SUBMITTED VIA CFTC PORTAL

October 28, 2024

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: Comments Regarding the Rule Certification filing by KalshiEX, LLC, Submission No. 2409-1100-4224-55

To Whom It May Concern:

KalshiEX, LLC ("Kalshi" or "Exchange") is grateful to the Commission for its consideration of Kalshi's Request for Quote ("RFQ") rule certification. The Exchange welcomes the opportunity to address the Commission's questions and concerns in full, should it have any.

I. The Exchange's proposed RFQ process

At the outset, the Exchange thinks it may be helpful to give a plain-language description of the proposed RFQ process, to alleviate any confusion or potential ambiguity regarding its functionality.

A Member ("Requester") Creates a Public Request

When a member (here "Requester") creates a two-sided RFQ through Kalshi's system, they will create a publicly-visible message indicating (i) a market, (ii) the number of shares requested for trade, and (iii) an unique and persistent pseudonymous ID code that is assigned to the Requester, so that their legal name is not published on the marketplace. (Kalshi will still have access to the Requester's identity for market surveillance and safety purposes).

One or More Members ("Quoters") Respond

Any other member (here "Quoter") can elect to respond with a structured response ("Quote") directly to the Requester for the proposed number of shares, provided that they have the available collateral to do so. The Quote will contain very limited information: (i) a maximum bid and ask, and (ii) the Quoter's own unique and persistent pseudonymous ID code. Importantly, the Requester and Quoter may not share the details of this limited information, and may not alter or place orders on the orderbook to take advantage of this information. Kalshi's market regulation staff will surveil for violations of this rule.

The Requester May Accept

The Requester may choose to accept one side of a Quote, if it has the collateral to do so. If the Requester accepts, the Quoter will be informed of the accepted transaction, and will have 30 seconds to confirm. The Requester can only accept a Quote containing the best price. Upon acceptance, an internal 15-second timer will begin, after which the platform will place the orders on the orderbook for execution.

A Transaction Occurs

The Platform will sequentially place the RFQ orders on the orderbook for execution on the existing public orderbook. However, all resting orders will maintain time priority, and shall execute before the RFQ transaction. Therefore, the Quoter and Requester may in fact never transact a contract between them, if existing book liquidity exists at the quoted price.

All members may use the above system of limited communication, which exists to facilitate transactions on the existing order book using the existing execution process. This is not a separate or private transaction; rather, the RFQ system is designed to facilitate price discovery for large transactions on the open marketplace, while establishing safeguards and limits to prevent any information asymmetry from being used for advantage. For market surveillance and compliance purposes, all uses of the pre-execution system (requests, quotes, etc.) are recorded and stored as part of the Exchange's audit trail.

II. Simultaneous execution is an improvement over staggered execution.

Under the Exchange's proposed RFQ functionality, both the "buy" and the "sell" orders are placed on the book sequentially without a delay between them, as opposed to the second order being placed a set duration of time after the first order. We understand the Commission may view this as potentially novel or worthy of examination, and so the Exchange endeavors to provide

additional information on this function. Upon examination, this structure is in fact an improvement over delayed order placement (which would misalign incentives and prevent efficient price discovery).[1]

Consider the alternative, in which the second RFQ order is placed some time after the first.

> *Example*
>
> An order book has limited liquidity due to the potential for sudden information risk. Two parties use a non-simultaneous execution RFQ system to propose a trade which would improve both the bid and ask on the order book. However, because the orders are entered with a time delay between them, non-participants have a guaranteed opportunity to execute the full trade and completely cut out an RFQ participant, without improving the existing bid or ask on the order book. A third party, or even a party with a worse bid in the RFQ process, can guarantee it will execute the trade instead of the Requester or best Quoter. In effect, the RFQ participant becomes the only disadvantaged party, as it is forced to wait for execution (at the price it helped discover), while non-participants and failed bids have guaranteed time priority. Under such a system, it becomes advantageous to *not* have the highest bid when giving a Quote.

Conversely, under the Exchange's proposed RFQ system, corresponding orders are placed on the order book in succession, but there is a 15 second delay after acceptance. During those 15 seconds, if a better priced order is placed on the book, on either side of the market, that order will fill against the contra side of the RFQ, and the RFQ-related orders will not match against each other. Thus the acceptance of the Quote is itself not a consummation of a trade, because the two sides might not end up matching with each other at that price. Market participants are still given an opportunity to execute at the RFQ-arranged trade price, but will not have a *guaranteed* opportunity to take the entire trade from one of the Members that discovered the price without improving the resting bid or ask. We proposed to implement this program without the delay because we determined that this would likely result in better pricing and utility to the system by avoiding the front-running concerns that are present when there is a delay between the order entries.

The Exchange's proposed pre-execution communication rules result in competitive execution of orders by providing non-RFQ market participants with the opportunity to place better-priced orders in the order book to interact with the RFQ participants' orders, during the built-in delay between when the Quote is confirmed and when the orders are then entered. This is the same functionality as other platforms that are currently operating approved RFQ systems.

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[1] This structure is also not novel because it is in conformity with other market offerings (*See infra* Section III).

III. The proposed RFQ system is in conformity with other market offerings.

The Commission has also raised the need for additional time to analyze the rule amendments due to novel and/or complex issues. Fortunately, the Commission can view the Exchange's proposal in the context of other substantially identical RFQ systems currently available in the marketplace.

Based on publicly available information, Kalshi believes that its proposed RFQ system is substantially identical to other market offerings with respect to execution methodology. For example, in ICE's Pre-Execution FAQs[2], Question No. 4 asks "How are orders resulting from Pre-Execution Communications required to be executed?" ICE provides that it has two options for traders to choose at their discretion, the first of which appears identical to Kalshi's proposed method, except it seems to contemplate even more robust pre-execution communication. ("Entry of [a crossing order] will trigger an [RFQ] message… which will automatically be exposed to the market for the prescribed time period before [the crossing order is executed]").

Under that first option, the trading interest from the pre-execution communication is entered into ICE's system as a "Crossing Order" ("CO"), which is analogous to our confirmed Quote. Upon entry of a CO into ICE's system, an RFQ is triggered and sent to the marketplace that lets the marketplace know that there is interest in executing a trade. The RFQ notice that is triggered by the entry of the CO does not have a price, and does not contain any indication that it is the result of a CO. During the time period between when the RFQ is issued and the CO is executed (5 seconds on ICE), if a better order is entered into the book, the CO will first execute against that better order. That is the same as Kalshi's proposal, except that Kalshi would require a longer 15 second window during which other participants may improve the price by entering orders into the book.

Kalshi's proposal is also similar to the R-Cross functionality implemented by CME, as detailed in their recent Pre-Execution Communications MRAN.[3] As described in the MRAN, the participants may choose from a variety of order-entry protocols that CME offers in order to enter the orders resulting from pre-execution communications. In the R-Cross, prior to executing orders resulting from pre-trade execution, an RFQ must first be sent to the marketplace, which contains no information that it was created as part of an R-Cross. Between 5 and 30 seconds later (the exact parameters depending on the asset class), an RFC ("Request for Cross"), which contains both the buy and sell orders, must be submitted in order to proceed with the trade. This RFC will immediately execute both orders against each other, or, if a better order exists in the book exists on either side, the RFC will first execute against that better order. As with Kalshi's

[2] *Available at* *https://www.ice.com/publicdocs/futures_us/Pre_execution_Communication_FAQ.pdf*
[3] *Available at* https://www.cmegroup.com/rulebook/files/cme-group-Rule-539.pdf

proposed RFQ system, both orders resulting from pre-execution communications are entered without a delay between them.

IV. The RFQ system is designed to avoid the concerns held by the Commission.

A. The RFQ system provides for a competitive, open, and efficient market, and a mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.

In accordance with Core Principle 9, Kalshi's proposed RFQ system would provide added functionality for more efficient price discovery within a competitive and open centralized market. On a typical market, there frequently exist barriers to high levels of liquidity in the form of resting orders. For example, in a market with sudden information risk, a trader would justifiably be cautious about leaving a large resting order on the order book, because a counterparty might access new public information more quickly and act on it (at the trader's disadvantage). Similarly, taker-side traders looking for a larger transaction on a market with limited liquidity currently have limited recourse, as their large order could impact the market significantly and lead to price slippage. For these and other reasons, order books can fail to reflect the true availability and willingness of participants to trade on a given market at any given moment.

Kalshi's proposed RFQ system would make additional pricing options available to all market participants, fostering efficient price discovery and efficiency. The system would increase participation among traders who would otherwise find insufficient liquidity to participate. Accordingly, several existing liquidity providers on the platform have expressed to us that they are willing to provide additional liquidity at scale under the Exchange's proposed RFQ system. We also expect that greater participation from this cohort will lead to greater volume and more rapid price discovery. Indirectly, this should draw more liquidity providers to the platform and lead to greater average liquidity on the book. Further, even Members not participating in the RFQ bid/ask process would have the benefit of (1) potential execution against a side of the RFQ trade on the marketplace, and (2) the pricing information resulting from such a trade. This is because all orders generated from RFQs are entered into the order book and interact with any resting bids or offers, further safeguarding the integrity of price discovery for large orders. Absent an RFQ system, such a trade would not occur.

B. The RFQ system does not promote, or facilitate, an "abusive trading practice."

For the reasons described above, Kalshi's proposed RFQ system is also in furtherance of Core Principles 2 and 12, prohibiting abusive trading practices and pre-arranged trades. The market

will be protected from pre-arranged trades due to the design of the RFQ process, which mandates that all RFQ-initiated trades be exposed to the open market and take place on the public order book while giving preference to all resting orders. Further, only the best bid may be accepted in response to an RFQ, eliminating the possibility of preferential or non-public pricing.

It is worth noting that this process is in conformity with (or an improvement upon) the requirements for an RFQ system as implemented by a Swap Execution Facility, which is undoubtedly built to avoid "abusive trading practices." The primary distinction and improvement between this system and the SEF analogue (adjusting the delay between order entry, as explained in Section II, *supra*) does not undermine the purpose of the delay, which is to ensure that "an order is exposed to the market and other market participants have a meaningful opportunity to execute against such order." 17 C.F.R. § 37.9. Market participants still have queue priority under the Kalshi system, and thus have a meaningful opportunity to execute against the order. And participants in the RFQ system are prohibited from taking advantage of the limited non-public information derived from the RFQ process.

Furthermore, as discussed in Section III, Kalshi's proposed system is in accordance with other currently-available market offerings. In fact, with respect to pre-execution communications, Kalshi's proposed rules are an improvement on the rules of other exchanges, because unlike under the other exchange rules, communications under Kalshi's rules are (i) public and alert the public to the interest in the contract, and (ii) competitive because requesters are only able to accept the best quote. Additionally, in *none* of the above-described exchange rules is any notice or indication of a pending trade sent to the market.

V. Better Markets' concerns regarding the Exchange's proposed RFQ process are unfounded.

As of the date of this filing, Better Markets, Inc. has posted a public comment ("Comment") expressing concerns regarding the Exchange's RFQ rule certification.[4] Those concerns demonstrate some misunderstandings regarding the functionality of the proposed RFQ system. To correct the record:

- The Comment characterizes the RFQ process as "bypassing the centralized order book." *Id.* at 3. This is incorrect. All RFQ transactions would occur on the centralized order book, and in fact would cede priority to existing resting orders. For this reason, there is no scenario by which "market prices may no longer reflect the true consensus of event outcomes." *Id.*

[4] *See* Better Markets, Comment No. 74598 Re: KalshiEx, LLC's Rule Certification Submission No. 2409-1100-4224-55 (October 28, 2024), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=35614

- The Comment repeatedly states that certain market participants would be "excluded" from RFQ access. *See id*. at 3, 4. *See also id.* at 5 (referring to "privileged participants"). This, too, is incorrect. The RFQ system would be available to all market participants.
- The Comment repeatedly characterizes the RFQ system as involving "private negotiations." *Id.* at 1-5. However, as detailed above, the Exchange's rules contemplate a single round of pseudonymous bids in response to a public message visible to all market participants, with no written commentary or other related communication. Furthermore, participants are forbidden from acting upon the minimal nonpublic information derivable from this process, and the Exchange's robust surveillance function remains in place to enforce that rule.
- Contrary to the Comment, the RFQ system would make pre-arranged trades even more difficult, because (1) all RFQ trades must first execute against existing book liquidity; (2) a Requester can only accept the best price in response to their public message; and (3) all messages submitted through the RFQ system are surveilled by the Exchange. The RFQ system would merely add a layer of protection on top of existing order book functionality.
- The Comment avers, with no basis beyond speculation, that an RFQ system would siphon existing order book liquidity. *See id.* at 3, 4. This contradicts the very nature of an RFQ system, which is to provide *additive* liquidity in circumstances where resting orders do not reflect the market's willingness to trade. In circumstances such as the one described in Section IV(A), large transactions would not occur absent a system like this.
- The Comment characterizes a 30-second confirmation window as subject to "manipulation." *Comment at 6.* This demonstrates a basic misunderstanding of the purpose of this window, which is to protect a quote from sudden information risk after time has passed between the quote and its acceptance.
- The Comment avers that the proposed rule would set a "dangerous" and "deeply troubling precedent." *Id.* at 1, 5. However, the Comment does not address the existing exchanges with substantially identical rules. *See supra* Section III.

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For the foregoing reasons, Kalshi respectfully submits that the amendments to the rulebook are not inconsistent with the CEA and the CFTC's regulations, and would serve and promote a competitive, open, and efficient market. If you have any questions or comments or require further information, please do not hesitate to contact me.

Sincerely,
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