

September 25, 2022

Secretary of the Commission, Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: KalshiEX Proposed Congressional Control Contracts Under CFTC Regulation 40.11

Dear Chairman and Commissioners:

I was appointed by President Barack Obama in 2011 as a Commissioner of the Commodity Futures Trading Commission (CFTC), where I served for five years, including as acting Chairman for several months. I also sponsored the agency's Global Markets Advisory Committee and was a principal of the U.S. Financial Stability Oversight Council. During this time, the Commission worked extensively on writing, implementing, and enforcing new rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Today, I am head of policy and regulatory strategy at FTX US and director with FTX US Derivatives.¹ I am writing this comment to support Designated Contract Markets (DCMs) listing event contracts based on partisan control of Congress, as doing so would provide a valuable risk management tool to market participants as well as promote the public interest.

In 2012, I was a Commissioner of the CFTC when another DCM, Nadex, submitted several contracts on political control, including control of Congress. While the Commission voted to prohibit them at that time,² conditions have changed in the last ten years, and the concerns the Commission expressed in its Nadex order have not materialized. Further, while I was at the agency in 2014, the Commission issued a No-Action Letter to Victoria University of Wellington to operate the platform now known as PredictIt. For the last eight years, PredictIt ran a successful prediction market on various election outcomes, with no observed ill effects on election integrity. In addition, the hedging and price-basing utility of these contracts are clearer now than they were in 2012.³ Substantial academic research, investment analysis, and financial institution

¹ The views expressed in this comment are my own and not necessarily those of FTX US Derivatives. FTX US Derivatives is not party to Kalshi's submission to the Commission for approval. FTX US Derivatives operates its own DCM. FTX US Derivatives clears trades that occur on Kalshi.

² See here:

<https://www.cftc.gov/sites/default/files/idc/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>

³ For an example, see Minutes of the Federal Open Market Committee, December 13–14, 2016, pp. 2. <https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20161214.pdf>

publications have addressed how contracts like these can be used both for hedging purposes and as the basis for pricing a commercial transaction involving a physical commodity, financial asset, or service. This demonstrates that these contracts satisfy the economic purpose test the Commission employed in its Nadex order.

Economic Purpose

Event contracts on Congressional control serve an important role in risk management. Specifically, these contracts would allow individuals to be able to reduce their risk exposure to changes in the probability of different parties gaining control of government. Many changes in taxes, subsidies and program design are favored by one party or another, and are thus more likely to become law if one party is in power versus another. A small-scale supplier for a semiconducting foundry may expect to see more orders under a government that has signaled through their campaign speeches and policy documents that they will prioritize building a domestic semi-conducting supply chain. An electric car dealer may expect to see fewer orders under a government who may not re-authorize subsidies for purchase. While the specific policies that become law cannot be known with certainty, there remains a change in *risk*, and a change in *risk* is what hedging instruments are designed to manage. These contracts can help those who face disproportionate risk offload the risk to those who can.

Hedging is not the only economic value that these contracts provide. These contracts can also serve as the foundation to price other goods and services.

The price of commodity futures is based on market expectations of supply and demand for related goods, assets or services in the near future. Both supply and demand can depend, in part, on government action. Farm bills, energy bills, appropriating direct government payments to individuals, and many other Congressional actions can have clear effects on the prices of commodities. It's not enough for commodity traders to wait until a bill becomes law to respond—the most accurate pricing will reflect the probability of various policy changes as well and it is impossible to accurately forecast the probability of a bill passing without knowing the probability of political control of Congress. This explains the considerable amount of academic articles, news reports and industry analyses discussing the implications of various elections, or even changes in election polling, for commodity prices.⁴

But knowing the probability of a given party controlling Congress implicates more than just the prices of financial assets—it also impacts the way businesses make decisions. For instance, a firm may not invest in creating a program that relies on specific tax breaks if they are uncertain about whether those subsidies will continue into the near future. To wit, the Federal Reserve's October

⁴ For one representative example, see here: <https://seekingalpha.com/article/4218314-midterm-elections-in-u-s-impact-commodities-prices>.

2016 Beige Book notes that many contacts had held off on making core business decisions until after the elections had occurred, in order to reduce uncertainty.⁵ Having a market-based probability estimate could thus help them make the best decision without having to forgo months of lost profits by waiting.

Social purpose

Beyond providing a tool for risk management and price discovery, these contracts serve a valuable social purpose and promote the public interest by providing a market-derived data point on the outcome of the election. In recent years, the rise of asymmetric non-response bias can result in egregious polling “misses” in key states (see: the 2016 and 2020 presidential and Congressional elections). As a result, media companies are often left reporting inaccurate polls to the public, leaving their viewers misinformed.

Prediction markets help improve this state of affairs through two mechanisms. First, they introduce competition into the polling industry, as the media now has an alternative. If prediction markets consistently outperform polls (as some historical evidence suggests they might⁶), then the media might opt to use them instead. As a result, the demand for any given polling company will decline, and they thus have an incentive to invest resources in solving many of the issues that had bedeviled polling in the past.

Second, prediction markets can incorporate information faster and more comprehensively than polls and statistical models. After a crucial event, polling companies must wait several days to conduct a sufficient sample size to report their effects, and statistical models must wait until a sufficient number of these post-event polls have been conducted in order to update. In contrast, because non-hedging prediction market traders are highly incentivized to closely follow the news and gain an edge over their fellow traders, they will react as soon as the event occurs, offering a more real-time analysis of the state of the race. As a result, media companies who wish to report on the effect of the event (and who are unlikely to wait the one to three weeks for enough polls to come in) can rely on a validated, market-based approach instead of the prognostication of individual pundits (who tend to have a much worse track record than even a simple polling averages). While media companies may benefit from having more accurate information, the true beneficiaries are the broader public, who will be better informed as a result of the introduction of these contracts into the marketplace.

⁵ [https://www.federalreserve.gov/monetarypolicy/beigebok201610.htm](https://www.federalreserve.gov/monetarypolicy/beigebook/beigebok201610.htm).

⁶ Arnesen, S. and Bergfjord, O., “Prediction Markets vs Polls- An Examination of Accuracy for the 2008 and 2012 US Elections”. *The Journal of Prediction Markets* 8(3):24-33 (2014).

https://www.researchgate.net/publication/282123487_PREDICTION_MARKETS_VS_POLLS_AN_EXAMINATION_OF_ACCURACY_FOR_THE_2008_AND_2012_US_ELECTIONS

Election integrity

In the last decade plus, millions of contracts on political contracts have traded, and election trading has picked up in volume on overseas exchanges (especially those in Britain).

Notwithstanding this trend, I am aware of no data or studies suggesting it has had an impact on election integrity. This should assuage Commission concerns about impacts on elections themselves.

Conclusion

In short, election markets are a powerful tool for hedging, price-basing and promoting the public interest. They represent the kind of innovation that the CFTC should embrace, and I would encourage them to allow the proposed contract to proceed.

Very truly yours,

DocuSigned by:


Mark Wetjen
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