

UNITED STATES OF AMERICA

Before the

COMMODITY FUTURES TRADING COMMISSION

In the Matter of the Self-Certification by North American Derivatives Exchange, Inc., of Political Event Derivatives Contracts and Related Rule Amendments under Part 40 of the Regulations of the Commodity Futures Trading Commission

**ORDER PROHIBITING THE LISTING OR TRADING OF POLITICAL
EVENT CONTRACTS**

By a submission dated and received by the Commodity Futures Trading Commission (“Commission”) on December 19, 2011, the North American Derivatives Exchange (“Nadex” or “Exchange”) self-certified, pursuant to Section 5c(c)(1) of the Commodity Exchange Act (“CEA”) and Commission Regulations 40.2(a) and 40.6(a), new contracts: a Democratic Majority in the U.S. House of Representatives Binary Contract; a Republican Majority in the U.S. House of Representatives Binary Contract; a Democratic Majority in the U.S. Senate Binary Contract; a Republican Majority in the U.S. Senate Binary Contract; and ten 10 U.S. Presidency Binary Contracts (collectively, the “Political Event Contracts”) and related rule amendments. The Political Event Contracts are each binary option contracts that pay out based upon the results of the various United States federal elections in 2012. Having reviewed the complete record in this matter, including Nadex’s submission, public comments and a Nadex supplementary submission, the Commission makes the following findings and rulings:

WHEREAS, under CEA Section 5c(c)(5)(C)(i), the Commission may determine that a contract in certain excluded commodities, as defined in CEA Section 1(a)(19), is contrary to the public interest if the contract involves: (1) activity that is unlawful under any Federal or State

law, (2) terrorism, (3) assassination, (4) war, (5) gaming, or (6) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest;

WHEREAS, the legislative history of CEA Section 5c(c)(5)(C) indicates that the relevant question for the Commission in determining whether a contract involves one of the activities enumerated in CEA Section 5c(c)(5)(C)(i) is whether the contract, considered as a whole, involves one of those activities;

WHEREAS, CEA Section 5c(c)(5)(C)(ii) mandates that no “contract . . . determined by the Commission to be contrary to the public interest under Section 5c(c)(5)(C)(i) may be listed or made available for clearing or trading on or through a registered entity”;

WHEREAS, Commission Regulation 40.11(a)(1) provides that registered entities, as defined in CEA Section 1(a)(40) and inclusive of designated contract markets such as Nadex, shall not list for trading any contract based upon an excluded commodity, as defined in CEA Section 1(a)(19), that “involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law”;

WHEREAS, several state statutes, on their face, link the terms gaming or gambling (which are used interchangeably in common usage, dictionary definitions and several state statutes) to betting on elections,¹ and state gambling definitions of “wager” and “bet” are analogous to the act of taking a position in the Political Event Contracts;²

¹ See, e.g., 720 ILL. COMP. STAT. ANN. 5/28-1 (West 2011) (“A person commits gambling when he . . . [m]akes a wager upon the result of any game, contest, or any political nomination, appointment or election”); NEB. REV. STAT. § 28-1101(4) (2011) (“A person engages in gambling if he or she bets something of value . . . upon the outcome of a game, contest, or election”); N.M. STAT. ANN. § 44-5-10 (1978) (“Bets and wagers on an election authorized by the constitution and laws of the United States, or by the laws of this state, are gaming within the meaning of this chapter [on gambling debts and losses.]”); N.D. CENT. CODE ANN. § 12.1-28-01 (West 2011) (“‘Gambling’ means risking any money . . . upon . . . the happening or outcome of an event, including an election . . . over which the person taking the risk has no control.”). See also GA. CODE ANN. § 16-12-21(a)(2) (West 2011) (“A person commits the offense of gambling when he . . . [m]akes a bet upon the result of any political nomination, appointment, or election”); MISS. CODE ANN. § 97-33-1 (West 2011) (“If any person . . . shall wager or bet . . . upon the result of any election . . . he shall be fined in a sum not more than Five Hundred Dollars”); S.C. CODE ANN. § 16-19-90 (2011) (“Any person who shall make any bet or wager of money . . . upon any election in this State

WHEREAS, a federal statute defines the term “bet or wager” as “the staking or risking by any person of something of value upon the outcome of a contest of others. . . .”³ and taking a position in a Political Event Contract fits the plain meaning of a person staking “something of value upon a contest of others,” as the Political Event Contracts are all premised either directly (in the case of the presidential Political Event Contracts) or indirectly (in the cases of the House and Senate majority control Political Event Contracts) on the outcome of a contest between electoral candidates;

WHEREAS, the legislative history of CEA Section 5c(c)(5)(C) indicates Congress’s intent to restore, for the purposes of that provision, the economic purpose test that was used by the Commission to determine whether a contract was contrary to the public interest pursuant to CEA Section 5(g) prior to its deletion by the Commodity Futures Modernization Act of 2000;

WHEREAS, the restored economic purpose test calls for an evaluation of an event contract’s utility for hedging and price basing purposes;

WHEREAS, the unpredictability of the specific economic consequences of an election means that the Political Event Contracts cannot reasonably be expected to be used for hedging purposes;

WHEREAS, there is no situation in which the Political Event Contracts’ prices could form the basis for the pricing of a commercial transaction involving a physical commodity, financial asset or service, which demonstrates that the Political Event Contracts have no price basing utility;

shall be guilty of a misdemeanor”); TEX. PENAL CODE ANN. § 47.02(a)(2) (West 2011) (“A person commits an offense if he . . . makes a bet on the result of any political nomination, appointment, or election”).

² See, e.g., N.H. REV. STAT. ANN. § 287-D:1(VI) (2011) (“‘Wager’ means a monetary agreement between 2 or more persons that a sum of money . . . shall be paid to one of them on the happening or not happening of an uncertain event.”); WIS. STAT. ANN. § 945.01(1) (2011) (“A bet is a bargain in which the parties agree that, dependent upon chance even though accompanied by some skill, one stands to win or lose something of value specified in the agreement.”)

³ 31 U.S.C. §§ 5361–5367 (2006).

WHEREAS, the Commission has the discretion to consider other factors in addition to the economic purpose test in determining whether an event contract is contrary to the public interest;

WHEREAS, the Political Event Contracts can potentially be used in ways that would have an adverse effect on the integrity of elections, for example by creating monetary incentives to vote for particular candidates even when such a vote may be contrary to the voter's political views of such candidates;

The Commission FINDS that the Political Event Contracts involve gaming as contemplated by CEA Section 5c(c)(5)(C)(i)(V) and Commission Regulation 40.11(a)(1);

The Commission FURTHER FINDS that the Political Event Contracts are contrary to the public interest as contemplated by CEA Section 5c(c)(5)(C);

Therefore:

IT IS HEREBY ORDERED that, pursuant to CEA Section 5c(c)(5)(C)(ii) and Commission Regulation 40.11(a)(1), the Political Event Contracts shall not be listed or made available for clearing or trading on the Exchange.

Issued in Washington, D.C. this 2nd day of April, 2012.

By the Commission



David Stawick
Secretary