions, *Public Opinion Quarterly*, Volume 18, Issue 3, Fall 1954, Pages 245–253, https://doi.org/10.1086/266513
[26] Nuño Sempere, "Real-Life Examples of Prediction Systems Interfering with the Real World (Predict-O-Matic Problems), LessWrong, 3 December 2020, https://www.lesswrong.com/posts/6bSjRezJDxR2omHKE/real-life-examples-of-prediction-systems-interfering-with

On the eve of the election, a letter from FBI director James Comey telling Congress he had reopened an investigation into Clinton's emails shook up the race with just days left in the campaign. Comey later acknowledged that his assumption that Clinton was going to win was a factor in his decision to send the letter.[27]

The converse risk is the self-fulfilling prophecy. One could imagine a hypothetical scenario in 2016 where overconfident win projections for Hillary Clinton lowered turnout for Republican voters sufficiently to tip the election in her favor.

The arguments here speak more to the integrity risks of faulty prediction systems generally rather than the proposed contracts specifically. The incentives for prediction markets to seek and disseminate truth is greater than the majority of the more commonly referenced predictions in mainstream discourse such as pundit predictions. Because of their active mechanisms to combat overconfidence, we consider one of the primary benefits of election markets to be a decrease of unrealistic projections, thereby reducing the potential for incorrect electoral modeling to affect election integrity.

The CFTC should not ban political event contracts on the basis that they are better predictors of election outcomes or it may run into First Amendment concerns around political discourse (see response to question 12 & 17).

Deliberately swaying election outcomes

We searched for historical attempts to use political event contracts to manipulate the outcome of elections. We did not find any instances of manipulation in Congressional control markets but did discover examples in other markets. An aide on a presidential campaign in the 2016 primaries informed one of us on background that he and his colleagues placed bets on their candidate on PredictIt as part of the campaign's strategy. They did so both in order to respond to media coverage that their candidate's price was slipping in the markets as well as to garner favorable news coverage about the supposed prospects of their campaign. The betting limits and relatively low liquidity on PredictIt made this a relatively inexpensive decision in the short-term, but it proved impractical as their campaign failed to gain traction and traders became increasingly bearish on its prospects. Another likely instance of attempted manipulation occurred recently in the UK in markets in the London mayor race. Anecdotal evidence suggests that an obscure candidate may have facilitated bets in the market to pump his price, and therefore, support notions that he may be a viable candidate. The gambit failed when media and political observers treated the candidate's briefly inflated price as noise.

[27] Zeynep Tufekci, "Can We Finally Agree to Ignore Election Forecasts", *New York Times*, 1 November 2020, https://www.nytimes.com/2020/11/01/opinion/election-forecasts-modeling-flaws.html

The relatively inconsequential cases of manipulation we found in our research are consistent with the academic literature on this topic. Studies on the so-called "Romney whale" in the 2012 Intrade markets, a single pro-John Kerry manipulator in the 2004 TradeSports market, as well as surveys of earlier political stock markets indicate that manipulation can be detected by traders, media, and researchers, and that systematic manipulation is difficult beyond short time periods.[28] As the efficient market hypothesis indicates, given sufficient interest and liquidity, traders can be expected to bring the market price to a more efficient level relatively quickly.

We expect the proposed contracts on a regulated exchange would be less prone to manipulation than on PredictIt. Due to higher position limits, the markets will be more liquid. Moreover, Congressional control contracts hinge less on the fate of any one or handful of individuals than other types of markets that have been historical targets of attempted manipulation.

Our prediction in this respect is informed by our conversations with UK-based colleagues, who have monitored Congressional control markets with large amounts of liquidity over many decades. They reported no clear, consequential cases of manipulation in these markets. They observed, moreover, that while allegations of manipulation in sports betting in the UK have led to the creation of a nationwide integrity unit, nothing comparable exists in politics and there appears to be no meaningful demand for one even by the most vocal advocacy groups.

We believe that the existing evidence of failed manipulation is reason for cautious optimism. It suggests that prediction markets are considerably less likely to mislead the public than the less transparent mechanisms already available today such as push polling, reporting based on background sources, election analysis platforms, and proprietary models. Lying in a market that has an active mechanism to counter noise and fake news is a dubious strategy when considering the alternatives.

Even if cases were to arise of market manipulation, calls for outlawing election contracts on this rationale should be weighed against the benefits that isolated attempts at manipulation have from an academic/research perspective. They would further knowledge on when and under what circumstances traders seek to manipulate election markets and how consequential these efforts are.

[28] Rothschild, David M. and Sethi, Rajiv, Trading Strategies and Market Microstructure: Evidence from a Prediction Market (November 22, 2015). The Journal of Prediction Markets 10 (1), 1-29, 2016, Available at SSRN: https://ssrn.com/abstract=2322420 or http://dx.doi.org/10.2139/ssrn.2322420; Rajiv Sethi, "The Romney Whale" 26 September 2013, http://rajivsethi.blogspot.com/2013/09/the-romney-whale.html; Rhode, P.W., Strumpf, K.S.: Manipulating political stock markets: A field experiment and a century of observational data. Working Paper (2008), https://users.wfu.edu/strumpks/papers/ManipIHT_June2008(KS).pdf

Using event contracts to 'buy votes'

In the Nadex Ruling, the CFTC declared that "Political Event Contracts can potentially be used in ways that would have an adverse effect on the integrity of elections, for example by creating monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter's political views of such candidates." A related argument is that, if the political event contracts truly worked as an efficient economic or emotional hedge, a voter could theoretically put enough money on one side or another such that they became wholly ambivalent to the outcome and abstain from voting.

This is not a well formulated integrity concern. It is in the nature of democratic elections that voters have the prerogative to weigh myriad personal incentives—including financial ones—in their choice of candidate. In an era in which the government has a profound impact on individuals' financial future through tax, spending, and regulatory policy, the relatively small amounts of money at stake in an election market can be expected to be a secondary concern at most. The CFTC's Nadex statement suggests that voters might voluntarily shape their own preferences and "steal votes from themselves", which does not constitute an election integrity risk.

These concerns, moreover, are speculative, abstract, and almost entirely absent from our experience with political prediction markets. In large part due to the difficulty of generating high profits in election markets relative to other types of betting markets with more frequent and consistent events, traders tend to participate in election markets because of their preexisting interest in politics. While traders routinely acknowledge that they are trading against candidates who they personally support, we are unaware of traders who consciously base their personal political activities on their investments in the market. Indeed, discussions in the political prediction community are replete with traders who disengage from election markets when they have a strong opinion about one of the involved parties and do not trust themselves to place an objective bet.

A more coherent example of the CFTC's concerns is as follows: a manipulator who wants people to vote Democrat could put a lot of money on Republicans winning, with the expectation of losing that money. Republican voters would see the easy money, and start betting on a Democratic victory, and thereby become incentivised to vote Democrat. Ultimately the Democrats win, and the manipulator has lost a lot of money on the prediction market but has effectively 'bought votes' and hurt the election integrity as a result.

This mechanism may appear dangerous, not least because it is indistinguishable from hedging behavior by an actor who hopes for a Democrat win but is hedging against a Republican win. However, this method of 'vote purchasing' is extremely impractical because there is no way to make the right amount of money go to the right people. A single individual, or even a dispassionate corporate entity that has no voting power could take all the money without providing any return on investment. Again, there exist far more direct and reliable ways to sway election outcomes today.

Direct financial incentive to manipulate elections

Another integrity risk is that election-based contracts, by introducing a profit motive, may incentivize individuals with a stake in those markets to alter election outcomes in order to make money on the markets. If an entity has a large position on an outcome, it has a financial incentive to make that outcome come to pass.[29]

This concern does not make sense given the size of the event contract positions ($25K position limit per individual) relative to the incentives already at stake. Individuals and organizations already have strong reasons to sway an election and the policy outcomes at stake far outweigh any market gains available in the proposed contracts. We do not see direct financial incentives as an issue even at several multiples of the current proposed limit.

The CFTC may have recognized in 2012 that the election integrity fears based on additional incentives created by political event contracts were frivolous as it did not elect to mention them in the Nadex Ruling.

Nevertheless, we sought historical examples of individuals attempting to manipulate elections to make money on prediction markets. The closest one we found were death threats against Andrew Yang during his presidential campaign from an anonymous trader who was attempting to manipulate PredictIt's briefly operating market on how many times Yang would tweet. PredictIt's decision to offer the market in the first place went against advice from veteran political prediction market traders who reasoned, correctly, that this type of niche market was on dubious regulatory grounds and was more likely to incentivize foul play than the election contracts proposed by Kalshi.[30]

Perception of the integrity of elections

We considered how the proposed contracts might affect perceptions of election integrity. As a meta point, considerations pertaining to the perception of election integrity hold much less weight than considerations of actual election integrity risk. Given logical analysis and reasoning, perception will approach reality—that is, that the proposed contracts have an insignificant impact on election integrity.

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[29] A literary example is the Jules Verne novel 'Around the World in 80 Days', in which, as a bet, Phileas Fogg travels the world in 80 days by train and ship.
[30] https://twitter.com/Domahhhh/status/1555320074524770304?s=20&t=8lPVPLjCs2ec5326j6n45w

Nevertheless, we do not take it on faith that the public will automatically take the same reasoned analysis and come to the same conclusions we have described above. We discuss some reasons why prediction markets might be perceived as threats to election integrity.

First, the financial incentives caused by prediction markets are more direct than conventional political incentives, as there is a direct payout in response to one side or another winning. This direct mechanism could be perceived as higher risk relative to its actual risk.

Second, although public perception of gambling has improved in general and prediction markets are meaningfully distinct from gambling, a minority may take offense at a financial incentive mechanism they consider to be gambling. In this case there is a focus on the mechanism of election integrity violation rather than the likelihood of the actual violation.

Third, there is a natural inherent distrust of any new potential mechanisms of abuse, regardless of its risks relative to the mechanisms already available.

Fourth, by adding 'skin in the game' for market participants, the proposed contracts increase the emotional and financial investment in the outcome. When the outcome does not go according to their wishes or expectations, it increases the emotional response, which leads to stronger, albeit unfounded perceptions that the election integrity has been compromised. For example, in the 2020 elections, millions of Americans went to the polls believing that their preferred candidates would win by a comfortable margin. When the results defied their expectations, many "blue wave" traders lost money on PredictIt while suspicions about election fraud gained traction. Conspiracy-oriented traders flooded political prediction markets with bets on Republican candidates, only to suffer losses as more sophisticated traders took the other side of their bets.

Conversely, there are strong reasons to believe prediction markets will be a net positive to both election integrity and perceived election integrity, as follows.

First, because prediction markets are inherently non-partisan, aggregate perspectives democratically and have strong incentives towards accuracy, they are less likely to be demonized by one side or another. This is coupled with the insight and social consensus building incentives of prediction markets, as laid out in the response to questions 12 and 17. Doubts about the integrity of U.S. elections have risen in the past few years for reasons that have little if anything to do with political prediction markets. Because of the transparency of prediction markets and its active mechanisms to combat falsehood, we consider one of the primary benefits of a political prediction market to be the reduction of incentives and effectiveness of current methods to interfere with election integrity

Second, mainstream understanding and acceptance of gaming and the benefits of forecasting have improved since the 2012 Nadex contracts, as discussed in the response to question 5. Prediction market platforms such as Kalshi and influencers within the forecasting and rationalist community are strongly incentivized to educate the public. Once election-based contracts are effectively regulated, we intend to undertake a follow up project to educate the public on prediction markets.

Third, the opportunity to trade on election outcomes in the context of PredictIt has created powerful incentives for the public to become informed about the political process and be more cognizant of one's own ignorance and biases. This is easily observed in discussions in the political prediction market community, which are often far more sophisticated than those in the mainstream or even professional discourse. This creates financial incentives for market participants to be rational, which in turn moves their perceptions of election integrity closer to reality. We would expect the Kalshi contracts to continue to produce a new generation of citizens whose interest in political prediction markets leads them to engage constructively in the political process and to have reasoned opinions about election integrity.

Fourth, prediction markets themselves give signals on election integrity. In 2020, at a time when the president of the United States and a major political party were seriously entertaining the possibility that the election was "stolen", that Trump would serve a second term, and that key Senate race calls would be reversed, market prices indicated that traders understood better than many members of Congress that the election was conducted without a meaningful amount of fraud and that the United States would see a transfer of power to Joe Biden. Reflecting widespread concerns about election integrity among the electorate, candidates since Trump have decried election fraud after losing their congressional races, but election markets on PredictIt and elsewhere have hardly moved on this news. At the same time, Congressional markets are among the most valuable sources available today to assess whether and how federal and state inquiries into election integrity will proceed.

Although political prediction markets play a limited role currently in shaping perceptions of election integrity, recent history shows that they are more likely to increase rather than decrease confidence in U.S. elections when the public at large sees that the "smart money" is betting on the assumption of fair elections.

14. Could the contracts facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations? For example, could the contracts make it easier to sidestep prohibitions governing coordination between candidate campaign committees and political action committees?

Facilitate or violate campaign finance laws

Over the course of extensive interviews with historians, practitioners, and industry leaders in both the United States and the United Kingdom, we did not come across any evidence that political prediction markets have been or are being used to facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations to any meaningful degree.

Relative to the existing mechanisms and loopholes by which parties may sidestep prohibitions governing coordination between candidate campaign committees and political action committees, the contracts do not offer a feasible mechanism to facilitate violations of, or otherwise undermine, federal campaign finance laws or regulations.

Insofar as election markets carry the risk of undermining campaign finance laws, however, law enforcement officials are more likely to determine if this is occurring on a regulated exchange with a responsible stakeholder like Kalshi rather than a decentralized or offshore site with less incentive to police its site in line with American legal and political norms.

15. Do the contracts present any special considerations with respect to susceptibility to manipulation or surveillance requirements? For example, could candidate campaign committees or political action committees manipulate the contracts by trading on internal, non-public polling data?

16. Should campaign committees, political action committees, candidates for the House and Senate, and other entities involved in political fundraising and expenditures or likely to hold non-public information, or subject to Federal Election Commission oversight, be prohibited from participating in the contracts? Would such a prohibition help address federal campaign law or manipulation and surveillance concerns? How would such restrictions impact the Commission's determination of whether the contracts are contrary to the public interest?

Market manipulation for profit

As part of our research for this comment, we sought examples of manipulation by insiders on existing prediction platforms.

A form of manipulation is the creation of fake polls by traders to move betting markets. Our British colleagues were not aware of fake polling being used to manipulate UK-based markets, but the phenomenon appears to be more common on PredictIt. FiveThirtyEight's report "Fake Polls Are A Real Problem" notes, as an example, that the price for one share — which is equivalent to a bet that Senator Debbie Stabenow will be re-elected — fell from 78 cents to as low as 63 cents due to a fake poll before finishing the day at 70 cents. Market motivations may have been secondary to the trolling factor, but the mere fact that the markets can be so easily manipulated is arguably noteworthy.[31] The paper "Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability" contains many more examples.[32]

Ultimately, the phenomenon of manipulation via fake polls is of some concern to certain types of political prediction markets with limited information, few public polls, and low liquidity. Even in such markets, the incentives for market correction and exposure tend to override any attempts to manipulate the market.

The proposed markets would be even more difficult to manipulate through fake polls due to the abundance of information available to market participants, frequent polling by reputable firms, and the high liquidity they draw.

Manipulation is also possible through sound polling. We interviewed one PredictIt trader who commissioned a real poll to move the markets. The trader told us that the poll was real with a sound methodology, and was commissioned to correct what he believed to be an inefficient market. Ultimately the trader financially benefited from the process of discovering truth via his poll and taking a position before releasing the polling results. We take this example as evidence that prediction markets may also reward truth seeking and truth dissemination by financially motivating the commissioning of accurate polls.

Rules against insider trading

Prediction markets may incentivize insiders to put money on an unlikely outcome and make the outcome occur. For example, a frontrunner candidate may bet against themselves and then intentionally lose the election to reap a profit. We have not found any historical examples of candidates throwing an election in order to make a profit from prediction markets.

Prediction markets may also enable insider trading of non-public information. We learned of several instances of campaign aides in the 2016 primaries trading on PredictIt while working for presidential candidates. Often, aides were simply trying to profit personally, calculating (often incorrectly as it turned out) that their experience on the campaigns would give them an edge.

Insofar as we are interested in political prediction markets that express efficient pricing, we would oppose prohibitions on any entity's participation in these markets given that they may have valuable information. A promise of election markets is that they will elicit knowledge from many market participants that wouldn't have otherwise been shared and that this knowledge will be used to make better decisions.

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[31] Harry Eten, "Fake Polls Are A Real Problem," *FiveThirtyEight*, 22 August 2017; https://fivethirtyeight.com/features/fake-polls-are-a-real-problem/

[32] Yeargain, T. (2020): "Fake Polls, Real Consequences: The Rise of Fake Polls and the Case for Criminal Liability," Missouri Law Review, 85,140-150

If, however, the Commission determines that such a prohibition would alleviate concerns among regulators and/or the public regarding campaign finance law, manipulation, and surveillance, it may be worth enacting such a policy. This prohibition, in combination with Know Your Customer laws, may not completely prevent insider trading, but it would give regulators advantages in monitoring and taking action against the practice that they would not necessarily enjoy on unregulated exchanges.

12, 17 Public Interest

12. Are the proposed contracts contrary to the public interest? Why or why not?
17. What other factors should the Commission consider in determining whether these contracts are "contrary to the public interest?"

In the 2019 ErisX case, Berkovitz stated that the Commission has interpreted the "public interest" test in the CEA gaming provision as a restoration of the "economic purpose" test that was eliminated in the Commodity Futures Modernization Act of 2000 (CFMA), and that the Commission also has concluded it has "discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest."[33]

From Berkovitz's statement, we also understand that the gaming component alone is not necessarily contrary to the public interest, as "contracts involving gaming should be permitted to be traded on a DCM if they have an economic purpose"[34]

We understand the difficulty the Commission may have in selecting additional factors to consider. In his book *Go East, Young Man*, Justice Douglas opined, "I also realized that Congress defaulted when it left it up to an agency to do what the 'public interest' indicated should be done. 'Public interest' is too vague a standard to be left to free-wheeling administrators. They should be more closely confined to specific ends or goals."[35]

More so perhaps, than any other regulatory body, the Commission is well-positioned to undertake a holistic review of what election markets might mean for the public interest. The Commission has received and considered thoughtful public comments on the topic since the early days of the Iowa Electronic Markets and has been at the forefront of managing practical regulatory considerations in these nascent markets.

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[33] Statement of Commissioner Dan M. Berkovitz related to Review of ErisX Certification of NFL Future Contracts
[34] *Ibid*
[35] W. Douglas, *Go East, Young Man*, 216–217 (1974)

Valuable source of insight and aggregation

The proposed contracts serve as a valuable source of insight to the public, even if they do not participate in the contracts market directly. The arguments are described in the response to question 11 on price basing.

Social consensus building mechanism

The Commission should consider the divided nature of American politics today. Individuals and groups with poor prediction records and limited accountability are contributing to a status quo in which millions of Americans operate on different sets of facts, consume "fake news", and live in different bubbles.

Institutions and modalities that Americans have traditionally been trusted to forecast elections such as experts and polls have seen drops in confidence in recent years. We urge the Commission to consider recent research demonstrating that political prediction markets in recent elections have outperformed polls, widely-covered election models based on polling aggregation, and pundit forecasts.[36]

Election contracts can help build social consensus in three ways.

First, the market price can create at least a semblance of a reality that all sides recognize is a byproduct of bettors with a financial "skin in the game" and clear incentives for honest contributions. At their best, the market mechanism aggregates more information than what could fit in the working memory of any one individual. They form a natural waterline which can be taken as a readout of what market participants think about a certain topic.

Second, as discussed in the sections on election integrity, efficient prediction markets help drive consensus because they are more transparent and less likely to be manipulated than public opinion polls. Insights from prediction markets spill over and improve the overall discourse. Third, prediction markets are inherently more engaging than polls and forecasts as they invite active participation from a broad audience. The financial incentives for prediction markets reward knowledge seeking and accurate perceptions rather than partisanship, leading to a more educated population. As pundits choose to trade or not trade on a prediction market they signal to viewers their true degree of conviction.[37]

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[36] H. Crane and D. Vinson. (2022). Models vs. Markets: Forecasting the 2020 U.S. election. Researchers.One, https://researchers.one/articles/20.10.00004

[37] Alex Tabarrok, "A Bet Is a Tax on Bullshit", *Marginal Revolution*, 2 November 2012, https://marginalrevolution.com/marginalrevolution/2012/11/a-bet-is-a-tax-on-bullshit.html

Build forecasting and decision-making infrastructure

The political event contracts proposed by Kalshi benefit the forecasting community by training and identifying forecasters. Forecasters in the Rethink Priorities community participate in and monitor trends in prediction markets to calibrate their long term forecasting skills. Success in prediction markets also creates a demonstrable track record that distinguishes forecasters, making them coveted candidates for recruitment and partnerships.

Forecasting researcher Nuño Sempere described the value of prediction markets as a way to incentivize forecasters. Relative to other platforms, prediction markets provide forecasters with a strong monetary incentive to make good judgments and are much more scalable. For example, a good forecast on a complex topic might take tens to hundreds of hours of research, which may only be enabled by the rewards available in prediction markets. Outside of prediction markets, the average forecaster is comparatively poorly compensated and the current supply of known-to-be-good forecasters is limited. For example, the Good Judgment Project pays $50-100 an hour, and the process of attaining Superforecaster™ status is onerous—an aspiring forecaster must first do a year of free predictions. Assuming high liquidity, efficient prediction markets, forecasters are better paid and are incentivized to provide their insights as a public good.

Finally, because prediction markets serve as a platform and a source of sustained interest for predictions, markets can be created quickly in response to new events, attract forecaster interest, and disseminate insights to the public. An example is pandemic.metaculus.com which drew upon the existing forecasting community at metaculus.com to respond to the need for COVID forecasting.

Academic and research value

Election markets generate unique data that can produce cutting-edge academic research and serve as a pedagogical tool to encourage new methods of education and political engagement. Data made available through PredictIt is a case in point.[38] We encourage the CFTC to establish a regulatory regime that allows, to the maximum extent, academics to use election market data for research purposes. We believe that Kalshi would be more amenable to making its data available than the offshore books that will benefit from a Commission decision to deny Kalshi's contracts.

An example of prediction market and research partnerships is Manifold Markets' partnership with the Center for the Study of Partisanship and Ideology and the Salem Center of the University of Texas at Austin to identify top forecasters on economic, social, and political issues.

As a meta point, we view prediction markets as a new technology with public interest benefits that have yet to be fully realized or even discovered. We believe a bet on prediction markets is a

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[38] Lukas Berg & John Chambers (2019) Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement, Journal of Political Science Education, 15:1, 2-16, DOI: 10.1080/15512169.2018.1446342

bet on the future with considerable upside. Prediction markets have significant potential to blossom into trusted forecasting and consensus building instruments with benefits that are not apparent at their current level of maturity and adoption.

For example, prediction markets may be used directly for decision making. Robin Hanson developed a proposal for governance called futarchy, where prediction markets are used for estimating the net benefit of strategic decisions, then the decision that leads to the highest welfare is chosen.[39] Prediction markets are already used by the rationalist community to make decisions today. An example is the partnership between Manifold Markets and Clearer Thinking Regrants, where forecasters help regrantors decide which projects to fund.[40]

By approving Kalshi's request, the Commission would be advancing its mandate of promoting responsible innovation by giving markets the space to experiment with election contracts as a hedging, price basing, forecasting, social consensus building and decision making instrument.

Injunctions against gaming do not apply to the proposed contracts

We believe the classic ethical, moral and religious injunctions against gaming are relatively inapplicable to the proposed contracts.

A common moral argument against gaming is that gaming is not constructive, is zero sum, and gives dishonest rewards. As discussed above, election markets are constructive, positive sum, and reward honest effort and skill, and on those merits do not meet the moral injunctions against gaming.

Another moral argument is that gambling is predatory and exploits human weakness. With classical gambling, there is an immediacy and instant gratification that leads to addiction. However, the proposed markets diminish the instant gratification component by focusing efforts on long term predictions leading to election day, thereby reducing the potential for addiction.

Political prediction markets in the UK tell an encouraging story on the relation between problem gambling and election markets. Sites such as Smarkets offer election lines and devote resources to marketing them even though they are nowhere near as profitable as contracts in sports and other areas. At the same time, they do not offer products such as casino games. Driven by a combination of reputational risk and company values, they have concluded that they have a long-term interest in contributing to the public interest, aggressively self-regulating to stay within the limits of gaming laws, and deterring problem gamblers from damaging their brands.

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[39] Hanson, Robin. "Shall we vote on values, but bet on beliefs?." Journal of Political Philosophy 21, no. 2 (2013): 151-178.

[40] https://manifold.markets/group/clearer-thinking-regrants

We believe that the economic purpose and broad public interest benefits of the proposed contracts outweigh concerns related to problem gambling. At the same time, we recommend properly structuring prediction markets to reduce potential predatory and exploitative behavior.

First Amendment

Restrictions on political prediction markets may violate the First Amendment. When traders bet on parties and candidates, they are engaging in an expression of political and commercial speech. In a recent podcast episode on "new frontiers in the First Amendment", Nico Perrino, Vice President of the Foundation for Individual Rights and Expression, raises the possibility that because political prediction markets "create information benefits for the public", regulations on these markets would deny Americans access to potentially truthful political information and would therefore violate the First Amendment. Renowned First Amendment scholar at UCLA law school Eugene Volock responded by acknowledging that there were "plausible arguments for protection" of speech in these markets.[41]

If the Commission fails to allow the proposed contracts, it may invite constitutional challenges that could lead the courts to undermine the Commission's jurisdiction over the prediction markets space. A ruling to protect the expression inherent in political prediction markets under the First Amendment—contemplated by legal academics well over a decade ago[42]—would be consistent with the expansion of First Amendment rights by the Supreme Court since the Nadex decision.

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[41] "Eugene Volokh and new frontiers in the First Amendment", So to Speak: The Free Speech Podcast, https://podcasts.apple.com/nz/podcast/eugene-volokh-and-new-frontiers-in-the-first-amendment/id1108027131?i=1000385548198

[42] Cherry, Miriam A. and Rogers, Robert L., Prediction Markets and the First Amendment. University of Illinois Law Review, Vol. 2008, No. 3, 2008, Available at SSRN: https://ssrn.com/abstract=1130644

Postscript - Transparent, effective and fair regulation

Despite prediction markets' theoretical appeal, lack of regulatory clarity has discouraged new entrants in the market. For example, Manifold Markets, created December 2021, elected to be a play money market due to regulatory uncertainty, as discussed in its Seed Round Memo. Insight Prediction, another promising company in the space, has been stymied in its ability to accept American accounts amid regulatory uncertainty.

We hope that the Commission will generalize its response to the proposed Kalshi contracts as an opportunity to establish a clear, transparent, and simple process that other companies can follow. We agree with Commissioner Pham's opinion that the Commission must apply principles of free competition and fair treatment to similar contract markets. We respectfully disagree with Commissioner Pham's implication that each political event contract submission should be evaluated independently, as that undermines the goal of promoting fair treatment to similar contract markets. We respectfully disagree with Commissioner Pham's implication that engaging in 36 meetings over nearly a year should influence the Commission's decision positively towards Kalshi. Instead, we should have consistent regulation across similar political event contracts, regardless of the number of meetings the party may have had with the Commission.

The Commission may find inspiration in the way the UK has approached the regulation of election contracts. Many of the concerns that animate the Commission's deliberations today weighed on British regulators in the mid-20th century in the context of political betting shops. The UK's thriving election markets, which have enriched British public life without threatening the integrity of the country's institutions, speaks to their potential in the United States.

With transparent regulation, enough prediction markets operating freely will increase the efficiency, usability and public awareness of these platforms, which in turn incentivizes the positive social value their insights can provide.