21 June 2024

*VIA Electronic Submission and Email*

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

Re: "Event Contracts" RIN number 3038-AF14.

Dear Mr. Kirkpatrick:

Thank you for providing an opportunity for the public to comment on the Commission's Proposed Rules PR 8907-24. I write to express my opposition to the proposed rules. My reasons are detailed below.

Adoption of the proposed rules would unfairly impact the ability of legal businesses in the gaming industry to hedge unwanted exposure to legitimate business risks by prohibiting event contracts designed with gaming industry risks in mind or the approval of specialized derivatives exchanges offering such contracts. This imposes an unfair burden on firms in the gaming industry.

The Commission justifies the proposed rules based on its interpretation of the Congressional intent behind the inclusion of CEA section 5c(c)(5)(C) from a colloquy between Senators Feinstein and Lincoln reported in the Congressional Record on 15 July 2010. However, the reasoning underlying the statements by Senators Feinstein and Lincoln is flawed. The proposed rules would impose an unrealistic and unnecessary burden on those seeking Commission approval of new event contracts. And, if the proposed rules were imposed retroactively to approved futures contracts, it would likely result in many, if not most, existing futures contracts being delisted. This is unlikely to have been the true intent of Congress.

1. **Proposed Rules Make It Difficult for Legal Businesses to Hedge Legitimate Business Risks**
   Many states have determined that sports betting is in the public interest and have allowed sports betting firms to operate in their states. These firms seek to manage exposure to legitimate business risks. The Commission has resisted requests to approve specialized exchanges or derivative contracts to be offered on existing exchanges for the gaming industry. The proposed rules would make it more difficult for firms in the gaming industry to efficiently manage risk. This is contrary to the public interest.

2. **Liquid Futures Markets Require Both Hedgers and Speculators**
   The colloquy between Senators Lincoln and Feinstein is used to support a broader definition of the *public interest* and an expanded economic purpose test that includes the requirement that the predominant users of a new futures contract must be hedgers. Again, the statement that contracts must be predominantly used by hedgers reveals a fundamental misunderstanding of futures markets by both senators. Market participants want to trade on deep, liquid, markets with tight bid/ask spreads and where price discovery occurs quickly. This requires the participation of both hedgers and speculators. Consider the following real-world example.

The U.S. Treasury market is arguably the largest and most liquid fixed income securities market in the world. Much of the liquidity in the spot market is provided by primary government securities dealers. However, their willingness to do so depends in part on their ability to hedge their risk exposure by transferring unwanted risks to speculators. On Tuesday, October 20, 1987, in the wake of the stock market crash the day before, 30-year U.S. Treasury bonds experienced their largest one-day rally ever. Spot market trading essentially ceased after Treasury futures prices went quickly lock-limit up. No primary government securities dealer would make a market for Treasury securities in the spot market because the futures market was closed, and the primary government securities dealers could not hedge themselves. Normal trading resumed in the Treasury spot market after the futures markets reopened and hedgers could transfer unwanted risks to speculators in the futures markets. Speculators are frequently needed to take the other side of futures contracts when hedgers put on hedges. There is often a dearth of speculators during financial crises and not a dearth of hedgers.

3. **Speculators in Existing Futures Markets May "Profit from Devastating Events"**
The Commission argues that former Senator Blanche Lincoln's statement that CEA section 5c(c)(5)(C) was intended to provide the CFTC with "the power to prevent the creation of futures and swaps markets that would allow citizens to **profit from devastating events** and also prevent gambling through futures markets" (emphasis added). Senator Lincoln's statement reveals a fundamental misunderstanding of how futures markets function. Futures markets rely on both hedgers and speculators to create deep, liquid markets that promote efficient price discovery. Hedging against potential adverse price moves locks in a purchase or selling price. Futures markets rely on both hedgers and speculators to create deep, liquid markets with efficient price discovery. Consider the following examples.

A. A farmer fears that the price of corn may fall before his corn crop is harvested so the farmer sells corn futures contracts today to lock in a selling price. A speculator takes the other side of the position and buys corn futures. If the spot price of corn is lower when the corn is harvested the lower price that the farmer receives for his corn in the spot market is offset by the profit, he has made on his futures market position. Ignoring transaction costs and assuming that the basis is zero at contract expiration, the farmer's gain in the futures market is exactly equal to the speculator's loss. Now suppose that a severe drought hits the corn belt destroying a large amount of the corn crop in the soil. The price of corn rises dramatically. The farmer--unaffected by the drought--sells his corn crop at the substantially higher spot price but his corresponding short futures position experiences significant losses. After considering the gains from selling his corn crop at the sharply higher spot price and the losses from his futures position, the farmer has sold his corn crop at the fixed price that he wanted to, given his earlier fear that corn spot prices might fall sharply by the time his corn crop is harvested. The speculator earns substantial profits from his long position in corn futures as corn prices rose due to a "devastating event" --a drought in the corn belt.

B. A shale oil producer routinely hedges its anticipated output in the futures market by selling crude oil futures contracts to lock in a selling price. A speculator takes the other side of the position and buys crude oil futures contracts. A major energy producing nation suddenly invades another country prompting sanctions on its oil production and crude oil prices skyrocket. The shale oil producer's extra revenue from selling oil in the spot market at sharply higher prices per barrel is offset by losses on his short crude oil futures position. The shale oil producer succeeded in locking in a selling price for crude oil. The speculator's long position in crude oil has benefitted greatly due to a "devastating event" – a surprise foreign war.

C. A steakhouse restaurant chain fears that the price of beef might rise so it locks in a purchase price by buying live cattle futures. A speculator takes the other side of the transaction. Shortly after putting on its hedge a case of mad cow disease is discovered in Canada. Even though

> Canadian cattle aren't deliverable on the US cattle futures contract, the price of live cattle drops sharply. The savings the restaurant chain subsequently has from being able to buy beef at a lower price in the spot market are offset by its losses on its long live cattle futures position. The speculator's short position has benefited greatly due to a "devastating event" –the discovery of mad cow disease in a Canadian cattle herd.

Put differently, the speculators in the above examples were able to "profit from devastating events" something that Senator Lincoln wanted to see the Commission prevent happening while hedgers were able to lock in a buying or selling price. One could easily imagine similar scenarios for most other futures contracts. Should the Commission ban corn futures, crude oil futures, live cattle futures, …, etc. to ensure that speculators never profit from devastating events? One could also easily imagine scenarios where speculators suffer substantial losses from "devastating events" while hedgers are also able to lock in a buying or selling price. Indeed, the gains that hedgers receive in such scenarios come from the losses borne by speculators ignoring transaction costs. Derivatives do not eliminate risk they merely transfer risk between or among parties.

**4. Most Futures Contracts Are "Gaming" Contracts Given that Speculators Dominate Trading**

The colloquy between Senators Lincoln and Feinstein is also used to support an unusual definition of gaming. Senator Feinstein asks Senator Lincoln: "Will CFTC have the power to determine that a contract is a gaming contract if the predominant use of the contract is speculative as opposed to a hedging or economic use?" Senator Lincoln replies: "That is our intent." Again, the colloquy reveals a fundamental misunderstanding about the nature of futures markets by Senators Feinstein and Lincoln. Speculation dominates most trading in futures markets. Rarely is a buy hedge on the other side of a sell hedge and vice versa. Rather, speculators create the deep liquid futures markets that make it easy for hedgers to hedge. Indeed, many existing futures contracts would need to be redefined as "gaming" contracts if the criterion is the amount of speculation versus hedging. It is doubtful that reclassifying virtually all existing futures contracts as gaming contracts because the market is dominated by speculators and other traders without a commercial or hedging interest was the intent of Congress given that the Commission was subsequently reauthorized.

The Commission has wisely rejected the definition of gaming by Senators Feinstein and Lincoln in its proposed "narrow" definition of gaming. However, the Commission should not use Senator Feinstein's and Senator Lincoln's criterion as part of an expanded economic purpose test. Doing so, imposes an unnecessary burden on those proposing new event contracts especially given that many existing futures contracts would be hard-pressed to meet that same standard.

**5. Some Event Contracts on Exempted Commodities Meet the Proposed Gaming Definition**

The Commission cites Senator Lincoln's colloquy with Senator Feinstein to support the notion that Congress intended to prohibit event contracts on sporting events. Senator Lincoln stated: "It would be quite easy to construct an ''event contract'' around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament. These types of contracts would not serve any real commercial purpose. Rather, they would be used solely for gambling." The Commission correctly notes that sporting events themselves are not considered "gaming." Instead, the Commission argues on page 23 that "CEA section 5c(c)(5)(C) – focuses on the overall characteristics of the contract … [and] the question for the Commission in evaluating whether a contract "involves" an Enumerated Activity or prescribed similar activity is whether the contract, considered as a whole, involves one of those activities."

The Commission also argues that commodities listed in CEA section 1a(19)(i) would be excluded from the proposed rules on event contracts. These commodities include, among others: an "index or measure of inflation, or other macroeconomic index or measure." The Commission argues that

these commodities should be excluded because they already "served as underlyings for a range of derivative contracts that were broadly traded on CFTC-registered exchanges at the time of enactment of CEA section 5c(c)(5)(C)."

It is easy to imagine event contracts tied to the release of various U.S. Government macroeconomic reports such as the inflation rate or the jobs (i.e., Employment Situation) report. These reports are closely watched by market participants and often have a significant impact on financial market prices when the outcome from the report differs from the consensus expectation of the outcome. Economists at major financial institutions participate in surveys capturing their beliefs as to what the reports will indicate. Various consensus forecasts are obtained by averaging the forecasts of surveyed economists. Basically, market participants are trying to determine whether the realized outcome (e.g., the monthly inflation rate or nonfarm payrolls—the number of new jobs created in a month) will be greater or less than the consensus forecast of economists. Put differently, market participants are arguably "staking" funds on the outcome of a competition among economists. This seems to meet the Commission's proposed definition of gaming. That is, "the staking or risking by any person of something of value upon: (i) the outcome of a contest of others; (ii) the outcome of a game involving skill or chance; (iii) the performance of one or more competitors in one or more contests or games; or (iv) any other occurrence or non-occurrence in connection with one or more contests or games." If so, how would a potential event contract on a "macroeconomic index or measure" differ from an event contract on a gaming industry variable? If they don't differ it appears that the Commission's proposed definition of gaming would be selectively applied to the detriment of firms in the gaming industry in need of tools to manage their risk exposure.

Finally, Senator Lincoln's assertion that event contracts "around sporting events … would not serve any real commercial purpose …[but] would be used solely for gambling" ignores both the need that firms in the sports betting industry have to manage their exposure to legitimate business risks and the potential benefit that specialized event contracts may offer such firms in managing their risk exposures. Again, nearly forty states have determined that allowing betting on sports events is in the public interest. Sports betting firms are regulated and licensed. They have legitimate business risks. They should be allowed to use tools that would help them manage their exposure to such risks.

Respectfully submitted.

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