

July 24, 2023

SUBMITTED VIA CFTC PORTAL

Secretary of the Commission
Office of the Secretariat
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Questions on the KalshiEX, LLC “Will <chamber of Congress> be controlled by <party> for <term>?” Contracts for Public Comment

Dear Chairman and Commissioners:

Aristotle International, Inc. (“Aristotle”), which acts as clearing house and service provider to Victoria University of Wellington’s PredictIt market, supports offering political event contracts on regulated exchanges. We have previously written to the Commission in support of efforts by KalshiEx (“Kalshi”) to offer political event contracts. This comment incorporates by reference our previous comment on Kalshi’s Industry Filing 22-002, which related to a different proposal for Congressional Control Contracts and addressed many of the Commission’s questions.¹

While Aristotle supports CFTC approval of Kalshi’s Congressional Control Contract, we believe the addition of minimum position limits to Kalshi’s proposed contracts will reduce both the accessibility and the public utility of the proposed contracts.

Background

Kalshi is proposing to list contracts that ask whether a given political party will control either of the two chambers of Congress as a result of the November 2024 elections to the United States House of Representatives and Senate. Both the previous Kalshi filing and the Dissenting Statement of Commissioner Pham in this matter referenced the fact that PredictIt has offered comparable contracts since 2014.²

¹ John A Phillips, Aristotle International, Inc. Comment for Industry Filing 22-002. 23 September 2022. <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70748>

² Commissioner Caroline D. Pham. Dissenting Statement of Commissioner Caroline D. Pham on Political Event Contracts. 23 June 2023. <https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement062323>

Indeed, PredictIt has offered similar markets since the issuance of a No Action Letter to Victoria University by the Division of Market Oversight in 2014.³ PredictIt has since offered Congressional Control Contracts for the 2016, 2018, 2020, and 2022 election cycles.

Event markets such as PredictIt serve an information aggregation function for members of the public— academics, companies, and governments—who use them to further their research, manage their business operations, and set policy. The “price” of the event contract reflects the probability of the specified event or outcome happening. By aggregating individuals’ beliefs with respect to an unknown future outcome, event contracts incorporate a wide diversity of thoughts and opinions that serve as a predictive tool for those who use them.

Since its launch in 2014, PredictIt prices have generated significant public interest. These prices have been widely cited in media and among investment analysts, often as an alternative to polling or election models. PredictIt data has been used by students at academics at over 130 universities across a wide range of subjects including microeconomics, political behavior, computer science, and game theory.

PredictIt tends to experience heavy website traffic as election results are reported, usually far in excess of the number of individuals who are trading contracts. This indicates that the public sees prediction market data as an important tool in understanding election results, which are often unclear and even misleading as individual counties across the country report partial results. PredictIt traders, for example, had priced in that Candidate Biden was likely to win the State of Michigan in 2020 well before ballot returns from Detroit gave him the lead in the official count.

Well over a million unique individuals visited PredictIt during the week of the 2020 election, far in excess of the 5,000 traders allowed to hold any given market contract under the terms of the No Action Letter. This indicates that members of the public were visiting PredictIt not only to make trades, but also to see how the market was reacting to information as it came in.

PredictIt data, which is compiled from a wide pool of small-dollar trades, has a clear public utility. Aristotle, which has itself filed an application for recognition as a Designated Contract Market, fully supports the effort to expand the offerings of political event contracts on regulated markets. Aristotle does not, however, believe that such contracts need to be limited to wealthy individuals and financial institutions, and in fact believes that such limits may hurt the utility of the market.

Commission Question 2: Kalshi’s Proposed Position Limits Would Negatively Affect the Accuracy and Integrity of the Market

As discussed in the previous comment, these accurate probabilistic forecasts serve a broader societal purpose; they do not merely serve the interests of traders. PredictIt market

³ CFTC Letter No. 14-130 issued to Victoria University of Wellington in New Zealand. Division of Market Oversight. October 29, 2014. <https://www.cftc.gov/csl/14-130/download>

prices receive significant attention from the news media, political actors, and investors. This is precisely because, over time, political prediction markets have built a reputation for accurately reflecting the probability that a candidate or party will win an election. The ease of access to PredictIt, including its low investment threshold, allows individuals with a broad array of viewpoints to, in aggregate, move prices quickly in response to events.⁴

The diversity of available viewpoints is essential to the accuracy of these price movements. In a political prediction market, individuals make trades based on a significant number of data sources. These include objective measures like polling results, fundraising, and endorsements, but they also include subjective measures like debate performance, the perceived impact of press reports, local yard sign or bumper sticker sightings, and perceived crowd sizes. One pool of traders, for example, may see a candidate's debate performance as likely to help earn votes, while others may see such a performance as likely to do more harm than good. These inherently subjective interpretations, which are critical in political prediction markets, underscore the need to maintain a diversity of viewpoints in order to ensure accurate pricing.

The case for prediction markets relies on the same insight that supports democracy⁵ and the efficiency of a market economy,⁶ that the aggregate of the decisions of millions of voters or consumers will produce better outcomes than decisions made by even the best qualified experts. Some modern research suggests that both diversity of viewpoint and individual expertise are important to the accuracy of prediction markets.⁷ A small dollar, real money prediction market such as PredictIt fulfills both of these conditions: aggregating diverse opinions while encouraging informed forecasting by requiring participants to put at least some money at stake in backing their prediction. By restricting participation to wealthier individuals and institutions, Kalshi's position limits are likely to reduce the predictive accuracy of their markets.

Kalshi's proposed contracts would limit traders to purchase multiples of 5,000 contracts per order. This minimum position limit is explicitly designed to limit access to wealthy individuals and large institutions. The market composition would look very different to that of PredictIt; so long as a given Kalshi contract is priced above \$0.17 per share, the dollar value of any given order would have to be greater than the \$850 upper position limit on PredictIt.

These limits risk creating a biased market. In 2020, for example President Biden won 55% of votes from individuals who make less than \$50,000 per year, but only 42% of votes from individuals who make over \$100,000 per year.⁸ A similar income gap was found in the 2018⁹ and 2022¹⁰ midterm elections. There are similar—and sometimes even more pronounced—gaps

⁴ Miller, Thomas W. "Predicting the 2020 Presidential Election." *Data Science Quarterly* 1.1 (2021)

⁵ Aristotle, "Politics," arguing that collective judgment is as good or better than that of experts.

⁶ Hayek, Friedrich A. "The Use of Knowledge in Society," *American Economic Review*, 4, pp 519-530 (1945)

⁷ Hong, L., & Page, S. (2012). Some Microfoundations of Collective Wisdom. In H. Landemore & J. Elster (Eds.), *Collective Wisdom: Principles and Mechanisms* (pp. 56-71). Cambridge: Cambridge University Press. doi:10.1017/CBO9780511846427.004

⁸ 2020 Exit Polls, *CNN*. <https://www.cnn.com/election/2020/exit-polls/president/national-results>

⁹ 2018 Exit Polls, *CNN*. <https://www.cnn.com/election/2018/exit-polls>

¹⁰ 2022 Exit Polls, *CNN*. <https://www.cnn.com/election/2022/exit-polls/national-results/house/0>

by age, gender, education level, and geography, all of which may bias a sample of traders that is limited to wealthy individuals and professional investors. Additionally, studies have shown that prediction markets are more accurate when they are composed of a larger number of participants.¹¹ Small and skewed samples may lead to less accurate market prices.

Political outcomes are of great interest to many Americans. In the 2020 election cycle, several million Americans donated money to¹² or volunteered on campaigns.¹³ Each of these Americans has a unique viewpoint and insight into the many pieces of data that contribute to the outcomes of elections. Limiting the market to higher income individuals and institutions is unnecessary and risks shutting out these viewpoints and creating biases in market pricing. While we support Kalshi's proposal despite this imperfection, Kalshi's proposed position limits may undermine the public utility of the market.

Commission Questions 8-10, Hedging

The Commission asks whether there are unique economic risks tied to the outcome of congressional control that cannot be hedged using existing products. This suggested test is unreasonably restrictive: almost no innovative financial derivative would be allowed under this test since there are almost always more or less perfect substitutes for economic transactions. There clearly are economic risks that can usefully and efficiently be hedged by political control contracts. Since the end of the Vietnam War defense spending has risen as a percent of GDP during Republican Presidential Administrations and fallen during Democratic Administrations.¹⁴ An economic dynamic spanning 50 years is "predictable enough" for a contract to serve a hedging function. Thus, defense contractors, or investors holding shares of those companies, could hedge a portfolio using a congressional control contract. As pointed out in our comment on Kalshi's prior filing, a similar type of dynamic exists for oil companies, alternative energy companies, and health care companies, among other economic sectors.

Commission Questions 15, 16, and 17, Integrity of Elections

Several of the Commission's questions and resulting comments conjure a parade of hypothetical horrors involving election interference or disruption. These questions effectively ask commenters to prove a negative. As difficult as that task is, real world evidence to disprove these hypothetical horrors is readily available. Political prediction markets exist in advanced democracies sharing many cultural and political similarities to the US including the UK, Australia, and Ireland. Those markets have existed for many decades in their modern forms with no significant harm to electoral processes or campaigns. Even academic critics of election

¹¹ Bassamboo, Achal, Ruomeng Cui, and Antonio Moreno. "Wisdom of crowds in operations: Forecasting using prediction markets." Available at SSRN 2679663 (2015).

¹² The Donors Powering the Campaign of Bernie Sanders, *The New York Times*, February 1, 20, 2020. <https://www.nytimes.com/interactive/2020/02/01/us/politics/democratic-presidential-campaign-donors.html>

¹³ Donald Trump Has More Campaign Volunteers than Obama Ever Did and Democrats Are Nervous, *Newsweek*. <https://www.newsweek.com/donald-trump-has-more-campaign-volunteers-obama-ever-did-democrats-are-nervous-1540398>

¹⁴ See, e.g. <https://www.macrotrends.net/countries/USA/united-states/military-spending-defense-budget>

markets admit that the markets raise no special concerns in terms of manipulation or corruption.¹⁵

As pointed out in our comment on Kalshi's prior filing, the suggestion that political event contract might somehow undermine prohibitions on coordination between candidate campaign committees and political action committees appears to be based on a misunderstanding of the Federal Election Commission's coordination rule. That rule comes into effect when there are, among other factors, communications between a campaign and a PAC or other outside spender. Political event contracts neither involve nor facilitate contact between campaigns and other entities, so those contracts cannot play a role in circumventing the FEC's coordination rule.

In a large, liquid market political event contracts could not be used successfully to manipulate perceptions of likely success, fundraising or voting. The only cited example of manipulation of perceptions is the "Romney Whale" who traded on the Intrade market. The Romney trader was able to generate a small, temporary spike in Romney support numbers only because the Intrade market was small and shallow. Even in that case, most of the bump caused by the trader's large positions was arbitrated away fairly quickly. In a large and liquid market which would be made possible by CFTC approval it would be financially impossible for a single trader or even a group of wealthy traders to manipulate prices because arbitragers and traders holding contrary opinions would be ready and able to counter inflated offers.

The primary alternative to prediction markets as a source of pre-election outcome forecasts is public opinion polls. In contrast to the barriers to manipulation in well-functioning, liquid markets, public opinion polls are routinely used with the express intent of manipulating perceptions of likely success, fundraising, and voting. Push polls, for instance, are designed and intended to spread negative information about a candidate and measure voters' reactions to that negative information rather than to produce an accurate reading of the likely electoral outcome. Partisan and in house campaign pollsters routinely manipulate sampling methodologies, question design, and even polling times and methods to generate positive indicators for their clients, which they then try to peddle to news organizations or share with supporters to improve fundraising and partisan enthusiasm. Efforts to manipulate well-functioning markets in similar ways are simply profit opportunities for informed traders. Thus, the approval of political prediction markets would not only not lead to the sort of manipulation that the commission's question posits, but would be a significant tool in combating election misinformation.

Commission question 19, Price Formation

The premise of this question misconstrues the genius of prediction markets. Prediction markets rely on aggregating the opinions of a large and diverse group of traders, not on a limited range of specialist reports, though prediction markets do quickly and efficiently incorporate information from expert or official sources into trading and pricing. The market itself regulates

¹⁵ Orr, Graeme. (2014). Betting on Elections: History, Law and Policy. 42. 309-331. 10.22145/flr.42.2.4. available at: https://www.researchgate.net/publication/271208621_Betting_on_Elections_History_Law_and_Policy/citation/download

the information informing pricing by bringing a large and diverse set of opinions to bear in interpreting information, whether from polls or purported expert predictions.

Commission question 23, involvement in fundraising or electoral processes

The CFTC has a sister agency charged with regulating political financing. Any activity which might be manipulative as to a CFTC-regulated market (such as a false fundraising report) would also likely be violative of FEC regulations. If such an event transpired, the CFTC could refer a matter to the FEC and allow the expert agency to determine whether a violation had taken place. If circumstances warrant the CFTC could partner with the FEC in an investigation just as the CFTC currently partners with the SEC and with state regulators in certain investigations already. Similarly, there are state bodies with responsibility for resolving election disputes and ultimately the Congress itself has final authority to adjudicate election disputes involving its members or claimants. The CFTC would not need to be involved in those processes to resolve disputes about contract outcomes.

Respectfully submitted,

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