



Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission (“CFTC,” “Commission”)
Three Lafayette Centre
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Washington, D.C. 20581

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17 CFR Part
40 RIN 3038–AF14
Event Contracts
Notice of proposed rulemaking (“NPR”)¹

Submitted electronically

Dear Mr. Kirkpatrick,

The Institute for Agriculture and Trade Policy (“IATP”)² appreciates the opportunity to comment on the Event Contracts NPR. We most recently wrote about one event contract proposal referenced in the NPR in our July 24, 2023, letter on the Kalshi “Control Contracts.”³ We urged the Commission to not approve that contract and such self-certified political event contracts and election-based betting contracts in general. IATP thanks the Commission for its decision to disapprove the “Control Contracts.”⁴

IATP strongly supports the preamble of the NPR and the proposed amendments to the § 40.11 “Review of event contracts based upon certain excluded commodities.” This short

¹ <https://www.cftc.gov/sites/default/files/2024/06/2024-12125a.pdf>

² IATP is a nonprofit, 501(c)(3) nongovernmental organization, headquartered in Minneapolis, Minnesota, with offices in Washington, D.C. and Berlin, Germany. IATP participated in the Commodity Markets Oversight Coalition (CMOC) from 2009 to 2015, the Derivatives Task Force of Americans for Financial Reform from 2010 to 2016, and the AFR Wall Street Reform Working Group from 2016 to the present. IATP is a member of the Commission’s Technology Advisory Committee. Since 2010, IATP has submitted over 50 comment letters to the Commission.

³ <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=72722&SearchText=>

⁴ Regarding KalshiEX LLC - Commission Regulation 40.2(a) Notification Regarding the Initial Listing of the “Will <chamber of Congress> be controlled by <party> for <term> ?” Contract [“Control Contract”] “CFTC Disapproves KalshiEXLLC’s Congressional Control Contracts,” September 22, 2023. <https://www.cftc.gov/PressRoom/PressReleases/8780-23>

comment emphasizes the well-reasoned statutory and regulatory foundation for the NPR.

Regarding the definitions of “war” and “terrorism” in an amended § 40.11

We propose that the Commission consider further definitions of “excluded commodities” in § 40.11 to anticipate possible regulatory evasion of prohibited contracts. For example, should the current prohibition on contracts involving “war” need further definition to include not just hostile military acts between states but also state sponsoring of or state affiliation with private actors that attempt to destroy or disable computer networked physical and financial infrastructure? The preamble states, “The Commission does not believe that it is necessary to define ‘terrorism,’ ‘assassination,’ or ‘war’ at this time.” (Federal Register (“FR”), p. 48977) A footnote to this sentence explains, “The Commission clarifies, however, that it believes that cyberattacks and other acts of cyberterrorism constitute terrorism, and in some cases war, and are also likely to constitute activity that is unlawful under state or federal law.” (Footnote 85)

While IATP appreciates this clarification, preambles, although crucial for understanding an agency’s reasoning about a regulation, are not legally enforceable. The federal definitions of terrorism⁵ do not anticipate that the intention of a terroristic attack could be economic gain or disruption. The Commission’s Technology Advisory Committee’s cybersecurity subcommittee will soon be presenting its report and recommendations on cybersecurity and financial markets. Before the Commission finalizes its definitions for the revised §40.11, it should review the report to help it decide whether the risks to markets of cyberattacks and cyber-security failures merits an amended definition of “war” and “terrorism” in the rule or whether the footnoted clarification will suffice.

In theory, the statute and the §40.11’s inclusion of “similar activities” to those explicitly prohibited as involved in event contracts might be considered as an adequate firewall against such event contract regulatory evasion of prohibited “Enumerated Activities.” However, we live in a perilous jurisprudential landscape in which long-standing precedents in the delegation of statutory authority and administrative law are in jeopardy. Therefore, we contend, the Commission should consider defining “war” and “terrorism” as prohibited activities involved in the listing of derivatives contracts. If the Commission decides that such definitions are not warranted, we urge the Commission to include footnote 85 in the amended rule itself.

Regarding the NPR’s proposed methodology for evaluating event contracts

The NPR is not a review of a single proposed event contract. (For readers unfamiliar with event contracts, the NPR gives a sample of those contracts that Designated Contract

⁵ <https://www.law.cornell.edu/uscode/text/18/2331>

Markets (DCMs) have self-certified for trading.⁶) It is important to understand the status of the NPR because if it were a review of a single contract, then Commissioner Caroline Pham would be correct to expect that the preamble to the NPR include a summary of comments on the Commission’s review of a single application for the Commission’s approval of political control event contracts. By deciding not to include a summary of comments from the Commission’s review of the Kalshi Control Contracts, the Commission is not engaged in “selective amnesia,” as Commissioner Pham charges.⁷

The NPR cites comments neither supporting nor opposing the Kalshi Control Contracts because the NPR concerns types of event contracts in general, not the Kalshi Control Contracts per se. If, in her invitation to request comments about the so-called “Missing Comment Letters,” the Commissioner seeks to build an evidentiary pathway to overturning an Event Contracts final rule for putatively violating the Administrative Procedures Act, IATP believes her request for comments about the so-called “Missing Comment Letters” will prove to be legally irrelevant.

In 2022, the Futures Industry Association (FIA) asked the Commission to provide guidance on categories of event contracts that were among the Enumerated Activities that would be contrary to the public interest: “In conducting this review [of the first Kalshi Control Contracts self-certification], we urge the Commission to set forth clear ex-ante guidance to market participants about which event contracts are permissible under the Act and applicable CFTC Regulations, including Regulation 40.11.”⁸ The Commission cannot provide ex-ante guidance on a contract by contract basis. In effect, the NPR responds to the FIA request for ex-ante guidance. The preamble notes, “As part of any final rule resulting from this Notice of Proposed Rulemaking, the Commission intends to include an Appendix E to Part 40 containing guidance in the form of factors the Commission may consider, in addition to other factors the Commission deems appropriate in light of individual facts and circumstances, when making a determination under § 40.11(a)(2) that such event contracts are contrary to the public interest.” (FR, p. 48984) Appendix E, together with the final rule, will supply the ex-ante guidance that FIA and other market participants have requested about event contracts.

⁶ “These have included event contracts based on the occurrence or nonoccurrence of international events, natural disasters in specific U.S. cities, heating/cooling degree days and cumulative average temperature in specific cities, the timing of video game and album releases, Oscar award winners, COVID–19 case levels and restrictions, the outcome of cases pending before the Supreme Court of the United States, the passage of specific laws by the U.S. Congress, U.S. Presidential approval ratings, confirmation of U.S. executive branch officials, National Football League (“NFL”) television ratings, the discovery of exoplanets, and the occurrence of a National Aeronautics and Space Administration moon landing before a certain date.” Federal Register / Vol. 89, No. 112 / Monday, June 10, 2024 / Proposed Rules, p. 48969, footnote 9.

⁷ “Appendix 4: Statement of Commissioner Caroline Pham,” “Missing Comments,” FR, 49900.

⁸ <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70906&SearchText=>, p. 2.

The NPR describes a two-step general methodology to determine whether a proposed event contract (or swap contract) is “contrary to the public interest.”

First, the Commission must assess whether a contract in a specified excluded commodity “involve[s]” an activity enumerated in CEA section 5c(c)(5)(C)(i)(I)–(V) (each, an “Enumerated Activity”) or other similar activity as determined by the Commission by rule or regulation (“prescribed similar activity”). If the Commission determines that the contract involves such activity, the Commission must assess whether the contract is contrary to the public interest. (FR, 48971)

Although this methodology is clear and straightforward, its application to each proposed event contract would be time and resource intensive both for the DCM researching and designing the proposed contract and Commission staff reviewing it according to the two-step process. Therefore, the preamble and the amended rule advise DCMs of which types of contracts involving Enumerated Activities, such as “war” and “gaming,” that the Commission will determine to be “contrary to the public interest” and therefore are prohibited.

IATP agrees with the Commission’s reasoning and conclusion that the amended rule will both assist DCM’s business planning and contract design while conserving Commission staff resources from repeated reviews of individual contracts that may be “contrary to the public interest.” (FR, p. 48972) Nevertheless, despite this two-step methodology for types of event contracts, the preamble allows that the Commission may have to review individual contracts in cases where the contract characteristics involved with “gaming” do not clearly identify it as a prohibited contract. (FR, p. 48974) In sum, this methodology is pragmatic but not inflexibly dogmatic.

In the following section, IATP affirms the Commission’s statutory authority for and regulatory implementation involving types of contracts determined to be “contrary to the public interest.” We conclude our comment with remarks on “gaming,” the one Enumerated Activity that the Commission proposes to define in its amendments to § 40.11.

The alignment of the Commission’s statutory authority and §40.11

The statutory authority for the NPR provides for the Commission to make determinations about which type of event contracts [and swaps] are “contrary to the public interest:” “the [Commission](#) may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve”⁹ followed by a short list of types of event contracts that would be prohibited as “contrary

⁹ “Special rule for review and approval of event contracts and swaps contracts,” in U.S. Code 7 § 7.a-2-“Common provisions applicable to registered entities,” <https://www.law.cornell.edu/uscode/text/7/7a-2#fn002034>

to the public interest. “Such,” meaning “of the type previously mentioned” or “of the type about to mentioned,”¹⁰ demonstrates that the statute concerns types of contracts and not individual contracts per se.

IATP disagrees with Commissioner Summer Mersinger’s interpretation of the statute and as a result with much of her dissent: “There is no provision in CEA Section 5c(c)(5)(C) for public interest determinations regarding event contracts involving enumerated activities to be made by category.”¹¹ A plain text reading of the statute shows that Commission has the discretion (“may determine”) to make public interest determinations on categories of contracts. Furthermore, the Commission notes, “the statute does not require this public interest determination to be made on a contract-specific basis.” (FR, p. 48978) If the CEA required the Commission to make public interest determinations on a contract-by-contract basis, much of the work of the Division of Market Oversight would be delayed, given the refusal of Congress to provide the Commission with resources adequate to oversee expanding markets in the hundreds of new contracts DCMs self-certify annually.

This NPR proposes that the Commission will evaluate a category of event contracts, namely prohibited contracts, by revising 17 CFR § 40.11, which currently reads in part:

(a) Prohibition. A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following:

(1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law; or

(2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references an activity that is similar to an activity enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest.¹²

IATP supports the Commission’s proposal to delete “relates to, or references” from § 40.11 to align the rule more closely with the language of its corresponding statutory authority. We also agree that “gaming” should be further defined, as we outline in the next section.

The impetus for the proposed amendments to § 40.11 is not the review of any one event contract, but the rapid increase in the number of DCM self-certified event

¹⁰ Oxford Languages, <https://languages.oup.com/google-dictionary-en/>

¹¹ Appendix 3, Statement of Commissioner Summer K. Mersinger, FR, p. 48994.

¹² “§ 40.11 “Review of event contracts based upon certain excluded commodities,” <https://www.law.cornell.edu/cfr/text/17/40.11>

contracts since §40.11 was promulgated in 2011. (The preamble does not refer to any Commission review of a swap contract based on an excluded commodity.) This increase is summarized in NPR footnote 9, which reads in part:

From 2006–2020, DCMs listed for trading an average of approximately five event contracts per year. In 2021, this number increased to 131, and the number of newly-listed event contracts per year has remained at a similar level in subsequent years. Since 2021, DCMs also have listed for trading a substantial number of event contracts not associated with traditional commodities, financial indices, or economic indicators.

Some of these event contracts do not serve the commercial hedging purpose of traditional commodity derivatives contracts, nor do they have corresponding cash markets whose trading data form the underlying assets of derivatives contracts. Furthermore, event contracts are no longer the domain of retail investors, as registered entities are organizing to attract institutional investors to event contracts.¹³

There are event contracts that involve financial, economic and foreign exchange indicators and rates that “would generally fall outside of the scope of CEA section 5c(c)(5)(C) and § 40.11.” (FR, p. 48973) IATP agrees with the proposed non-exhaustive list of indicators and rates proposed by the Commission for event contracts that are not prohibited under an amended §40.11.

In response to the Commission’s question, “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 of the scope of CEA section 5c(c)(5)(C) and § 40.11?” (FR, p. 48973) IATP believes that event contracts involved with cryptocurrencies and other digital assets (e.g., carbon credits tokens), when used in legitimate commercial activities may require explicit identification.¹⁴

The proposed redefinition of “gaming”

Since rule §40.11 was promulgated in 2011, only event contracts concerning “gaming” have been presented by DCMs for the Commission’s formal review and approval. The

¹³ Lydia Beyoud, “Susquehanna’s New Trading Desk Bets on Events from Bitcoin to Taylor Swift,” Bloomberg, April 3, 2024. <https://www.bloomberg.com/news/articles/2024-04-03/susquehanna-starts-trading-desk-for-event-contracts-on-kalshi>

¹⁴ IATP concurs with researchers who find legitimate use cases for cryptocurrency to be scarce. IATP notes that the CFTC Director of Enforcement reported that half of its enforcement activities in 2023 involved cryptocurrencies. “Remarks by Enforcement Director Ian McGinley at the White Collar City Bar: Trends in Cryptocurrency Enforcement,” May 23, 2024. <https://www.cftc.gov/PressRoom/SpeechesTestimony/opamcginley> Nevertheless, we cannot ignore the political and lobbying support to legitimize cryptocurrency transactions and clearing through legislation and regulation. As a result, if the Commission becomes the predominant regulator of digital assets, we make our recommendation to include cryptocurrency contracts in the non-exhaustive list of types of contracts not covered by §40.11.

Commission proposes to define “gaming” so that designers of proposed event contracts can evaluate whether the Commission “may determine” that event contracts involved with gaming are contrary to the public interest. The NPR states,

Proposed § 40.11(b)(2) states that “gaming” includes, but is not limited to, the staking or risking by any person of something of value upon: (i) the outcome of a political contest, including an election or elections; (ii) the outcome of an awards contest; (iii) the outcome of a game in which one or more athletes compete; or (iv) an occurrence or nonoccurrence in connection with such a contest or game, regardless of whether it directly affects the outcome. The Commission emphasizes that the list of examples provided in proposed § 40.11(b)(2) is non-exclusive. (FR, 48975)

IATP agrees with this definition because it is clearly stated and will assist the Commission to determine what type of event contracts are contrary to the public interest in the use of derivatives contracts, e.g., the price basing utility of a contract.

Part (i) of this definition, as explained in the preamble, is comprehensive, covering the widest range of domestic and foreign jurisdictions, to include one or more elections that result in a gaming outcome, such as the party control of a chamber of a legislature. Furthermore, a contract involving an occurrence or non-occurrence affecting political contests, such as the withdrawal of a candidate, would likewise apply to the definition of “gaming,” even if the occurrence or non-occurrence did not affect the outcome of the contest. (FR, p. 48976)

Gamblers who attempt to distract or disrupt athletic contests while gambling with the use of their cellphones has become a feature of sporting events.¹⁵ As the NPR notes, some state laws that allow gambling on sports events do not allow betting on occurrences or non-occurrences (e.g., a player doesn’t play) associated with a sporting event. (FR, p. 48976) Derivatives contracts based on “gaming” and such occurrences as heckling or the injury of a player during a contest would be prohibited under the definition of “gaming” in the amended §40.11. Likewise, IATP believes it would be contrary to the public interest if retail or institutional investors were allowed to bet on occurrences or non-occurrences associated with political event contracts, such as a contract based on which candidate was first to report X amount of political campaign contributions by Y date.

The likelihood would be high that such a contract would be susceptible to manipulation, in violation of Core Principle 3. For example, an event contract investor could produce a deep fake that disrupts political contributions and make a High Frequency Trading killing on the contract involving the candidate benefiting from the deep fake. IATP strongly

¹⁵ E.g., Danny Funt, “One soundtrack at the U.S. Open: Heckling from gamblers,” *The Washington Post*, June 17, 2024. <https://www.washingtonpost.com/sports/2024/06/17/one-soundtrack-us-open-heckling-gamblers/>

agrees with the preamble's statement that "The lack of price forming information for contracts involving "gaming," or the availability of only opaque and/or 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." (FR, p. 48982)

It may be the case that threatened or actual litigation against the revised §40.11 rule and/or a campaign of comment letters from retail and institutional political event contract investors opposing the rule will cite the 2018 U.S. Supreme Court decision striking down the 1992 federal prohibition against commercial gambling in most states.¹⁶ IATP does not believe that the definition of "gaming," in the context of an amended §40.11 applied to derivatives contracts, contravenes that ruling to allow states to license commercial gambling establishments offering cash-based contracts.

However, IATP cannot predict how courts will review a final amended §40.11 rule. The Commission is prudent to ask, "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?" (FR, p. 48977) In the event of an adverse court ruling concerning a final amended §40.11, the Commission should consider whether a political event contract is "similar to" gaming. A strong foundation for this consideration is the Commission's analysis of the public interest in derivatives contracts that have commercial hedging and price basing utility function, among other economic purposes that can be evaluated based on standardized, transparent and reliable data historically associated with categories of physically backed and financial derivatives contracts.

Defining and interpreting "contrary to the public interest"

IATP supports a review of event contracts "similar to" gaming in part because the Commission's very well-founded analysis of the public interest in derivatives trading and clearing cannot be overturned by the courts without also overturning the economic purpose, analytic tools and the supporting data of that purpose of derivatives trading embedded in a history of Commission decisions. Furthermore, as noted above, the Commission will reference other public interest factors in Appendix E to Part 40, which will be published with the final rule. (FR, p. 48984)

The NPR notes, "The term 'public interest' is not defined in CEA section 5c(c)(5)(C). As discussed more fully below, historically, the Commission has evaluated whether a contract is contrary to the public interest with reference to the contract's commercial

¹⁶ E.g., Adam Liptak and Kevin Draper, "Supreme Court Ruling Favors Sports Betting," *The New York Times*, May 14, 2018. <https://www.nytimes.com/2018/05/14/us/politics/supreme-court-sports-betting-new-jersey.html>

hedging or price-basing utility. The Commission has also, however, regularly stated that other public interest factors may be considered.” (FR, p. 48978) The NPR identifies five other factors: “identified in section 15(a) of the CEA: protection of market participants and the public; efficiency, competitiveness, and financial integrity of the markets; price discovery; sound risk management practices; and other public interest considerations.” (FR, 48991)

Commissioner Mersinger dismisses these factors but inadvertently raises an important regulatory issue: “Aside from the ‘economic purpose test,’ the Proposal points to a hodgepodge of other factors to try to justify prohibiting entire categories of event contracts, whose terms and conditions the Commission has never seen, from being traded on exchanges.” (FR., p. 48996) It is unfortunate that DCM self-certifications of hundreds of contracts as consistent with the CEA and the Core Principles allows such contracts to enter into trade, often without an adequate staff review of the contract’s supporting documentation, much less a Commission review of the contracts, even those with novel features, such as the Global Emissions Offset futures contract.¹⁷ Self-certification allows, but does not require, a Commission perennially starved of resources by Congress to delegate its authority over new contracts to the DCMs. Commissioner Mersinger’s disparagement points to a need for a Commission review of how self-certification documentation is reviewed by staff generally, not just for event contracts.¹⁸

Commissioner Mersinger argues that the CFTC is being “paternalistic” when it seeks to protect retail market participants who are investing in event contracts in competition with large institutional investors. (FR, p. 48996) While it is true that the Commission lacks the rules and staffing comparable to that for the Security and Exchange Commission’s protection of retail customers, it does not follow that the Commission should ignore or diminish the protection of retail market participants in event contracts. If a category of event contracts disadvantages retail market participants, compared to institutional investors with far greater information and financial resources, the Commission’s protection of retail investors is not paternalistic. The Commission has various means to protect retail investors, e.g., fraud alerts and educational programs. But the discretion to determine which category of contracts are contrary to the public interest is yet another indispensable means of market participant protection.

Conclusion

¹⁷ Steve Suppan, “What underlies the underlying (asset) of CO₂ emissions offset futures contracts?” Institute for Agriculture and Trade Policy, March 31, 2021. <https://www.iatp.org/blog/202103/what-underlies-underlying-asset-co2-emissions-offset-futures-contracts>

¹⁸ Lee Reiners, “Bitcoin Futures: From Self-Certification to Systemic Risk,” Global Association of Risk Professionals, January 24, 2019. <https://www.garp.org/white-paper/bitcoin-futures-from-self-certification-to-systemic-risk>

IATP thanks the Commission for releasing for comment this very timely and important NPR. We hope that our comments assist the staff and Commission to expeditiously finalize this rule.

Respectfully submitted,
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