coinbase

To:
Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st St NW
Washington, DC 20581

August 8, 2024

Notice of Proposed Rulemaking – Event Contracts (RIN 3038–AF14)

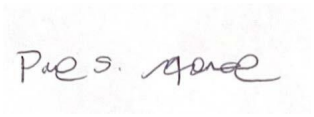
Coinbase Global, Inc. (together with its subsidiaries, **Coinbase**) appreciates the opportunity to respond to the proposed amendments to Commodity Futures Trading Commission (**Commission**) rules concerning event contracts in certain excluded commodities (**Proposal**).[1]

We support the Commission's mission to promote integrity, resilience, and vibrancy of the US derivatives markets through sound regulation. However, we have significant concerns with both the Proposal's content and the analytical approach it takes to support the proposed amendments.

The Proposal would effect a ban on certain types of event contracts, on a categorical basis, by adopting a broad and vague definition of "gaming" and determining that "gaming" contracts are contrary to the public interest. This not only oversteps the Commission's statutory authority, and departs from a longstanding practice of making determinations on a contract by contract basis, but it is also economically unsound. The Commission has failed to recognize the positive impact of prediction markets on the economy in its statutorily required cost benefit analysis under Commodity Exchange Act (**CEA**) Section 15(a)(2).

We urge the Commision to withdraw this Proposal and instead adopt an approach that is consistent with the CEA and the Commission's mission to protect innovation in US markets.

Yours sincerely,



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[1] Event Contracts, 89 Fed. Reg. 48968 (June 10, 2024), *available at* https://www.cftc.gov/sites/default/files/2024/06/2024-12125a.pdf.

Introduction

We strongly encourage the Commission to withdraw the Proposal. Not only do we disagree with its substance, we also believe it goes beyond the intent of Congress and the Commission's statutory authority to prohibit entire categories of contracts. Instead of allowing prediction markets to develop and flourish within the regulatory protections of the CEA and Commission regulations, and thereby provide new avenues for price discovery and hedging of economically consequential events, the Commission is proposing to ban them under a mistaken belief that it is protecting American customers from harm.

The CEA gives designated contract markets (**DCMs**) broad leeway to list event contracts using a self-certification process, but also prohibits a DCM from listing any event contract that the Commission determines is contrary to the public interest if it involves one of the enumerated activities in Section 5c(c)(5)(C) – i.e. activity that is unlawful under any Federal or State law, assassination, war, terrorism, gaming.[2]

In other words, following a two-step process, the Commission must first find that the event contract "involves" one of the enumerated activities (e.g. gaming), and *then* subsequently determine that the event contract is contrary to the public interest. This plain language interpretation of the statute is consistent with the current Commission approach of making these determinations on a contract-by-contract basis.

The Proposal seeks to deviate from this longstanding and well-established practice. In its place, the Commission proposes to use its rulemaking authority to define the term "gaming" to incorporate events that go well beyond a plain meaning of that term, and by doing so, categorically deny a DCM the ability to list contracts that reference them, regardless of whether any particular contract is in the public interest. While the CEA permits the Commission to write rules that cover similar activities, this approach is wrong; it removes important discretion that should be afforded to both the Commission and market participants with respect to future listing determinations.

We firmly believe that this all-or-nothing approach to the treatment of event contracts is not consistent with the promotion of responsible innovation and growth in regulated, transparent markets with appropriate safeguards to protect market integrity and protect customers.

Our core concern is the Proposal's overly broad definition of "gaming." If adopted, Rule 40.11(b) would capture contracts as "gaming" that by any common understanding are not, in fact, gaming. Few would agree that elections or professional awards such as Nobel

[2] 7 U.S.C. § 7a–2(c)(5)(C)(i).

Prizes or Academy Awards are granted through a process that should generally qualify as games, yet these are the examples presented as constituting such a definition. As we describe in more detail below, this is inconsistent with both the CEA and the supporting legislative history related to gaming, neither of which suggest that gaming should extend beyond sporting events.

A consequence of the overly broad definition is that many economically viable contracts would be prohibited for reasons contrary to a public interest finding. This is a mistake. Critically, the Proposal fails to recognize the value of prediction markets. The Proposal questions their scientific merit and highlights their potential to harm investors, but without citing evidence to support these conclusions. Instead, the Proposal laments that event contracts do not work like those that the Commission is familiar with, because the event contracts do not have underlying cash markets, and that somehow this innovation is inconsistent with a public interest.[3]

It is also incumbent on the Commission to meet its statutory obligation set forth in CEA Section 15(a)(2) to fully account for the costs and benefits to market participants of prohibiting event contracts, including the impact on efficiency, competitiveness, and financial integrity of futures markets.[4] The Proposal fails to do this, which is a shortcoming that needs to be corrected.

As discussed below, the Commission fails to recognize the important risk management tools event contracts can provide, as well as other important public interest considerations described in this response. Instead, the Proposal exclusively focuses on the lack of Commission resources to conduct a contract-by-contract review via the self-certification process, and how this will also save market participant compliance resources because they will not have to bother listing products.[5] We disagree that this is an appropriate basis for the Commission's proposed categorical ban. The Commission and Congress should instead focus on ensuring the Commission has the needed resources to continue its "self-certification" process that has, by all accounts, worked well across industries and market types.

To the extent the Commission believes that it must move forward with this rulemaking, the focus should not be on a broad definition of gaming. Instead, the Commission should focus on types of event contracts that are sufficiently similar to each other such that the Commission is able to conduct a comprehensive public interest analysis applicable to all potential contracts of that type. Only if the Commission can then demonstrate that the contract is contrary to the public interest, meeting all statutory requirements in making

[3] Proposal at 48982.
[4] 7 U.S.C. § 19(a)(2).
[5] Proposal at 48972.

that determination, should those contracts be prohibited under Commission Rule 40.11(a) (along with certain contracts referencing terrorism, assassination, gaming, and war).

The Commission should not review event contracts on a categorical basis.

The Commission suggests that it is not required to make a public interest determination on a contract-specific basis and that the CEA authorizes categorical public interest determinations.[6]

We disagree. The Commission's proposal to review contracts as a category is not contemplated by the CEA, departs from long standing practice in Commission-regulated markets, and would harm innovation in event contract markets. While it may be appropriate for the Commission to think about categories of contracts in developing principles with which to inform their determinations, adopting a broad categorical determination approach to event contracts is a flawed method to review novel products and risks upending the Commission's longstanding product review framework.

For the following reasons, we believe the Proposal's approach exceeds the Commission's statutory authority.

First, Congress did not direct the Commission to define "gaming" in CEA Section 5c(c)(5)(C)(i)(V), clearly evidenced by the very next subclause – CEA Section 5c(c)(5)(C)(i)(VI) – which provides that the Commission "by rule or regulation" can determine whether "other similar activity" is contrary to the public interest.[7]

Second, the Proposal fails to establish a basis for an overly expansive definition of "gaming." The Proposal's definition is broader than what can be reasonably established based on the legislative history and remarks by legislators. Nowhere does the legislative history suggest that gaming includes elections, awards, or even contests more generally outside of sporting events. Instead, the Commission seems to be taking the approach that gaming is not only speculative, but that speculation itself is gaming, and therefore a rational basis for expanding the set of events that qualify as gaming. The Proposal wholly fails to clearly articulate a basis for distinguishing certain behavior as market "speculation" and other activity as "gaming" or "gambling."

Finally, nowhere does the statute indicate that all gaming event contracts are contrary to the public interest. To the contrary, the statute authorizes the Commission to prohibit only gaming contracts that it deems contrary to the public interest. If the Commission

[6] Proposal at 48978.
[7] 7 U.S.C. § 7a–2(c)(5)(C)(i)(VI).

otherwise believes that an event contract outside of those already enumerated in the statute involves specific activity contrary to the public interest, it should then make that determination by "rule or regulation" as provided by CEA Section 5c(c)(5)(C)(i)(VI).

For these reasons, the Commission's proposed approach of establishing a broad definition of "gaming", and then prohibiting contracts that fit under that definition, is statutorily infirm.

If the Commission does not take a more tailored approach, the rule will inevitably be used to reject new types of event contracts for which a DCM could otherwise make a viable public interest argument through the well-established self-certification process. Had such broad authority been exercised in the past, it could have prevented, for example, the introduction of "financial futures" should the Commission have concluded in its nascent days that it did not have adequate economic purpose or public interest benefit. In the case of event contracts, we do not believe that this Commission should handcuff the discretion of future Commissions by making sweeping determinations about a market that is at the early stages of development and maturation.

More to the point, the current process for product listings is not broken. The Commission has historically reviewed new product submissions through its Part 40 rules for self-certification or Commission approval. The process includes a submission for each contract that demonstrates, among other things, the product's terms, a concise explanation and analysis of the product and its compliance with the CEA, and how the product is not readily susceptible to manipulation.[8]

DCMs should continue to have the flexibility to launch new products that they deem compliant with the CEA (including, CEA Section 5c) following their own thorough review and analysis of such products. Moreover, as history has shown, DCMs have the economic incentive to take the appropriate time, effort, and care as a regulated registered entity to design the contracts it lists for trading to assure compliance with the CEA and Commission Regulations, including compliance with DCM Core Principle 3.[9]

To this end, we strongly believe that the Commission can meet statutory objectives reflected in CEA Section 5c to ensure a DCM satisfies its regulatory obligations to take the time, effort, and care to design the contracts they list for trading to ensure compliance with the CEA. We understand the need for standards in filing to list new products, but such standards should align with the need to allow registrants the flexibility to launch new products upon submitting the requisite certification.

[8] 17 C.F.R. § 40.2(a)(3).
[9] 7 U.S.C. § 7(d)(3).

The Commission's broad definition of "gaming" is inconsistent with legislative history and longstanding state rules.

While the Commission has previously interpreted the term "gaming" in orders prohibiting and disapproving certain event contracts,[10] it now seeks to establish a new and expanded definition solely for purposes of administering CEA Section 5c(c)(5)(C) and Rule 40.11. However, we see nothing in the legislative history[11] that suggests "gaming" was intended to go beyond contracts on sporting events, and in particular, there is no evidence that "gaming" was intended to cover the examples cited in proposed 40.11(b)(2).[12]

As Commissioner Mersinger observes, while senators identified contracts around the winner of the Kentucky Derby and the Super Bowl as "gaming," they did not suggest that Super Bowl attendance, or which nation is selected to host the World Cup, was "gaming."[13] Similarly, the legislative history does not support the position that election contracts or awards contracts were intended by Congress to be "gaming" given the absence of any reference to non-sporting events. Senators who spoke about the relevant provisions on the record did not identify these types of contracts as "gaming."

The expanded definition is also likely to capture contracts that the Proposal does not intend. As Commissioner Mersinger further notes, the Proposal's description of "gaming" contracts might capture other longstanding "acceptable" event contract markets, like weather-related event contracts.[14] Notably, and as we explain in more detail below, these contracts have clear economic value even without having an underlying cash market with bona fide economic transactions – a characteristic the Commission seems to think objectionable.

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[10] Proposal at 48975.
[11] See 156 Cong. Rec. S5906–07 (daily ed. July 15, 2010) (statements of Senator Dianne Feinstein and Senator Blanche Lincoln) (the "2010 Colloquy").
[12] Proposal at 48975.
[13] Dissenting Statement of Commissioner Summer K. Mersinger Regarding Proposed Rulemaking on Event Contracts (May 10, 2024), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/mersingerstatement051024.
[14] *Id*.

Finally, the Commission has put forward a new definition of "gaming" that conflicts with longstanding practices by states around what is, and is not, gaming.[15] In other words, not only is the Proposal's definition deficient as a definition for purposes of CEA Section 5c(c)(5)(C) and Rule 40.11, it further muddies the state and federal landscape of gaming and gambling rules and regulations with the creation of yet another definition for "gaming" for market operators, and market participants, to have to interpret and reconcile with other authorities' use of the term.

In recent years, the Commission has received input from relevant experts and stakeholders surrounding the definition of "gaming" or "gambling" and how it aligns with state and federal laws.[16] We encourage the Commission to further engage with this community, including regulators, gaming operators, institutions like sports leagues, as well as academic experts through staff roundtables, Commission advisory committees, or other forums. It is critical to have their expertise, input and coordination, particularly because these stakeholders do not engage in Commission matters in the normal course.

Because the Commission has gone beyond the legislative intent of "gaming" in this Proposal, it should withdraw this rule amendment and reconsider whether to re-propose in a manner consistent with its statutory authority.

The Commision has failed to conduct a meaningful economic analysis and recognize the benefits of prediction contracts.

Academic research has long understood the value of prediction markets. For example, in one prominent paper published two decades ago, and that has been cited more than 1,800 times in other academic research, the authors concluded:

> *We analyze the extent to which simple markets can be used to aggregate disperse information into efficient forecasts of uncertain future events. Drawing together data from a range of prediction contexts, we show that market-generated*

[15] For example, Nevada defines "gaming" as "any game played with cards, dice, equipment or any mechanical or electronic device or machine for money, property, checks, credit or any representative of value, including, without limiting the generality of the foregoing, faro, monte, roulette, keno, bingo, fan-tan, twenty-one, blackjack, seven-and-a-half, klondike, craps, poker, chuck-a-luck, wheel of fortune, chemin de fer, baccarat, pai gow, beat the banker, panguingui, slot machine, any banking or percentage game or any other game or device approved by the Commission, upon the recommendation of the Board, pursuant to NRS 463.164." By contrast, New Jersey defines "gambling" as "staking or risking something of value upon the outcome of a contest of chance or a future contingent event not under the actor's control or influence, upon an agreement or understanding that he will receive something of value in the event of a certain outcome."

[16] See comments to 90-day Review of RSBIX NFL Futures Contracts Proposed by Eris Exchange, LLC, *available at* https://comments.cftc.gov/PublicComments/CommentList.aspx?id=5203.

> *forecasts are typically fairly accurate, and that they outperform most moderately sophisticated benchmarks. Carefully designed contracts can yield insight into the market's expectations about probabilities, means and medians, and also uncertainty about these parameters. Moreover, conditional markets can effectively reveal the market's beliefs about regression coefficients, although we still have the usual problem of disentangling correlation from causation.*[17]

Quite to the contrary, the Commission concludes in the Proposal that because there are no underlying cash markets for event contracts, price forming information is non-existent or driven by unregulated information sources, such that the contracts may not follow scientifically reliable methodologies.

This is a rather extraordinary conclusion given that the Commission made no effort to explain what scientific research supported it. And that is a problem, because this is precisely what Congress intended for the Commission to do when justifying proposed rules. As the Proposal rightfully recognizes, Section 15(a)(2) the CEA requires the Commission to consider the costs and benefits of its actions before promulgating regulation under the CEA, and this includes considerations of the efficiency, competitiveness, and financial integrity of futures markets.[18]

However, instead of assessing the potential economic impact of the proposed rule on the broader economy, the Commission focuses its cost-benefit assessment on how denying categories of contracts would:

1. benefit registered entities because they wouldn't have to waste the cost and effort of trying to list them – i.e. "avoid situations in which registered entities expend resources to develop and submit a contract that the Commission subsequently determines may not be listed."[19]
2. benefit the Commission in its oversight of derivatives markets – i.e. "promote the Commission's responsible stewardship and efficient use of the tax dollars appropriated to it" by "helping to reduce the likelihood that contracts are submitted to the Commission that raise public interest concerns."[20]
3. engender a one-time compliance cost for registrants to understand how not to list unapproved categories of contracts.[21]
4. cause 60 hours of work to delist 30 contracts estimated to be in violation of the proposed definition of gaming.[22]

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[17] Justin Wolfers and Eric Zitzewitz, *Prediction Markets* 18 Journal of Economic Perspectives 107 (2004).
[18] 7 U.S.C. § 19(a)(2)(B).
[19] Proposal at 48988.
[20] *Id*.
[21] Proposal at 48989.
[22] *Id*.

We cannot disagree that the proposed ban on event contracts would save both registrants and the Commision time and resources trying to list them – and require only minimal work to delist them – but that seems to miss the point of the statutory requirement to assess the potential impact of the regulation. In particular, the Commission wholly ignores the potential economic benefits of event contracts, which will be lost in perpetuity if they are not permitted.

In our view, the Commission should not make such an important decision from a resource allocation perspective. Rather, we encourage the Commission to work with Congress to ensure it has the necessary resources to carry out its core functions, which include the review of new products on a case-by-case basis. We support Commissioner Pham's statement on this point that "If the number of contract reviews has increased, then the Commission should increase its resources and capacity—not to prohibit public activity."[23]

Prediction markets are an important source of predictive data that should be encouraged, not discouraged, and the Commission – by statutory requirement – must recognize the public interest benefits.

For example, there is strong empirical evidence across a number of sectors and applications supporting the view that event contracts can outperform experts not only in forecasting accuracy, but also in costs. Prediction markets allow for the dynamic updating of forecasts in a cost-effective way,[24] and can save significant resources relative to more imprecise alternatives – e.g. polling and other ways political campaigns assess the status of an upcoming election. Prediction markets can also avoid wasteful use of private and public resources, as resources can be better allocated to projects with strong market potential (for example, prediction markets were able to accurately predict box-office performance of upcoming Hollywood movies, allowing firms to adjust their spend and resources).[25]

In addition, firms have implemented internal prediction markets to improve their own processes,[26] and prediction markets have outperformed experts across DOD applications, healthcare, and tech firms. This is an area of incredible promise and innovation, and will almost certainly lead to further market structure and financial market breakthroughs in the future. Nobel laureate Kenneth Arrow and co-authors have proposed reforms at the federal level to encourage the safe implementation of these markets (including a safe-harbor for political events, environmental risks, or economic indicators), and have

[23] Dissenting Statement of Commissioner Caroline D. Pham on Event Contracts Proposal (May 10, 2024), https://www.cftc.gov/PressRoom/SpeechesTestimony/phamstatement051024b.
[24] Wolfers and Zitzewitz, *Prediction Markets*.
[25] *Id. at 111.*
[26] Bo Cowgill and Eric Zitzewitz, *Corporate Prediction Markets: Evidence from Google, Ford, and Firm X*, 82 The Review of Economic Studies 1309 (2015).

written that "these markets have great potential for improving social welfare in many domains."[27]

The literature on prediction markets goes well beyond these examples and the Commission should understand what it says before making any determination about the treatment of any class of contracts within its authority. This would not only help prevent mistakes, like we believe would occur under this Proposal, but also would give the Commission an opportunity to consider ways to improve event contract market quality and promote access to these markets and the information they generate.

By allowing economically incentivized predictions to materialize in regulated markets, and by virtue of the results being publicly available, prediction markets can democratize access to information that would otherwise be only available to a subset of well-funded market participants. These measures can have pro-competitive effects on the economy, as information does not remain siloed within a single firm with the resources to acquire accurate forecasts on their own account. Public availability can thus create a separate public benefit that accrues not only to those who trade – the Commission fails entirely to consider this in its analysis

Such an approach would not only be in the public interest, but also consistent with the legislative history on the inclusion of "public interest" provision in the CEA. As the Proposal explains, the term "public interest" is not defined in the CEA, and the Commission has historically relied on an "economic purpose" test. Such a test, based on the expectation that a contract can be used for hedging or price discovery, is the longstanding and appropriate measure by which public interest should be determined. The 2010 Colloquy cited in the Proposal, in which Senator Feinstein asked about the speculative use of contracts, and which the Commission believes now motivates a different approach, does not change this historically correct interpretation.[28]

The Commission is now proposing to add three factors to the determination of public interest:

1. The extent to which the contract, or category of contracts, would draw the Commission into areas outside of its primary regulatory remit;

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[27] Kenneth J. Arrow, et al., *The Promise of Prediction Markets*, 320 Science Magazine 877, 878 (2008).
[28] In the 2010 Colloquy, Senator Feinstein recognizes that "a contract is a gaming contract if the **predominant** use of the contract is speculative as opposed to a hedging or economic use." (emphasis added) The Proposal states that "the Commission believes" participants who may trade these event contracts "are most likely to trade such contract for entertainment purposes only." Proposal at 49892. This statement is made without any further explanation, analysis, or reference to any source that might justify such a belief. The Proposal fails to recognize the number of commercial and information-based benefits of these markets and, worse, is devoid of facts or authorities to support such a belief.

2. Whether characteristics of the contract, or category of contacts, may increase the risk of manipulative activity relating to the trading or pricing of the contract; and
3. Whether the contract, or category of contracts, could result in market participants profiting from harm to any person or group of persons.[29]

It is unclear why these factors are needed. The Commission's general core principles regulatory approach for trading venues already promotes these goals; for example, designated contract markets are required to make information publicly available, which aligns with some of the many public benefits of prediction markets on registered exchanges. Additionally, DCMs have obligations as self-regulatory organizations, making them well suited to establish and enforce standards that promote market integrity through its surveillance and authority to investigate and deter abusive trading practices like fraud and manipulation.

It is also unclear why any of the legislative history cited in the Proposal should change the existing listing process, or how many of the enumerated activities that the Proposal attempts to capture through its broad definition of gaming – Nobel and Pulitzer prizes, Oscars, elections – is contrary to the public interest in light of the legislative history.

Many of the event contracts proposed to be prohibited have bona fide economic value beyond speculation, and we disagree with the Commision statement:

> *While there may be individuals or entities for whom a particular occurrence in connection with a contest or game have more direct and more predictable economic consequences, the Commission believes that any such segment of individuals or entities is likely to be narrow as compared to the broader universe of market participants, including retail market participants, who may be able to trade in an event contract listed on a CFTC-registered exchange—and who, the Commission believes, are most likely to trade such contract for entertainment purposes only.*[30]

To the contrary, the Commission has made no attempt to assess the potential economic consequences of the Proposal outside of compliance implications. Instead, the Commission makes sweeping and unsubstantiated statements about the speculative nature of event contracts, suggesting that they would be of little economic value, and create confusion and risk for retail investors.

The only reference to research (that we found) in the Proposal is in reference to the potential impact of fake news reporting and potential manipulation of the contracts – i.e.,

[29] Proposal at 48980.
[30] *Id*. at 48982.

it "could be used to distort the information underlying price formation in such [event] contracts."[31]

We don't discount that "fake news" and misinformation can distort market prices – this is true today for all financial market instruments that trade on regulated exchanges, and not unique to any one market, including prediction markets. And somewhat ironically, unlike with any other market, prediction markets are particularly well suited to addressing the problem of fake news. In particular, prediction markets are not static, but continually updating, so if investors are fooled at any one time, in the case of the article by a fake poll, that will be quickly corrected by the ongoing incentives or price discovery. So, the evidence the Proposal cites is exactly one of the reasons why a well-regulated prediction market would be good in the long run for the U.S. economy.

It is also not clear how confusion or risk will be sowed with retail investors about events that are often much more easily understood than many financial contracts. For example it is hard to argue that an event contract on who will win the next Presidential election or the Nobel prize is harder to understand than a futures contract on corn. Moreover, it is a false premise for the Commission to say or believe that "[a]mong other things, it could improperly signal to certain retail investors that these contracts are instruments to be used for investment purposes …" when the nature of the contracts are very easy to understand, and the contracts can, in fact, be used for investment purposes.[32]

Summary

We recommend, in light of the considerations we highlight in our letter, that the Commission abandon the Proposal. Rather than prohibit event contracts that involve "gaming", broadly defined, the Commission should promote responsible innovation by encouraging certain types of contracts to be made available on registered futures exchanges. The Commission has authority and institutional expertise – unlike any other regulatory authority – to monitor novel product submissions and market operation, including in futures markets that have an increasing retail customer base.

Should the Commission otherwise decide to move forward with a rule, we strongly urge the Commission to repropose. Separate from our belief that this Proposal has overstepped the Commission's statutory authority, the Commission has not met its statutory obligations under 15(a)(2) to fully explain the economic impact of prohibiting this nascent market from further developing. Doing so would provide the public an opportunity to more fully respond to the Commission's thinking and logic behind such an action, which we don't currently believe is merited.

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[31] *Id*. at 48983.

[32] This is even true for sporting events – a vendor costs of printing t-shirts in anticipation of a team winning a championship can be hedged by taking a position in favor of that team's loss.