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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
TRADING AND MARKETS

Received CFTC
Records Section
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September 3, 2008

David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

COMMENT

Re: Commodity Futures Trading Commission Concept Release on the Appropriate Regulatory Treatment of Event Contracts

Dear Mr. Stawick:

Recently the Commodity Futures Trading Commission ("CFTC") requested comment on the appropriate regulatory treatment of financial agreements offered by markets commonly referred to as event, prediction, or information markets (generically "event contracts").[1] The staff of the Division of Trading and Markets ("Division") of the Securities and Exchange Commission ("SEC" or "Commission") would like to offer the following brief comments.

The Division recognizes that event contracts raise difficult issues under the Commodity Exchange Act ("CEA"). As the Concept Release points out, many of these event contracts are neither dependent on, nor necessarily relate to, market prices or broad-based measures of economic or commercial activity, but instead are frequently based on eventualities and measures as varied as the world's population in a particular year, the results of a political election, or the outcome of particular entertainment events. The Division supports the CFTC's efforts to determine the appropriate regulatory treatment of contracts on such non-economic events as a means of fostering market innovation and fair competition and to promote efficiency in regulatory oversight.

Event contracts that generate trading prices that predictably correlate with market prices or broad-based measures of economic or commercial activity raise more difficult issues. For instance, as the Commission has stated, the definition of security includes binary options (which are a type of event contract) whose pricing in the secondary market moves in relation to the value of an underlying security or securities.[2] Hence, the correct regulatory treatment of event

1 See Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 FR 2569 (May 1, 2008) ("Concept Release").

2 See Securities Exchange Act Release No. 55871, 72 FR 32372, 32375 (June 12, 2007).

contracts depends, in part, on whether the contract is based on a security or group or index of securities (or an interest therein or based on the value thereof).[3]

In addition, event contracts that relate to corporate events, such as mergers or earnings per share announcements, raise even more difficult issues and policy considerations.[4] For instance, there is potential for this type of contract to create a potential for insider trading and an incentive for management to manipulate such accounting measures as earnings per share. Accordingly, the Division is concerned about the effects that trading such contracts may have on securities markets.

Event contracts thus clearly contain elements of interest to both agencies. In keeping with our agencies' Memorandum of Understanding,[5] we look forward to working with you to resolve these difficult regulatory issues with an eye toward fostering market innovation and fair competition and promoting efficiency in regulatory oversight.

We appreciate the opportunity to comment on the Concept Release. Should you require any further information, please do not hesitate to contact me.

Sincerely,

Erik R. Sirri

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3 Cf. Concept Release at note 2; see Section 2(a)(1)(C)(i) of the CEA (which excludes options on one or more securities, including any group or index of such securities, or any interest therein or based on the value thereof, from the CFTC's exclusive jurisdiction).

4 We note that, in 1993, the Iowa Electronic Markets requested no-action relief from the CFTC regarding an Earnings Market comprised of contracts based on the projected quarterly earnings of several corporate stocks. The staff of the CFTC referred the proposal to the SEC at that time, noting that "it appears that the Earnings Market contracts could be viewed as in the nature of options on securities, which may be excluded from the Commission's jurisdiction pursuant to Section 2(a)(1)(B)(i) of the [CEA], but which may be subject to the jurisdiction of the Securities and Exchange Commission." Letter from Andrea Corcoran, Director, Division of Trading and Markets, CFTC, to Brandon C. Becker, Director, Division of Market Regulation, SEC (June 18, 1993) (with Letter from Andrea Corcoran, Director, Division of Trading and Markets, CFTC, to Professor Neumann, Professor of Economics, University of Iowa attached) (available at: http://www.cftc.gov/files/foia/repfoia/foirf0503b004.pdf).

5 See Memorandum of Understanding Regarding Coordination of Areas of Common Regulatory Interest (March 11, 2008).