Response to CFTC Request for Comment

The Commodity Futures Trading Commission ("CFTC" or "Commission") notice of proposed rulemaking 17 CFR Part 40, RIN 3038-AF14 ("Proposal") seeks sweeping restrictions on event contracts with potentially far-reaching negative implications for the public interest. The core of the Proposal, which aims to categorically disallow any event contract involving or relating to one of the Enumerated Activities (defined as activity unlawful under state or federal law, terrorism, war, assassination, gaming, or similar activities), betrays a fundamental misunderstanding of how event contract markets operate and ignores well established public benefits of these markets.

The Proposal does not stand up to legal, logical, or empirical scrutiny. The Commission's overly broad interpretation of the Commodity Exchange Act (the "Act") and its gerrymandered definition of "gaming" are contrary to both the spirit and the letter of the Act, and are sure to invite intense legal opposition in light of the recent Supreme Court decision in *Loper Bright Enterprises et. al. v. Raimondo.* The Proposal's claim that legalization and regulation of markets on Enumerated Activities blanketly harms the public interest has no sound logical basis, brushing aside markets' clear and substantive public benefits for hedging risk and aggregating information in favor of hypothetical and unsubstantiated claims of the markets' harms. Finally, many of the Commission's claims concerning the potential drawbacks and risks of such markets are directly refuted by a mountain of empirical evidence and data that, in fact, proves the converse of the Commission's claims: event contract markets are a valuable public good for which there is no evidence of significant manipulation or widespread use for any of the nefarious purposes that the Commission alleges.

The Commission's proposed actions are against the public interest. Plainly, event contract markets enable participants to efficiently hedge risks to one-off or non-standard events, such as elections, global events (war, terrorism, pandemic), and other catastrophic outcomes. This internal benefit of facilitating hedging produces the additional external benefit of a well-honed price signal which informs the general public about significant events in the public and national interest. The Commission's Proposal seeks to do away with these benefits, instead advancing a distorted perspective clouded by remote possibilities and unsubstantiated claims about adverse consequences of these markets. The resulting draconian measures in the Proposal would disallow entire categories of event contracts for which there are substantial public and national benefits.

The Commission's Proposal ignores widely publicized and well known data and case studies that demonstrate the clear public and national interest benefits of event contracts, without offering any concrete data or evidence to substantiate the concerns voiced in the Proposal. The available data, as detailed below, shows that many of the event contracts the Commission aims to classify as contrary to the public interest are, in fact, critical to the public and national interest.

The Proposal is an attempt to side step the Commission's mandate under the Commodity Exchange Act. Under the Commodity Exchange Act ("CEA" or "the Act") Section 7a-2(c)(5)(B), the Commission "shall approve a new contract or other instrument unless the Commission finds that the new contract or other instrument would violate this chapter (including regulations)." Section 7a-2(c)(5)(C) provides specific guidance on event contracts, which when combined with 7a-2(c)(5)(B) requires that event contracts be approved unless they (i) involve illegal activity, terrorism, assassination, war, gaming, or similar activity ("Enumerated Topics") and (ii) are

determined to be contrary to the public interest.

The Act does not expressly declare contracts involving one or more of the Enumerated Topics as contrary to the public interest. Rather, the Act tasks the Commission to (i) identify that a contract involves one or more of the Enumerated Activities and, if it is deemed that the contract involves an Enumerated Activity, (ii) to determine whether the contract is contrary to the public interest. The Commission's mandate under the Act is explicitly a two-step process, which the Commission seeks to arbitrarily collapse to a one-step process by virtue of its proposed amendment.

Sections 7a-2(c)(5)(B) and 7a-2(c)(5)(C) together imply that any given event contract shall be regarded as in the public interest unless and until determined otherwise by the Commission, as is clear by the wording of the Act which states that the Commission "shall approve [...] unless the Commission finds that the new contract [...] would violate this chapter".

The Commission's proposal to categorically disqualify all contracts involving one of the Enumerated Activities, therefore, contradicts the Commission's mandate under the Act, which explicitly calls for a two-step evaluation protocol. The Commission states:

> The Commission interprets CEA section 5c(c)(5)(C) to provide that the contract may not be listed or made available for clearing or trading by a registered entity if the Commission finds both that (i) the contract involves an Enumerated Activity or prescribed similar activity, and (ii) the contract is contrary to the public interest. (Proposal, p. 11)

We agree with this interpretation. In particular, the mere categorization of a contract as involving one of the Enumerated Activities does not, on its own, disqualify the contract from being listed for clearing or trading by a CFTC-regulated entity. A contract satisfying criterion (i) must also be determined to be contrary to the public interest (criterion (ii)).

The Commission lacks the authority to simply declare broad categories of contracts as contrary to the public interest. As discussed in detail below, the Commission offers no clear criteria on which to base their public interest judgment, much less a cogent argument establishing that the categories it wishes to disqualify fail to meet the public interest standard. To refute the Commission's overly broad interpretation that contracts involving the Enumerated Activities are "contrary to the public interest", it is enough to provide just a single contract involving those activities that does serve the public interest. Several such examples are given throughout the comment below, and specifically in Sections 1.3.1 and 1.3.2.

For the reasons summarized above and detailed below, the Commission's Proposal itself is a public interest concern. It is an ill-conceived, logically backwards attempt to vest unelected Commissioners with undue power by depriving the people of a necessary and invaluable public good.

To avoid these public interest concerns, the Proposal must be rejected in its entirety. At minimum, the comment period should be extended for at least 90 days. The Commission should use this extended period to further investigate and consider the data presented below and also to solicit more thorough input from those individuals and businesses who will be most affected by the Commission's action.

A detailed explanation of the above position and response to specific questions posed by the Commission are given below.

1 Background and Overview

Before addressing specific questions in the Commission's Proposal, it is worthwhile to establish core background information about event contracts, the markets in which they are traded, the purposes for which they exist, the ways in which they serve the public interest, and potential public interest concerns. We refer back to this section throughout the letter.

1.1 Event contracts

In simple terms, an *event contract* is an agreement that depends on the occurrence or non-occurrence of some event. For this letter, we assume that the contingency in event contracts specifies the circumstances (related to an event) under which one party will be entitled to collect a pre-specified amount of money from another party.[1]

A *simple, binary event contract* concerns a binary outcome (e.g., 'Yes' or 'No') for a well-defined event (e.g., the winner of the 2024 U.S. Presidential election will be from the Democratic Party) and well-defined valuations depending on the outcomes (e.g., the contract is worth $1.00 if 'Yes' and $0.00 if 'No').[2] For simplicity throughout this letter, we discuss only simple, binary event contracts.[3]

Prediction markets. We refer to any platform that enables the buying, selling, or trading of event contracts interchangeably as a *prediction market* or an *event contract market*.[4]

1.2 The underlying asset of event contracts

Event contract markets enable (i) participants to hedge exposure to risks associated with the contingent event and (ii) the general public to aggregate otherwise diffuse or inaccessible information about the contingent event into a single, easily understood probability value (derived from the current market price). In enabling the hedging of risk and aggregation of information, event contract markets thus provide a sense of certainty about an uncertain future event (through reduction in risk and accurate assessment of the likelihood of future events). This sense of certainty often cannot be achieved through a more efficient means other than the event contract market.

[1] Event contracts need not be monetary in nature, but the most relevant cases discussed here involve a contract in which one party is entitled to some payment on the occurrence or non-occurrence of some event.

[2] Note that the specific valuations of $1.00 and $0.00, on Yes and No, respectively, are not fundamental to this definition. Specific event contracts can resolve to any values, without change in the fundamental discussion given here. Our assumption that contracts assume the values of $1.00 or $0.00 do not limit the scope of the discussion. An agreement between parties that instead pays, say, $54.50 on Yes and $0.00 on No can be handled by assuming 54.5 contracts are exchanged between the parties.

[3] Event contracts can be more complex, assuming a range values depending on a continuum of possible outcomes. For example, put and call options are also event contracts. Everything discussed here applies generally to event contracts, but such generality is not needed for this discussion.

[4] Event contracts can be traded on exchanges, offered over-the-counter by a swap dealer, or made available for wagering by a casino, sports book, or similar operator. The mechanism by which event contracts are traded is not a point of focus in this report. We refer to them generically as event contract markets or prediction markets.

1.3 Serving the Public Interest: Hedging Risk and Aggregating Information

Event contracts serve the public interest in a few ways. Such contracts can be used to hedge exposure to uncertain future outcomes, inform individual and organizational decisions and shape policy on complex questions, and aggregate information from diverse and disparate sources in a wide range of corporate, regulatory, and societal applications. In this report, we focus on two primary and complementary ways that the vast majority of event contracts can and do serve the public interest: (i) by offering a vehicle to hedge risk and (ii) by aggregating diffuse information through an accurate price signal. In Section 1.4, we discuss how event contract markets simultaneously achieve both of these objectives in a mutually beneficial way.

1.3.1 Hedging Case Studies

Event contracts provide a straightforward way for individuals and businesses to hedge non-standard, isolated, and specific risks that cannot be mitigated by other means. Without an alternative outlet to hedge such risks, individuals and businesses are forced to accept an unwanted risk profile or otherwise modify behaviors to avoid these risks. Either way, these risks are ultimately passed along to the rest of society and the general public.

Case study 1: *Hedging election risk*

The 2017 Tax Cuts and Jobs Act (TCJA) enacted a number of tax benefits for small businesses. One such benefit is the Qualified Business Income (QBI) deduction, which is set to expire in 2025. The scheduled expiration date can change, however, depending on the outcome of the 2024 election. Expiration of the QBI deduction could reduce net profit of a small business by as much as approximately 8% annually.[5] Businesses eligible for the QBI deduction could realize an extended increase in net income should the deduction be extended beyond 2025. Such an outcome could have long-term implications for the sustainability and growth of the business, as the increased income could be used to invest in new technology, better training for employees, new facilities, and improved processes. Uncertainty in the outcome of the 2024 election, however, puts any small business owner currently relying on this deduction in limbo, unable to plan appropriately for the future.

Suppose a business owner believes that there is a high (greater than 95% probability) that the QBI deduction will be extended beyond 2025 upon election of a Republican president in 2024. The possibility that a Democratic president is elected therefore exposes the business owner to risk. Without an event contract market involving the related events, i.e., whether the QBI deduction will be extended or the related electoral events, the business owner cannot manage its risk, and is at the mercy of the election outcome. Event contracts related to the 2024 election would, however, enable the owner to manage risk by purchasing contracts that are worth $1.00 if the Republican party does not win the presidency. By purchasing, such contracts, the owner is able to lock in some of the benefit of the potential QBI deduction extension, ensuring economic stability regardless of the outcome.

This example is one of many ways that event contract markets enable businesses and individuals to hedge against the risks of one-off future events. For example, the owner of a different business

[5] The QBI deduction allows for a company to deduct a maximum of 20% of net income. A pass-through entity in the top marginal 37% bracket therefore, realizes an overall saving of approximately $20\% \times 37\% \approx 7.4\%$.

than the one above, whose company is involved in green energy, may not be concerned with the QBI deduction but rather the potential repeal of favorable acts of legislation if a Republican president were to win the 2024 presidential election. The risks facing this business are, therefore, complementary to the risks of the first. The existence of a regulated prediction market that offers event contracts on the U.S. presidential election provides a valuable service in allowing these parties to trade risks in a mutually beneficial way.

Case study 2: *Hedging marketing risk*

Jim McIngvale, also known as Mattress Mack, is the founder and owner of Gallery Furniture, a retail furniture chain known for its idiosyncratic marketing promotions. With his company based in Houston, McIngvale often runs promotions whose value depends on whether or not a certain Houston-based sports team will win the championship. During the spring and summer of 2022, Gallery Furniture offered customers who bought furniture before October the opportunity for a full refund up to $3,000 if the Houston Astros were to win the 2022 World Series. In all, the promotion exposed Gallery Furniture to an estimated $50 million in potential refunds if the Astros were to win.

Anticipating the company's exposure, McIngvale placed a $10 million bet on the Astros to win the World Series at 7.5-to-1 early in the 2022 MLB baseball season. Ultimately, the Astros did win the World Series, forcing McIngvale to refund his customers, but also making McIngvale's $10 million bet a $75 million winner.

Prior to legalization of sports betting, it would be impossible for Gallery Furniture to execute the above marketing strategy and similarly impossible for regulators to foresee that sports betting markets could be leveraged for the above economic purpose. It is worth noting that both Gallery Furniture and its customers benefit from the above promotion: Gallery Furniture is able to offer customers a lucrative and community-building discount without having to take imprudent business risk. This case study, therefore, demonstrates both the clear hedging value in event contract markets involving sports and the folly in regulators speculating on how such markets would or could be used once activated. The Gallery Furniture case study indicates that many more businesses and organizations likely would use sports prediction markets for hedging non-standard risks if such markets were made available to them.

Case study #3: *Hedging Covid risk*

In 2021, Kalshi initiated a market on the question "Will indoor dining be closed in New York City?" The market served as an important hedging vehicle for New York City restaurants, whose business would suffer from prolonged closing of indoor dining. It also served as an indirect way for businesses and organizations to hedge against risks that were correlated to the closure of indoor dining, such as airline usage, school closures, and most other in-person activities.

The public interest benefits for hedging risk and aggregating information about an uncertain future should be clear. But it is unclear whether such a market would be approved for trading under the Commission's new proposal, which takes an overly broad view its authority relating to Enumerated Activities under Section 7a-2(c)(5)(C) of the Act.

Case study #4: *Hedging geopolitical risk*

An airline requires fuel to fly its planes. To operate successfully, the airline often begins scheduling flights months in advance. In selling a ticket for a flight three months in the future, the airline is exposed to potential changes in the price of fuel. The airline can hedge this exposure by trading

in the appropriate commodities and futures markets that are regulated by the CFTC.

As the airline industry provides an important public service, the continual and smooth operation of airline companies is in the public interest. But airlines face many more risks than the future price of fuel. In refusing the authorize event contract markets that would allow airlines to hedge those risks, the CFTC forces many airlines to take excess risks. These risks, in turn, are passed along to the general public.

For example, consider an airline for which 100% of business involves flights to and from the United States and China, Russia, eastern Europe, and the Middle East. By focusing exclusively on international flights to these regions, the airline realizes a competitive advantage which allows it to offer higher quality and lower cost service to customers who travel to those regions. The ability of such a company to operate is therefore in the public interest. But the company's ability to provide this service is limited by the company's ability to manage the host of risks associated with operating between the United States and these specific countries.

Such a business is constantly exposed to the risks posed by the political situation and diplomatic relationships of the countries it operates within and between. Myriad events can and do impact the airline's ability to operate including changes in tax rates, whether the United States government will continue to grant Chinese nationals visas to visit, study, or work in the United States, whether the Chinese government will continue to allow U.S.-based airlines to operate within its country, civil and political unrest in the Middle East, territorial disputes between Russia and neighboring countries, and the unexpected outbreak of a global pandemic.

The above risks are not hypothetical or of remote likelihood. During the past decade, every one of the above events has occurred. As this example shows, risk exposure is not limited to the cost of physical goods or other well known financial indicators, such as fuel and interest rates. Events involving political elections, international relations, and similar such occurrences all pose risk to companies, individuals, and the public as a whole. Event contract markets on the relevant events provide a straightforward vehicle to hedge and better manage these risks, to the benefit not only of the parties of the event contract but also the general public, which benefits from the smooth and stable operation of the economic sectors otherwise impacted by such risks. Thus, although the hedging use case of any given event contract market may be tailored and specific to a small number of participants, the impact of that one participant's ability to hedge has far reaching public benefits.

Though illustrated in the context of the airline industry, the circumstances of this case study apply to almost every industry and business sector in the broader economy. All industries are exposed to specific risks that are neither widely publicized nor well understood outside of the industry. Due to the interconnectivity of the economy, these risks impact the entire economy. As these risks could easily be mitigated through individual or a basket of event contracts, there is a clear public benefit to broad availability of event contract offerings.

1.3.2 Event contracts for aggregating information

Built-in financial incentives make event contract markets efficient and reliable for aggregating information about unknown outcomes. The price signal in markets can therefore serve as a valuable source of information in idiosyncratic situations, for which reliable information is unavailable, and in well documented situations, for which the market provides an independent, objective signal against

which to validate other sources. The existence of such an independent outlet is especially important as the public is increasingly inundated by propaganda, misinformation, and obfuscation via social media and other official communications channels.

Event contract prices in a properly functioning market correspond to an estimated probability that the underlying event will occur before the expiration of the contract.[6] For example, ignoring the impact of fees and commissions, a contract trading at $0.34 corresponds directly to the estimated 34% probability that the underlying event will occur before expiration (i.e., the contract will resolve to $1.00).

Case Study #1: *PredictIt price signal for 2018 and 2020 elections*

Since 2014, PredictIt has offered markets on the U.S. Presidential, Congressional, and Gubernatorial elections. PredictIt operates under No Action Letter (NAL) relief from the CFTC. The terms of the NAL restrict PredictIt markets in terms of number of participants (at most 5,000 per contract), volume (at most $850 per market, per participant), and demographics (U.S. based persons only). Despite these limitations, research from the 2018 and 2020 election cycles (Crane, 2018; Crane and Vinson, 2023) suggests that the PredictIt price signal is a more reliable predictor of election outcomes than state-of-the-art polling methods and poll aggregators, such as FiveThirtyEight.

Such a reliable source of information on electoral outcomes is valuable to businesses and citizens alike. For citizens, the availability of an accurate, objective assessment of elections is helpful to reduce national tensions and cut through bias in media reporting on such matters.

Prediction markets are most valuable for aggregating information about events for which information is diffuse, conflicting, or non-existent. Such markets are especially valuable for informing the public about consequential events of public and national interest, such as elections, national security, and public health. By the sensitive nature of these events, reporting can be compromised by national biases, misinformation, or simply an incomplete understanding of the complex factors involved (as in the early days of Covid-19). The price signal produced by a corresponding event contract market strips away these compromising factors.

Case Study #2: *Real-time information aggregation*

An often-overlooked aspect of event contract markets is their ability to aggregate and incorporate information in real-time, as events transpire. A recent example of this feature was on display in the PredictIt markets for the 2024 U.S. presidential election.

Figure 1 shows a 30-day price history which includes May 30, 2024, the day on which Donald Trump was found guilty on 34 felony counts. Whereas daily volume in this particular market is mostly steady, the market data shows a noticeable spike on the day of the verdict, which carried over to the following day. The price history also shows a temporary blip in the prices of contracts on Trump and Biden: the prices converged briefly upon announcement of the verdict, but separated again and have mostly remained near their pre-verdict values in the weeks since.

So, in addition to showing how markets react to news in real time, this particular market provides a clear and objective assessment of the verdict's impact on Trump's chance of winning the election: the market's quick return to pre-verdict prices suggests that the verdict had a negligible impact on the electoral outcome. Without the clarity offered by this market, the public would be resigned to

[6]Due to commissions, fees, and other transaction costs, there may be a slight difference between the price and the corresponding probability, but we ignore these technical details now.

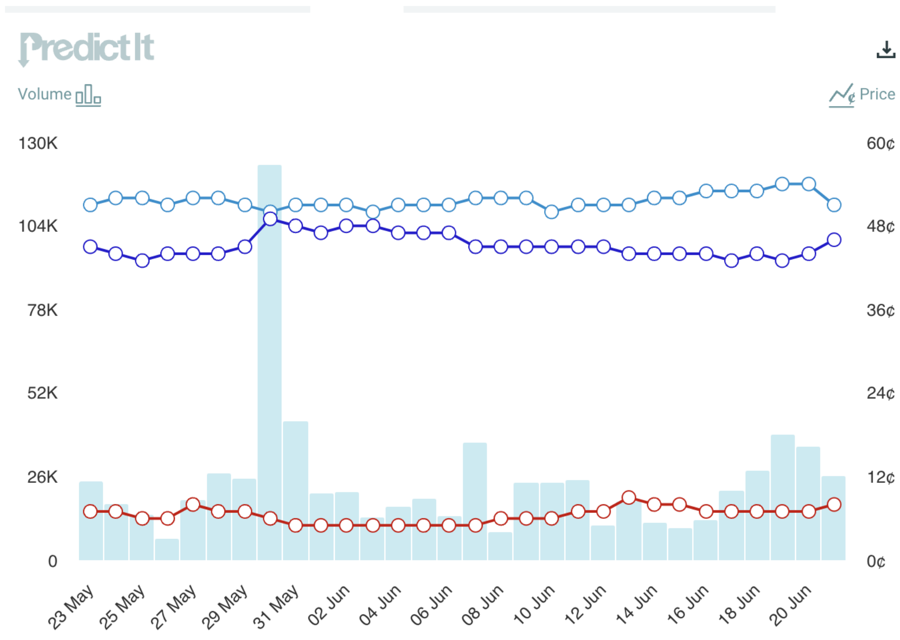

Figure 1: 30-day price history for 2024 U.S. Presidential Winner market at PredictIt.org. Price history shows spike in volume on May 30, 2024, the day on which Donald Trump was found guilty on 34 felony counts. Source: PredictIt

the debate by divergent and spirited opinions on both sides of this question.

Case Study #3: *Conditional markets*

Yet another recent illustration of the importance of election prediction markets occurred after the Presidential debate held on June 27, 2024 between Donald Trump and Joe Biden. Joe Biden's poor performance caused many pundits and political operatives to suggest that Biden might be replaced as the Democratic nominee.[7] During the debate, the few active prediction markets offering contracts on the election, such as PredictIt and Betfair, showed dramatic price changes in favor of Donald Trump. The markets for Democratic party nominee even showed dramatic real-time moves against Joe Biden. Greater public awareness of these markets would lead to higher civic engagement by the general public and less confusion and chaos surrounding the state of our politics.

Given the importance of the presidential election, and the unprecedented possibility of replacing a major party candidate less than six months before the election, the general public would greatly benefit from well-functioning prediction markets offering (i) simple contracts on the major party nominees and (ii) conditional contracts on the general election winner given the different possibilities.[8]

[7] This consensus reflects opinions on almost every major news outlet. For example, https://abcnews.go.com/Politics/bidens-shaky-debate-panics-democrats-republicans-celebrate-trump/story?id=111503732

[8] Unlike simple event contracts, which are determined by the occurrence or non-occurrence of a single event, a

Given the serious discussions that Joe Biden may be replaced by Gavin Newsom or another candidate, and the lack of polling available to assess the popularity of those candidates, a conditional market would be an efficient way to inform the public discourse concerning this possibility. For example, a market with conditional event 'Newsom is the Democratic nominee' and 'Democrat party to win presidential election' would generate a price signal which would inform the general public about the likelihood of various contingent possibilities beyond its control.

Such markets are relevant to all Americans, whether they support the Democratic party candidate or not. Those who support the Democratic party benefit from knowing which candidate gives them the best chance of winning. Such information, on its own, is especially relevant when faced with the decision to potentially replace the candidate. For those who do not support the Democratic party, knowledge of which potential opponent is most formidable is also relevant to choice of their own candidate as well as to better understand the political landscape that is likely to impact the country for many years to come.

Beyond the obvious informational value of such markets, which cannot be replicated by any other means, conditional markets offer a powerful, and currently impossible, way to hedge many risks that may arise under specific contingencies. The risk of war, recession, or certain regulatory policies may be higher if one candidate wins than another. Conditional markets allow individuals and businesses to hedge against those risks contingent on specific future events.

Case Study #4: *Covid-19 early warning signs*

In early 2020, the U.S. government's official public announcements on Covid-19 was that the threat to the public "was low". This official position remained, with news coverage by and large downplaying the threat of Covid in the United States, until March 2020, at which point the previously low threat turned into a threat so dire that it led to mass lockdowns and numerous drastic measures to control the spread of Covid.[9]

In addition to raising questions about the competence and honesty of the government in its response, the delayed response likely contributed to tens or hundreds of thousands deaths that could have been avoided by an earlier response. Event contract markets are especially equipped for assessing the likelihood and potential consequences of such a seemingly unpredictable and uncontrollable event.

On February 27, 2020, PredictIt launched a market on the event "Will WHO declare COVID-19 to be a 'pandemic' before Mar. 6?" According to conversations with PredictIt, someone from the Commission expressed disapproval about the market.[10] The market resolved on March 6, 2020, and PredictIt did not subsequently offer any further Covid-19 markets, even as widespread confusion persisted for the months and years to follow. At least some of the damage, and many of these deaths, may have been avoided if the Commission had not intervened to prevent PredictIt from offering a market on the Covid-19 pandemic in early March 2020.

At a time when the government and media were either ignoring or downplaying the threat to

conditional event contract depends on two events, called the *conditional event* and the *key event*. The event contract is null and void, resulting in a net-zero transfer among all involved parties, unless the conditional event occurs. Upon the occurrence of the conditional event, the contract behaves like a simple event contract based on the occurrence or non-occurrence of the key event.

[9] https://www.scientificamerican.com/article/how-the-u-s-pandemic-response-went-wrong-and-what-went-right-during-a-year-of-covid/

[10] The Covid market is also referenced by the CFTC in its action to withdraw the PredictIt No-Action Letter, available at https://az620379.vo.msecnd.net/static/files/docs/09db8efd-1031-404a-bd0d-e431236f3313.pdf

Americans as low or non-existent, the market price signal of the above and similar markets would have been invaluable in either corroborating or refuting these official claims in real time. By simply operating such a market, hundreds of thousands if not millions of lives could have been saved. Instead, the Commission, for unknown reasons, chose to deprive the public of such a powerful and informative mechanism, to the public's great detriment.

1.3.3 The value of event contract markets

The above case studies demonstrate the clear value of event contract markets for hedging risk and aggregating information, and the grave danger in vesting the decision to deprive the public of this powerful resource in the hands of five unelected Commissioners. In preventing such markets from being offered, the Commission is depriving the general public of a valuable and important tool that could provide economic stability and would better inform the public on important matters in the national interest.

1.4 Market Dynamics: Incentives, Value, and Information

Market participants respond to incentives: every trade reflects both a buyer's and a seller's response to complementary incentives, the buyer's incentive to buy and the seller's incentive to sell at a given price. In responding to their incentives, traders seek to extract value from the market. In exchange for the value they extract, traders contribute either liquidity by injecting capital and driving volume or information by helping to bring the market price into closer alignment with the underlying event's true probability of occurrence. The different motivations of market participants create a robust dynamic that enables markets to serve the public interest for hedging risk and aggregating information.

Whether a prediction market adequately serves the above hedging and information aggregation purposes, and thus advances the public interest, is largely driven by who its participants are. Attempts to restrict or regulate market participation in favor of certain participants or specific participant motivations distorts market dynamics and undermines the market's ability to serve its purpose.

Event contract participants fall into three general categories: hedgers, profiteers, and gamblers. *Hedgers* buy and sell contracts for the purpose of managing exposure to risk on future contingent events. *Profiteers* buy and sell contracts seeking financial gain, by using superior information and pricing methods. *Gamblers* buy and sell contracts for recreation or speculation.

Although the participation of so-called profiteers and gamblers may be initially viewed as contrary to the stated purpose of these markets, the involvement of participants from all three categories is necessary to the healthy function of any market. Wherever a market exists, there will be participants motivated by profit and those who only want to gamble. This is true of all currently regulated and operating stock, commodities, and futures markets in the United States and abroad. It is both foolish and counterproductive to seek to limit participation of such individuals or to disallow entire markets because of the possibility that such individuals will participate. As we now discuss, markets can only serve the public interest if participants from all three categories are able to trade.

Hedging risk and aggregating information are two primary purposes of event contracts with clear and far reaching public benefits. Achieving either purpose requires a healthy demographic

split among the three participant categories above. A party wishing to hedge risk must find a counterparty willing to take on the risk being hedged. The example in Section 1.3.1 describes two companies whose risks cancel out, enabling them to trade risks on the outcome of the presidential election in a mutually beneficial fashion. In general, however, one cannot expect that the risks of participants will align so perfectly that every dollar seeking to be hedged on one side can be matched with a dollar seeking to hedge the other side. There is often an imbalance among those seeking to hedge. Gamblers help to resolve this imbalance, as their desire to speculate leads to the injection of the additional liquidity needed for the market to service those looking to hedge risk.

But Gamblers and Hedgers alone cannot serve the market's information aggregation purpose. Profiteers are sophisticated operators who often have access to better information and more reliable pricing methods than their non-profit seeking counterparts. Their deep understanding of the market and precise approach to trading allows them to trade profitably by identifying price discrepancies. For example, an event that has a 30% probability of occurring but for which a contract is selling at \$0.20 offers the savvy trader an expected profit of \$0.10 for every \$0.20 invested, for an expected 50% return on investment.[11] In exchange for the opportunity to profit, these informed participants tend to contribute to a more stable, accurate market signal. More accurate pricing, in turn, has the positive internality of providing additional liquidity to the market and fairer pricing to those seeking to hedge risk and the positive externality of informing the general public (many of whom do not directly participate in the market, and therefore enjoy this benefit at no cost).

Understanding the interplay among the above three categories of market participants is essential when assessing whether and how a proposed event contract market will achieve its stated purpose.

2 Response to Commission Proposal and Questions

We now address specific questions from the Proposal.

1. *The Commission further requests comment on the examples provided of event contracts that the Commission believes would generally fall outside of the scope of CEA section 5c(c)(5)(C) and § 40.11. In particular, the Commission requests comment on the following questions:*

   - *Are there additional types of event contracts that should be explicitly identified by the Commission in the non-exclusive list of contract types that would generally fall outside the scope of CEA section 5c(c)(5)(C) and § 40.11?*
   - *What indices or measures are "other macroeconomic index[es] or measure[s]" for purposes of contracts that "exist predominantly to enable gambling."1CEA section 1a(19)(i)? Are tax rates (e.g., corporate and capital gains tax rates) among such macroeconomic measures?*

Any index or measure that is correlated with a pre-established macroeconomic index or measure should be regarded as "other macroeconomic index(es) or measures(s)" for the purpose of CEA section 1a(19)(i). This includes corporate tax rates, which have been shown to be correlated with GDP growth in a recent study by Peterson, et al (2022).

[11]Typically, a trader will build in a margin of safety of at least a few percent, so the price will not reach exactly \$0.30 based on a single trader's activity, but will be driven upward from \$0.20 closer to the \$0.30 fair value.

2. *The Commission requests comment on all aspects of its proposed definition of the term "gaming."*

In its proposed definition of "gaming", the Commission appears to bend over backwards to ensure that the definition explicitly includes certain types of events, such as sporting events, elections, and award shows, while omitting or leaving ambiguous a number of other events that should obviously also fall under "gaming" by any common sense interpretation of the term. For example, the proposed definition excludes events, such as climate-related or other natural occurrences, on which staking something of value would logically constitute gaming by its vernacular meaning (i.e., as synonymous with gambling). At the same time, the proposed definition singles out other events, such as contests of others (e.g., sporting events and political elections), which are categorically indistinguishable to the aforementioned omitted events. From the perspective of a party uninvolved in a contest, game, or performance, to stake something of value on such a contest, game, or performance is akin to staking something of value on a natural event. As both categories of events are beyond the control of the parties of the contract, there is no logical basis on which the two would be treated as different with respect to the Commission's definition of gaming.[12]

Climate-related event contracts involve gaming, or don't involve gaming, just as much as contracts on elections or sporting contests. From the Commission's perspective, therefore, either both should be considered gaming, or both should not. Perhaps the Commission has purposely contorted its definition of gaming to exclude climate-related events because such contracts have gained the Commission's blessing for their obvious use in hedging weather-related contingencies in agriculture and farming. But there are tangible circumstances, some of which have been highlighted in Section 1.3, in which markets on all of these events, climate, sports, and elections, are useful for hedging risk and for informing the public about events in the public interest. Regardless, such observations about hedging are irrelevant to whether or not such an activity involves gaming. And herein lies the fundamental flaw of the Commission's proposed definition.

An event contract that involves "gaming" can, nevertheless, be useful for hedging. The determination of whether a market is useful for hedging risk is unrelated to whether or not the market involves "gaming". And by the same token, whether an activity involves "gaming" has nothing to do with whether a related event contract can serve as a vehicle for hedging. The Commission's definition, therefore, must be reworked to accurately reflect the common sense meaning of the term "gaming", without respect to whatever ulterior motives the Commission may have in attempting to frame the narrative about specific types of contracts.

A further problem with the Commission's approach throughout the Proposal, including its handling of "gaming", is in confounding event contracts involving Enumerated Activities with event contracts that are contrary to the public interest. The relevant sections of the CEA make clear that event contracts involving Enumerated Activities and those that are contrary to the public interest are not one and the same. The Act merely states that the Commission can only disallow event

[12]It is further worth highlighting that eligible event contracts (so-called "excluded commodities") are tacitly required by the CEA to involve events "beyond the control of the parties to the relevant contract, agreement, or transaction" (Section 1a(19)(iv) of CEA). Therefore, the singling out of "contests of others" in the Commission's definition of "gaming" is redundant to the eligible class of contracts under Section 1a(19)(iv). By this provision, it is implied that any event contract for which one of the parties is involved in a sporting event underlying the contract cannot be approved. On the other hand, a contract involving the same event but between two parties who are uninvolved in that event can and should be approved, per Section 7a-2(c)(5)(B), regardless of whether the contract is determined to involve gaming.

contracts involving Enumerated Activities, provided such a contract is also contrary to the public interest.

Gaming, in itself, is not automatically against the public interest, as is clear by the wording of the Act, the fundamentals of market function reviewed in Section 1.4, and the mounting data of voters and lawmakers across the supermajority of states in which sports betting has been approved in recent years.[13] The Commission's proposed definition of "gaming", which purposely aims to include events that it seeks to disapprove and exclude events that it wishes to approve, further highlights the Commission's own misunderstanding and misapplication of the Act.

Plainly, an activity can involve "gaming", or any other Enumerated Activity for that matter, and yet still be in the public interest. If this were not the case, then the legality of every event contract market would be in jeopardy, as all event contract markets involve gaming or are similar to gaming to some degree, and such activity is necessary for healthy market function (see Section 1.4).

There is no evidence of manipulation or other nefarious uses of election event contract markets. The Commission raises a number of specific concerns about the offering of event contracts on election outcomes. Specifically, the Commission asserts that such contracts

> "raise concerns that conduct designed to artificially affect the electoral process could be used to manipulate the markets in such contracts, or conversely, that the markets in such contracts could be manipulated to influence elections or electoral perceptions." (Proposal, p. 54)

This claim is a red herring, not supported by data from active markets involving election betting over a period of decades. The Commission voices valid concerns about influence in the above quote, but the concern is misplaced. To the contrary, election markets are the antidote to manipulative practices undertaken by political parties to unduly influence the electorate via the media and other means. The fallout of the first presidential debate between Trump and Biden on June 27, 2024 underscores the point. While political operatives within the Democratic party leveraged the media to control the narrative, the election markets on PredictIt, Betfair, Polymarket, and other outlets gave the public an insight into what was actually happening, and what it meant for the upcoming election. It is the lack of election markets, rather than their existence, that enables widespread manipulation and undue influence of the electorate.

In addition to Iowa Electronic Markets (IEM) and PredictIt, both of which have operated under CFTC No-Action Relief, election betting is offered by a number of entities, some of whom operate unregulated or outside the United States.[14] Therefore, although the Commission has tried to limit public access to political event contracts within its jurisdiction, such markets have existed and will continue to thrive into the future, despite the Commission's attempts to prevent them.

Notwithstanding any legal or regulatory issues, these markets serve a useful purpose for evaluating the Commission's concerns over election markets. Whatever alleged opportunities such markets would offer to "influence elections or electoral perceptions" would have surely been realized through the robust offering of betting markets that are at once accessible to U.S. persons but which operate

[13] https://www.forbes.com/betting/legal/states-where-sports-betting-is-legal/

[14] A non-exhaustive list includes InTrade, Smarkets, Betfair, and Polymarket.

outside the Commission's regulatory jurisdiction. Betfair's election markets for the 2024 election offer a timely illustration.

Betfair political markets for 2024 elections

As of June 12, 2024, Betfair, a betting exchange based out of Australia, offers markets on a variety of political outcomes in Australia, Ireland, United States, and United Kingdom. The largest such markets concern the 2024 U.S. Presidential Election. So far, the total volumes of matched bets on these various markets are:

- Winner of the 2024 U.S. Presidential Election: $36,890,277
- Popular vote winner: $985,664
- Party of the popular vote winner: $518,018
- Democratic nominee: $19,007,886
- Republican nominee: $13,086,382
- Republican vice president nominee: $1,463,378

Much more volume will be traded between now and November 2024 when the election takes place.

If the Commission's concerns are valid, the robustness of these markets, which will have matched hundreds of millions of dollars in trading by the time of the election in November, should offer ample incentive for manipulation or other adverse action referenced by the Commission in its Proposal. The fact that no such adverse events have been observed over several years of offering these same markets indicates that the threat of such an adverse event is negligible and does not outweigh the many more significant public benefits of such markets. The Commission's claimed reasons for opposing these markets are not supported by the empirical evidence.

"Gaming" is not categorically contrary to the public interest. Before addressing the questions below, it is important to reiterate several key points from Section 1. The premise of the Commission's proposal is flawed. Per the wording of the CEA, "gaming" is not categorically contrary to the public interest. Therefore, when we respond to the Commission's questions below regarding other contracts that constitute "gaming" but which fall outside the proposed definition of the term, we are by no means suggesting that such event contracts should be considered as contrary to the public interest nor are we endorsing the Commission's proposed definition. To the contrary, in recognizing the many event contracts that should rightly fall under the heading of "gaming", we call attention to the flaws in the Commission's Frankenstein of a definition of "gaming" and its position that such contracts ought to be regarded by default as contrary to the public interest.

> *In particular, the Commission requests comment on the following questions:*
>
> - *Are there examples of activities that would constitute "gaming" that may fall outside of the proposed definition?*

For this section we assume the common sense definition of "gaming": *to stake something of value on a contingent outcome.* By this definition, event contracts related to the climate or weather

would most certainly involve gaming, but do not fall within the scope of the proposed definition as climate-related events are natural events that do not result from a contest, game, or performance. Therefore, event contracts involving the number of hurricanes, the amount of annual rainfall in a specific location, whether a magnitude 5.0 earthquake will be detected in a specific location, damage caused by wildfires, annual snowfall, and similar such events are intuitively "gaming" but fall outside the scope of the proposed definition of gaming.

Similarly, event contracts relating to prices, indices, interest rates, or other macroeconomic metrics and indicators also involve gaming, but are not within the scope of the proposed definition. Regarding this latter case, we note that such prices, indices, etc. are specifically carved out for approval in the CEA. This does not, however, preclude them from involving gaming. The CEA makes clear that gaming is not inherently contrary to the public interest, and therefore some (in fact many or most) event contracts may involve gaming to some degree and yet still serve the public interest.

Other activities that constitute gaming but fall outside of the proposed definition are legislative outcomes, such as whether a particular bill will pass the House or Senate or whether a bill will be vetoed by the president, and judicial decisions, such as whether a specific justice will be in the majority of a specific Supreme Court decision or how a court will rule in a specific case. Unless the Commission strains its definition even further to regard the passing of legislation or a judicial ruling as the result of a "contest" — they are proceedings, not contests — such events would be excluded from the definition. And yet, to stake something of value on these would constitute gaming under any reasonable interpretation of the term.

To be clear, the offering of such contracts is in the public interest, just as the offering of contracts on elections, sports, and other contests is in the public interest. The omission of such events from the Commission's proposed definition of "gaming" underscores a deficiency of the Commission's proposed definition, rather than call into question the validity of markets involving such events.

- *Are there other types of votes or elections that the Commission should specifically identify, for clarity, in the illustrative examples in proposed § 40.11(b)(2)? What types of other votes or elections should be identified, and why?*

No. In fact, the illustrative examples specified in proposed § 40.11(b)(2) should be removed as they unjustifiably disregard specific event contracts as contrary to the public interest.

- *Should the availability at gaming venues of bets or wagers on a particular contingency, occurrence, or event be a relevant factor in the Commission's consideration of whether an event contract involving that contingency, occurrence, or event involves "gaming" for purposes of § 40.11?*

No. The availability of wagers at gaming venues is irrelevant to the Commission's consideration, as the Commission's decision is governed by the CEA and the availability of wagers at specific venues is governed by other laws and regulations which may be incongruent with the Act in various ways. However, the availability of such wagers at gaming venues should be considered relevant for determining whether contracts on such events are in the public interest. Widespread opportunities to wager on such outcomes is strong evidence that the public and the legislatures in those jurisdictions have determined that such offerings are in the public interest. In taking action contrary to the

supermajority of state legislatures, the Commission is asserting that five unelected Commissioners are better equipped to assess the public interest than the public and its elected leaders.

The existence of such venues offering bets or wagers on events that involve Enumerated Activities also provides a straightforward and objective way to evaluate Commission claims that event contracts on such activities are contrary to the public interest. As such venues offering wagers and bets on such events are widespread, e.g., state-regulated sports betting, offshore regulated betting through Betfair and similar operators, the lack of incidents involving any of the Commission's perceived concerns about manipulation, influence, or negative consequences undercuts the Commission's claims that such contracts pose a threat to the public interest.

- *If, on judicial review, it is determined that staking something of value on the outcome of a political contest does not involve "gaming," the Commission may consider whether that activity is "similar to" gaming. Is staking something of value on the outcome of a political contest similar to gaming?*

This question is ill-posed and cannot be appropriately addressed until such a judicial review were to take place, as the reasoning underlying the decision to exclude political contests from "gaming" would likely be material to the determination of whether such a contest is "similar to" gaming.

However, it is worth posing the obvious question. If the Commission could disqualify political event contracts on grounds of being "similar to gaming", then what event contract could survive the ever-widening scope of the Commission's definition of "gaming" and its all-encompassing criterion for determining when a contract is contrary to the public interest? Broadly defined, all event contracts involve the risking of something of value (usually money) on the occurrence or non-occurrence of some future event. As such events may not be a contest, game, or performance, there are many contracts that technically do not fall within the Commission's proposed definition of "gaming". But if "similar to gaming" is taken to mean "risking something of value on a contingent outcome", then all event contracts must be considered as similar to gaming, including the various legacy commodities and futures contracts that are currently approved and traded by CFTC-regulated entities. The end result is regulation run amok: a framework in which the public interest is at the whim of a fickle regulatory body.

3. *The Commission may also consider whether it should enumerate contracts involving political contests or some subset thereof as contracts involving a "similar activity" to any one or more of "war," "terrorism," "assassination," or "activity that is unlawful under any Federal or State law" under CEA section 5c(c)(5)(C)(i)(VI) and determine that contracts involving this newly enumerated activity of political contests are contrary to the public interest. Are contracts involving political contests contracts involving a similar activity to any one or more of "war," "terrorism," "assassination," or "activity that is unlawful under any Federal or State law"? If so, should the Commission determine such contracts are contrary to the public interest?*

This question once again highlights the problem with the Commission's proposal to classify all contracts involving an Enumerated Activity as contrary to the public interest by default. Contracts involving political contracts do not, in general, involve "war", "terrorism", "assassination", or "activity that is unlawful under any Federal or State law". But any given political contract very

well may involve such activities. Even so, the involvement of "war", "terrorism", "assassination", or "activity that is unlawful under any Federal or State law" in a political event contract does not, on its own, justify a determination that such a contract is contrary to the public interest.

Under specific circumstances, the outcome of a presidential or congressional election may well have implications for the declaration of war or the likelihood of a terrorist attack. But such implications do not, on their own, raise a public interest concern, and it is a stretch to conclude that such an outcome "involves" war or terrorism in any material way. As discussed below in response to the relevant question, contracts involving war, terrorism, assassination or similar activities are not inherently against the public interest and should not be categorically disallowed on such grounds.

> *4. The Commission requests comment on all aspects of its discussion of the factors to be considered in evaluating whether a contract, or category of contracts, is contrary to the public interest for purposes of CEA section 5c(c)(5)(C).*

The Commission's proposed criteria, by which event contracts are deemed contrary to the public interest simply by their association with one of a few enumerated categories, is inadequate and, in itself, fails to serve the public's interest in having robust and efficient markets to facilitate hedging risk and information aggregation. In determining whether a contract is contrary to the public interest, the Commission must first clarify in what ways a market can serve the public interest or be contrary to the public interest. The Commission provides no explicit examples of event contracts that are contrary to the public interest for specific reasons, opting instead for generic assertions that certain classes of markets are "offensive and [have] no place in CFTC-regulated markets" (Proposal, p. 45), "could be manipulated to influence elections or electoral perceptions." (Proposal, p. 54), or similarly baseless claims that are refuted both by logic and an overwhelming body of data and evidence to the contrary.

The case studies discussed in Sections 1.3.1 and 1.3.2 make clear how event contract markets involving sports, politics, war, terrorism, pandemic, and similar such activities can and do serve the public interest in hedging risk and aggregating information. At minimum, those case studies invalidate any justification for the Commission's proposal to categorically disallow all such markets as contrary to the public interest. If it is conceivable that some contract involving a given Enumerated Activity would not be contrary to the public interest, and thus should be approved according to Section 5c(c)(5)(B), then the Commission cannot categorically disqualify all contracts involving said Enumerated Activity as contrary to the public interest.

Event contract markets serve the public interest. Section 7a-2(5)(B) of the Act asserts that the Commission "shall approve" any market or contract unless it is expressly determined to be contrary to the public interest. Section 7a-2(5)(C) provides for limited circumstances under which specific markets may be determined contrary to the public interest. So without further justification that takes into account the specific aspects of a given event contract, CEA 7a-2(5)(B) defaults to the assumption that event contract markets are in the public interest.

The Commission's determination that markets involving Enumerated Activities are contrary to the public interest contradicts empirical data. Several case studies showcasing the usefulness of event contracts for hedging and aggregating information are detailed in Sections 1.3.1 and 1.3.2. These case studies are either real (as in Jim McIngvale's hedging case study and

the PredictIt price signal case study) or realistic (i.e., referencing real world events for which event contracts would serve an obvious public good). By contrast, the Commission justifies its own position with hypothetical doomsday scenarios for which there is no support.

Whether the Commission likes it or not, event contracts involving one or more of the Enumerated Activities are actively traded on a daily basis on exchanges around the world. Whatever supposed damage such markets would supposedly cause — in the form of manipulating events, motivating participants to violence, or any of the other fabricated reasons given in the Commission's Proposal — would likely have already come to fruition because of these existing markets. Yet the Commission provides no concrete evidence to make its case.

In particular, the Commission requests comment on the following questions:

- *Should hedging and price-basing utility be considered as factors when evaluating whether a contract, or category of contracts, is contrary to the public interest? Why or why not?*

Yes, the public interest in these market functions is made clear throughout Sections 1.3.1 and 1.3.2. They represent significant public interest benefits with few, if any, documented drawbacks. These clear benefits raise the Commission's burden for determining that a contract is contrary to the public interest. In order for a contract to be deemed contrary to the public interest, it must be shown that the negative impacts of such a contract outweigh its positive impacts. It is not sufficient to merely raise the possibility of some potential, hypothetical, or remote negative impacts of a contract, as the Commission has done. The contract, as a whole, must be contrary to the public interest. For the vast majority of contracts, including all of those discussed in case studies above and all of those cited by the Commission, the positive benefits of the hedging and information aggregation far exceed any perceived negative consequences of offering the market.

- *If hedging and price-basing utility should be considered as factors when evaluating whether a contract, or category of contracts, is contrary to the public interest, how should such utility be assessed?*

If hedging and price-basing utility are factors in a given contract, then in order to determine that such a contract is contrary to the public interest, the Commission must articulate the competing factors that it deems to be contrary to the public interest and further demonstrate that the totality of the competing factors clearly outweigh the totality of beneficial factors. The onus is on the Commission to determine a satisfactory and transparent protocol by which to make this determination. The current proposal is entirely lacking in this regard.

- *Are there factors, in addition to those described herein, that may be relevant when evaluating whether a contract, or category of contracts, is contrary to the public interest? Are there any factors the Commission should specifically not consider? Why or why not?*

The Commission should strongly consider the importance of informing the public about significant events in the national interest, and how event contract markets can uniquely serve that purpose for a number of matters such as elections, public health emergencies, national disputes, and

a host of related events for which the limited information or conflicting interests of the government and media often gets in the way of the facts.

The Commission should not consider the manner in which a market is or could be used by specific participants, but rather should consider only the way in which a market is designed to be used. Much of the Commission's argument for categorically classifying any event involving an Enumerated Activity as contrary to the public interest is based on speculation about certain market participants' frame of mind, about which the Commission is speculating.

Election and government-related event contracts are increasingly in the public interest. The public's relationship to traditional institutions, including the federal government and media, has deteriorated steadily over the past decade. What exactly has caused this strained relationship is a matter of debate, and is not relevant to this report. But the fact that such a deterioration has occurred is both apparent to the naked eye and is supported by data.

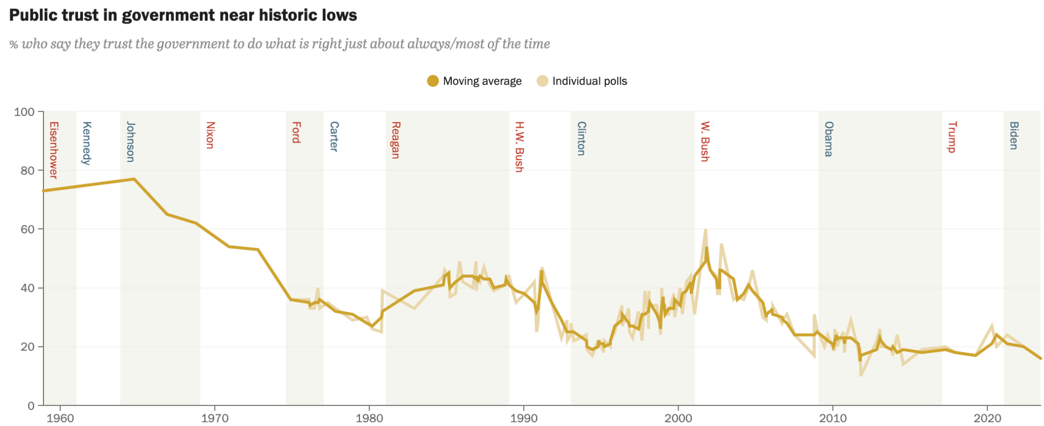

Figure 2: Pew Research Center, https://www.pewresearch.org/politics/2023/09/19/public-trust-in-government-1958-2023

Figure 2 shows PEW research center data on the public trust in government from 1960 to the

present. The data shows that public trust in government is currently at an all-time low during the period in question, and has been near that low for at least a decade. Relatedly, Figure 3 shows Gallup data reporting that American trust in the media is also at an all-time low for the period 1973 to the present.

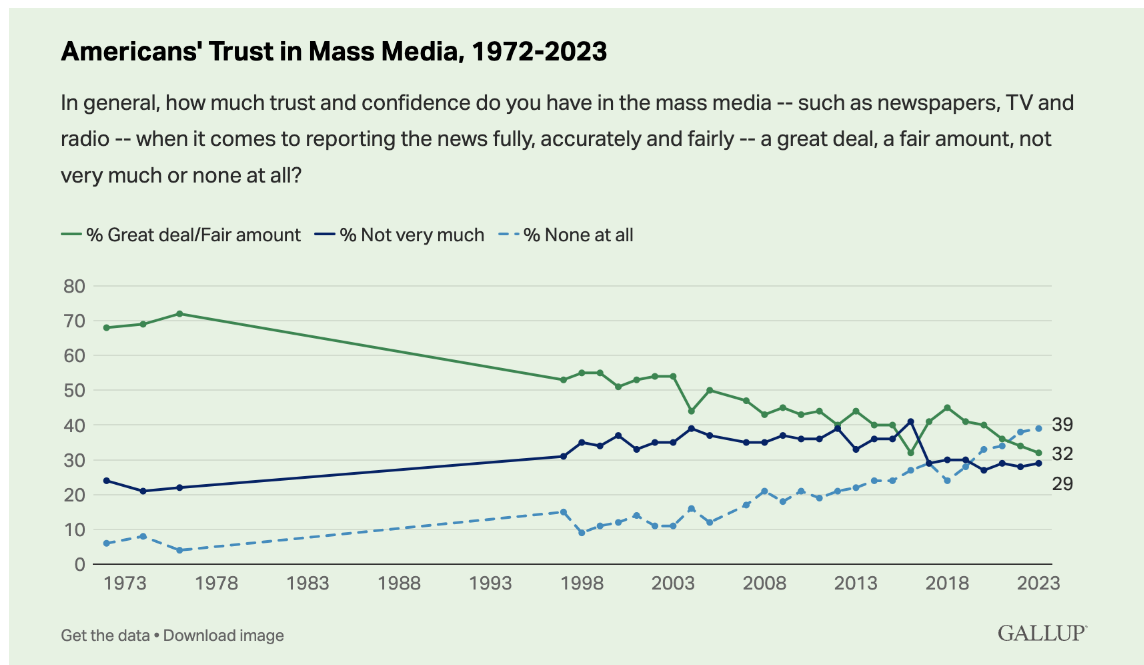

Figure 3: Gallup, https://news.gallup.com/poll/512861/media-confidence-matches-2016-record-low.aspx

The public interest in event contract markets, which provide an independent, objective source of information on sensitive matters of national and public interest, is all the more pronounced given the diminished trust in legacy institutions that have historically served as gatekeepers for such information. Event contract markets on political outcomes and other events of national importance (such as events involving war, terrorism, and significant national and international events) are invaluable to informing the civic discourse.

The fact that some participants may use a market for "gaming" does not undermine its public benefits. The Commission refers repeatedly to Senator Lincoln's statement during the 2010 colloquy in which Lincoln states that the intention of CEA section 5c(c)(5)(C) is "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." Notwithstanding that this one sentence from Sen. Lincoln is cherry picked from a 108-page Congressional hearing, the examples highlighted throughout Section 1 lay bare the far reaching public benefits of event contract markets on a wide range of events, including war, elections, sporting events, and other devastating events (e.g., Covid-

19). The benefits far exceed any perceived, but unsubstantiated, harms that might transpire by enabling some citizens "to profit from devastating events" or "[gamble] through futures markets".

When determining whether to approve or disapprove of a given market, the Commission ought to bear the totality of consequences, both positive and negative, in mind. If it were to do this objectively, and with the public's interest in mind, the Commission would find that the vast majority of event contracts are a net positive benefit to the public and the national interest.

> *5. The Commission requests comment on all aspects of its proposed public interest determinations with respect to contracts involving terrorism, assassination, and war. In particular, the Commission requests comment on whether there are contracts that may involve terrorism, assassination, or war that do not raise the above-described public interest concerns. Why or why not?*

There are sensitive matters surrounding contracts involving war, assassination, and terrorism, but such sensitivities should be dealt with appropriately, not by simply throwing up one's hands and regulating an entire class of contracts out of existence, as the Commission proposes to do. An event contract on the assassination of a specific person would not be an excluded commodity under the CEA because any of the participants in such a contract would conceivably have some control over whether such an event occurs. Such a contract would not be eligible for approval under Section 1a(19)(iv). Similar such issues arise for contracts involving assassination of specified members of congress or the judiciary. Such contracts would raise public interest concerns, but such contracts are not within the purview of the Commission's proposal as they do not fit within the definition of "excluded commodity" under Section 1a(19)(iv) of the Act.

With that said, contracts involving terrorism, assassination, and war do not, as a category, raise the above-described public interest concerns. The reasons are articulated throughout Section 1 and highlighted again here for emphasis. As long as the underlying event, be it war, assassination, or terrorism, is outside the control of the event contract participants, it is an excluded commodity that is eligible for consideration under the CEA. In order to prohibit such a contract, the Commission must explicitly determine that it is contrary to the public interest. As Case Study #4 in Section 1.3.1 and Case Study #4 in Section 1.3.2 show, there are clear cases in which markets involving such activities, or similar activities, serve the public interest.

While the threats of terrorism, assassination, and war are real, and the topics themselves are sensitive, the Commission cannot simply disregard markets relating to such activities as distasteful, while ignoring the significant benefits that such markets can offer in specific circumstances. By their grave and serious nature, acts of terrorism, assassination, and war are very much matters of public interest. Whether offering an event contract market on a specific such outcome adequately serves the national and public interest requires the Commission's consideration. In particular, as it relates to the purpose of event contract markets, accurate and trustworthy sources of information about such matters are often hard to come by. Such markets would be immensely valuable for informing the public in moments of true crisis, especially on matters of public health and national security. Also by the nature of such events, almost every individual and business is exposed to their risks, without any recourse to hedge those risks at present.

Public interest in event contracts for Covid-19. For a concrete example, consider Case Study #4 of Section 1.3.2. Case Study #4 concerns whether the WHO would declare Covid-19 a

pandemic by a specific date. The Commission at the time objected to PredictIt's offering of such a market, and PredictIt refrained from offering additional Covid-related markets after the initial market resolved on March 6, 2020, even though such markets could have saved tens of thousands if not hundreds of thousands or millions of lives.

Although a participant who purchases contracts on such a market can "profit from devastating events", there is nothing any single participant can do to advance that outcome. The spread of Covid is beyond the control of any one individual. One person cannot cause Covid-19 to become a global pandemic. So while it may not sit well with the Commission that a person could profit from such a devastating event, the potential public benefits of such a market, which are enjoyed by hundreds of millions of Americans, far outweigh these otherwise isolated concerns. As the Commission is also surely aware, such widespread public benefits of markets cannot be realized without the possibility that some participants will profit at the expense of others. That's simply how and why markets work as they do.

The potential negative consequences of such markets are isolated to individual participants, whereas the potential positive benefits are widespread. For an event such as the Covid pandemic, the Commission overlooks the possibility that such a market could mitigate or prevent the possibility of the very event it concerns. Suppose, for example, that the market under consideration above (i.e., concerning whether WHO will declare Covid a pandemic) traded at $0.35 for Yes as of January 2020.[15] At the same time, the official announcements of the U.S. government insisted that the threat to the general public was low. Not until mid-March did the government take action to stop the spread of Covid-19 within the U.S. If such a market were to exist in January 2020, however, the general public would have had an outlet for obtaining more accurate information two months before the delayed government response.

Thanks to the information aggregated by such a market, tens or hundreds of thousands of Covid deaths could have been prevented. Such a possibility raises an important question for the Commission: does the potential of saving hundreds of thousands or millions of lives not outweigh Senator Lincoln's concern that some participants might "gamble through futures markets" or "profit from a devastating event"?

The same rationale applies to the consideration of whether other markets on war, assassination, terrorism, etc. should be permitted. Is the stability afforded by enabling businesses to hedge against the inevitable instability of such an event not in the public interest? Is the efficiency and accuracy of information transmitted through such markets about events of grave national and international importance not in the public interest? Does the possibility of preserving billions, if not trillions, of dollars in economic value and hundreds of thousands, if not millions, of lives not far outweigh the isolated and inconsequential possibility that a handful of participants could profit from such a devastating event? Viewed another way, is preventing a handful of participants from profiting from a devastating event worth risking the trillions of dollars and millions of lives that a related event contract market could save?

> *6. The Commission requests comment on all aspects of its proposed public interest determination with respect to contracts involving activity that is unlawful under federal*

[15] Note that this is a purely hypothetical price scenario. Because this market had not yet been offered at the time, it is impossible to know what the market price would have been as of January 2020.

or state law. In particular, the Commission requests comment on whether there are contracts that may involve such activity that do not raise the above-described public interest concerns. Why, or why not?

A great number of contracts involving illegal activity would serve the public interest with no discernible adverse impact. Contracts about the crime rates in specific locations would provide owners of businesses and real estate in those places to hedge risk exposure to public safety concerns. As long as crime rate metrics are chosen to be sufficiently diffuse so that no single person can contribute substantially to the overall rate, such contracts would be excluded commodities under the Act. In addition to their hedging value, the market would aggregate diffuse and domain-specific information to provide the general public with a more accurate assessment of public safety than otherwise available through anecdotes of local officials or slow moving crime statistics released by the local municipality.

More generally, markets concerning illegal activity are especially valuable on matters of direct concern to national security for which public trust in the government's ability to handle has decreased or deteriorated. Such matters currently include crime rates, as mentioned above, as well as statistics on specific crimes, such as illegal immigration and drug use.

7. The Commission requests comment on all aspects of its proposed public interest determination with respect to contracts involving gaming. In particular, the Commission requests comment on whether there are contracts that may involve gaming that do not raise the above-described public interest concerns. Why, or why not?

The Commission's public interest determination with respect to contracts involving gaming is flawed to its core. Event contracts do not raise public interest concerns as a simple matter of involving "gaming". Moreover, the public interest concerns raised by the Commission do not reflect the reality of such markets. These concerns are instead based on hypothetical scenarios for which there is no direct observation in the various markets that exist and which would fall under the Commission's proposed definition of "gaming".

Public sentiment towards gambling has shifted dramatically since 2010. In 2018, the Supreme Court overruled the Professional and Amateur Sports Protection Act (PASPA), which had previously outlawed sports betting nationwide, with a few exceptions. Since the 2018 repeal of PASPA, 38 states have voted to legalize sports betting. Beyond sports betting, gambling is currently legal in some form in 48 states (all except Hawaii and Utah).

The Commission makes frequent reference to the 2010 colloquy, and in particular Senator Lincoln's statements against "gambling through futures markets". At the time of Senator Lincoln's statement, sports betting was illegal nationwide, due to PASPA, and a reasonable position, due to its illegality, may have been that gambling, particularly on sports, is contrary to the public interest by virtue of these laws. We note, however, that the oft-cited quote to Senator Lincoln dates to well before the much more recent and ongoing movement of gambling legalization that is sweeping across the country.

With the repeal of PASPA, sports betting is no longer illegal, and state legislatures have taken swift action to legalize sports betting within their borders. As of June 2024, a supermajority of states

(38 in total) have voted to legalize sports betting.[16] So while the public interest argument against sports betting and related event contracts may have been justified pre-2018, such an argument no longer passes muster, as the general public and lawmakers across 38 states have made clear that legal and regulated sports betting is in the public interest. To argue that event contracts on sporting contests are against the public interest is to argue that the overwhelming majority of U.S. citizens are ill-equipped to determine their own interests; such a task is reserved for the five unelected CFTC Commissioners.

Gaming is not inherently contrary to the public interest. The Commission may argue that markets existing purely for purposes of gambling are contrary to the public interest. The Commission's proposal goes even farther in suggesting that any contract deemed to involve gaming or be "similar to" gaming is contrary to the public interest. The overwhelming preponderance of data rejects the Commission's stance. To the contrary, the fact that gambling is currently legal in some form in 48 states (all except Hawaii and Utah) is an explicit expression by the citizens and lawmakers of those states in the belief that gambling is in the public interest. And as the interplay between hedgers, profiteers, and gamblers described in Section 1.4 makes clear, some amount of gambling is essential to the healthy function of markets. On that note, by the Commission's own draconian stance, all of its currently approved markets are contrary to the public interest because all of its markets somehow involve gambling, or something similar. The markets could not operate otherwise. The proclivities and motivations of specific event contract participants cannot be used to evaluate whether that contract serves the public interest overall. When considering whether a particular event contract serves the public interest, the totality of market dynamics must be taken into account.

Additional response to the Commission's treatment of "gaming". Below we address several specific claims made by the Commission about "gaming".

> As such, the Commission believes that contracts involving such occurrences are likely to be traded predominantly "to enable gambling" and "used predominantly by speculators or participants not having a commercial or hedging interest," and cannot reasonably expected to be "used for hedging and/or price basing on more than an occasional basis." (p. 50)

An important attribute of trading in general, and event contract trading in particular, is that market participants (buyers and sellers) do not have to explain *why* they choose to buy and sell. This aspect of market participation is critical to the efficient and effective function of markets. As explained in Section 1.4, market participants do not declare their motivations for trading, but the existence of traders from diverse backgrounds with divergent motivations is essential for markets to serve their primary purposes for hedging risk and aggregating information. On what basis, then, does the Commission conclude that broad classes of contracts would be traded predominantly "to enable gambling" and cannot reasonably expected to be "used for hedging and/or price basing on more than an occasional basis"?

The Commission continues:

[16] Source: https://www.forbes.com/betting/legal/states-where-sports-betting-is-legal/

> “Moreover, the Commission believes that an individual or entity for whom a particular occurrence in connection with a contest or game may have more direct and more predictable economic consequences may also be more likely to have access to information and/or influence that could be used to engage in activity that could artificially move the market in an event contract involving such occurrence, potentially raising heightened manipulation concerns. For example, a professional athlete or coach may be economically impacted by their team’s wins or losses, but may also have access to information – for example, about a team member’s health or a potential injury – that could be used to trade ahead of the market in an event contract involving the team’s performance. Further, the athlete or coach would potentially have a platform – for example, access to media, combined with public perception as an authoritative source of information regarding the team – that could be used to disseminate misinformation that could artificially impact the market in the contract for additional financial gain.”

There is no evidence that such attempts at manipulation are in any way widespread. As the research literature has demonstrated, the few documented attempts to manipulate election markets have, in fact, only served to make those markets more resilient (see cited work by Rhode and Strumpf). Such is the nature of well-designed markets, as highlighted in Section 1.4 and also by Hanson (see citation). Well-designed markets are robust to manipulation, as attempts to manipulate market prices primarily serve as an injection of so-called “dumb money” which incentivizes savvy traders (referred to as “profiteers” in Section 1.4), increases trading activity, and strengthens the market’s pricing signal.

The Commission’s go-to example, which highlights so-called insider trading concerns is a red herring, as it does not fall within the scope of the relevant sections of the CEA. As it is a requirement that the event is “beyond the control” of parties of the event contract, such participants would not be eligible to trade contracts on such events, and such a circumstance is not within the purview of the relevant sections of the CEA on event contracts.

> “The Commission further notes that most contracts falling within the proposed definition of “gaming” would have no underlying cash market with bona fide economic transactions to provide directly correlated price forming information. Rather, price forming information is either nonexistent, or driven by informational sources that are unregulated, have opaque underlying processes and procedures, and may not follow scientifically reliable methodologies.121 This differs from the informational sources used for pricing the vast majority of commodities underlying Commission-regulated derivatives contracts (e.g., government issued crop forecasts, weather forecasts, federal government economic data, market-derived supply and demand metrics for commodities, market-based interest rate curves). The lack of price forming information for contracts involving “gaming,” or the availability of only opaque and unregulated sources of price forming information, may increase the risk of manipulative activity relating to the trading and pricing of such contracts, while decreasing the ability of the offering exchange, or the Commission, to detect such activity.”

The above claims are hard to address because, to quote physicist Wolfgang Pauli, they are “not even wrong.” In other words, these claims are so off the mark that it’s hard to specifically identify ways in which they are wrong. But here is an attempt.

To reiterate the Commission's core claim, *"The lack of price forming information for contracts involving "gaming," or the availability of only opaque and unregulated sources of price forming information, may increase the risk of manipulative activity relating to the trading and pricing of such contracts, while decreasing the ability of the offering exchange, or the Commission, to detect such activity."* Indeed, the points raised as concerns by the Commission are in fact reasons for why such markets offer value and should exist. Regulated, robust markets are most valuable in the situation that the Commission describes: when there is opaque information from potentially unreliable sources.

A specific point made by the Commission is worth singling out. The Commission calls out the existence of *"only [...] unregulated sources of price forming information"* as a reason for why such markets should continue to be unregulated. First, if the Commission's concern over unregulated markets is valid, then it could easily counteract this concern by approving such markets for regulation. Second, as such "unregulated" markets are governed by the same self-regulating dynamics as those described in Section 1.4, the Commission's concerns over price signals derived from unregulated markets is unfounded. In fact, unregulated markets can often produce more reliable price signals than their regulated counterparts, which can often suffer from market distortions caused by over-regulation and rogue regulation, of which the Commission's Proposal is a prime example.

3 Concluding Remarks

The Commission's proposal is riddled with fundamental errors about event contract market dynamics and the various ways in which event contract markets serve the public interest. Instead of consulting data and paying deference to the public interest benefits of markets, the Commission is hung up on remote hypothetical scenarios oft-cited but rarely observed, and never witnessed to any consequential extent. The Commission raises concerns about election markets, highlighting their potential for misuse and abuse if approved. But betting markets on U.S. elections already exist at scale (see above discussions on Betfair), and none of the concerns posited by the Commission have come to light. U.S. elections are not unduly influenced by market manipulators and nefarious actors on Betfair or any other exchange. U.S. elections are instead unduly influenced by political operatives whose self-serving narratives are allowed to spread through the media unchecked against the signal of an independent, objective event contract market. Like elections, the proliferation of legal state-regulated sports betting has not resulted in massive scandals to the degree the Commission projects. Nor have such scandals arisen from markets offered on any other topics related to any of the Enumerated Activities. There are, however, well documented instances in which these markets have served legitimate public benefits use cases, as detailed throughout the above discussion, and in Sections 1.3.1 and 1.3.2 in particular.

So while the Commission's Proposal paints a grim picture of a world in which event contract markets are widely used to manipulate and unduly influence the public, such a world is pure fantasy, cooked up in the minds of commissioners grasping for a justification to starve the general public of the important benefits promised by markets on elections, sports, war, public health, national security matters, and numerous other topics in the public's interest. All available data and evidence, which are cited throughout the above comment and are plentiful, support the opposite conclusion: that event contracts by and large serve the public interest, with few isolated exceptions.

In proposing to categorically disqualify entire classes of obviously beneficial contracts on sig-

nificant events in the national interest, the Commission is penalizing the general public in order to squeeze out any possibility for misuse. Given the many public benefits of such markets in the overwhelming majority of cases, does such a draconian stance serve the public interest? Is it appropriate that a business owner, wishing to hedge tax risk, should be forced to bear the burden of that risk because of the remote possibility that the same contracts that would enable him to hedge might also be used by some participants to speculate? Could hundreds of thousands if not millions of lives, in the United States and internationally, billions of dollars in lost economic activity, and public trust in government and official institutions not been preserved if there were robust and widely publicized event contract markets on the Covid-19 pandemic as early as January 2020? Do the benefits of such an outcome not substantially outweigh the concern that such a contract would be traded speculatively? In fact, does the speculation on such markets not increase liquidity and incentivize smart traders to inject useful information into the market, and thus provide the public with an even more valuable and reliable price signal?

Indeed, this is precisely how and why markets work. The Commission portrays speculation and profiteering as inherently negative activities that are to be prevented at the expense of any benefit, no matter how great, that such markets provide. But by that rationale, all markets would have to be shut down.

Are there contracts for which these benefits may be outweighed by substantial costs or risks to the public or national interest? Of course, and the Commodity Exchange Act vests the Commission with the authority to disallow such contracts from being offered. But the Commodity Exchange Act does not advocate for over regulation, as the Commission's Proposal would be accurately described.

As a matter of serving the public and as a matter of logic, the Proposal must be rejected in its entirety, and replaced by a more thoughtful and even-handed proposal which gives due consideration to the public benefits of event contract markets and the potential negative consequences to their disapproval. At minimum, the comment period should be extended for at least 90 days to solicit additional information about and allow for the Commissioners to research the substantial benefits and use cases of these markets. Comments should be especially encouraged from businesses and individuals who stand to be most impacted by the Commission's action, those who have used or would use prediction markets for their predominant use cases of hedging and information aggregation.

Author The above comment was written by Prof. Harry Crane.

Signatories The following have signed on in support of the above comment.

Prof. Michael Abramowicz

Prof. Luke Froeb

Prof. Robin Hanson

Prof. Koleman Strumpf

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