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secretary RECEIVED C.F.T.C.

COMMENT

From: Bell, Tom W. [tbell@chapman.edu]
Sent: 2008 JUL -7 PM Sunday, July 06, 2008 11:32 PM
To: secretary
Cc: Bell, Tom W.
Subject: RECORDS SECTION Joint Comment on Concept Release on the Appropriate Regulatory Treatment of Event Contracts

Attachments: CFTC_JT_Reply.pdf

OFC. OF THE SECRETARIAT 2008 JUL -7 AM 10:11 RECEIVED C.F.T.C.

CFTC_JT_Reply.pdf
(89 KB)

Dear Office of the Secretariat,

On behalf of myself and 19 other signatories, I would like to submit a joint comment on the CFTC's recent Concept Release on the Appropriate Regulatory Treatment of Event Contracts. I have attached our comment as a PDF (the preferred format) file, as well as in the body of this email, below. Thank you.

Tom W. Bell

* * *

July 6, 2008

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

Sent via e-mail to <secretary@cftc.gov>.

Re: Joint Comment on Concept Release on the Appropriate Regulatory Treatment of Event Contracts

What regulatory treatment should the Commodities Futures Trading Commission ("CFTC") apply to event markets? We the undersigned, who represent a wide range of viewpoints, agree on three general observations. First and foremost, the CFTC should do no harm. Second, at a minimum, the CFTC should make more general the sort of "no action" status enjoyed by the Iowa Electronic Markets ("IEM"). Third, if the CFTC decides to regulate event markets more substantively, it should adopt clear and limited jurisdictional boundaries and allow affected parties to step outside of them.

First, do no harm: Many sorts of event markets—including public ones, private ones, ones that offer only play-money trading, and ones that offer real-money trading—already thrive in the U.S. They have provided a rich array of benefits without evidently harming anyone. The CFTC could help event markets achieve still greater success by clarifying their legality. Instituting the wrong sort of regulations could suffocate event markets in their cradle, however. The CFTC should exercise a light hand, taking care to do no more than offer qualifying event markets the shelter of federal preemption and freeing them to continue operating under the extant legal regime.

Second, open up the "no action" option: Thanks in part to the "no action" letters that the CFTC has issued to it, the IEM has for many years benefited the public by offering real-money event markets. No sound reason precludes the CFTC from giving similar treatment to other institutions that, like the IEM, offer event markets solely for academic and experimental purposes and without imposing trading commissions.

Although the CFTC's "no action" letters do not specify the exact criteria the IEM had to satisfy, they took favorable note of the IEM's account limits. Those account limits effectively prevent the IEM from supporting significant hedging functions. If the CFTC builds a similar requirement into any general "no action" guidelines, it should adopt limits considerably more generous than the meager $500/trader limit adopted decades ago by the IEM. Even a limit ten times that amount would still effectively preclude hedging.

The CFTC should not limit "no action" status to markets run by tax-exempt organizations. The no-action letters that the CFTC issued to the IEM emphasized not the nature of the hosting institution, the University of Iowa, but rather the business model adopted by the IEM itself. Profitability could not have mattered, as tax-exempt organizations can and do earn profits (indeed, as their burgeoning endowments demonstrate, many universities earn immense profits). The CFTC apparently cared only that the IEM did not plan to profit from charging traders commissions. A tax-paying organization could satisfy that condition just as easily as a tax-exempt organization could. In either event, price discovery would flourish and consumers would win a safeguard against getting fleeced.

Third, preserve regulatory exit options: If the CFTC decides to write substantive regulations for event markets, it should recognize and guard against the risk of overregulation. Even well-intentioned and well-informed regulators remain human and, thus, all too apt to make mistakes. They run an especially large risk of making mistakes when they first attempt to regulate new institutions, such as event markets. To make matters worse, regulators typically lack reliable signals to determine when they have gone too far. Industries wither away for many reasons, after all.

The CFTC's approach to regulating event markets should accommodate these policy considerations by establishing clear jurisdictional boundaries and opening exit options. Thus, for instance, the CFTC might specify that it has no jurisdiction over event markets that offer trading only to members of a particular firm, over markets that offer only spot trading in negotiable conditional notes, or over markets that do not support significant hedging functions. Then, if the CFTC enacts unduly burdensome regulations, an event market could opt out of them by changing its business model. So long as markets publicly announce that they operate outside the CFTC's purview, allowing them that freedom of exit would harm nobody. To the contrary, it would help the CFTC gauge the suitability of its regulations and serve the public by protecting the continued viability of event markets.

Signatures

Please note that the signatories to this comment speak only for themselves. Any institutional affiliations listed below serve only for purposes of identification, not representation. Signatures follow in order of receipt via email sent to Tom W. Bell.

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