93-66

**COMMODITY FUTURES TRADING COMMISSION**
2033 K Street, NW, Washington, DC 20581
(202) 254 - 8955
(202) 254 - 8010 Facsimile

DIVISION OF
TRADING AND MARKETS

June 18, 1993

Dear :

This is in response to your letter to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission (the "Commission"), dated March 16, 1993, as supplemented by the "Trader's Manual" forwarded with your letter and by telephone conversations with Division staff. As you note, the Division previously, by letter dated February 5, 1992, granted no-action relief with respect to the operation of the "A", a market on the 1992 presidential election operated for academic research purposes.

By your letter, you request, on behalf of the ("X") similar relief with respect to the operation of the "X", as such operation is described herein. In particular, you request that the Commission recognize that the "X" should not be required to obtain designation as a contract market or otherwise comply with the Commodity Exchange Act ("Act")[1/] and the regulations promulgated thereunder,[2/] and that its Operators (as defined below) need not register under the Act or Commission regulations.

Based upon the representations contained in your letter, as supplemented, we understand that the facts are as follows. The "X" is an electronic trading market trading contracts in specified "products" which is organized as an experimental and academic program at the (the "University"). Approval for the operation of the "X" was obtained from the President of the University. Its purpose is to determine whether markets can aggregate information and predict outcomes more accurately than alternative technology such as public opinion polling. Neither the "X" nor the University charges any commissions or receives a return in connection with its operation. It is operated strictly on a nonprofit basis and the method of issuing contracts and making final payoffs on these

---

1/ 7 U.S.C. § 1 et seq. (1988), as amended by the Futures Trading Practices Act of 1992, Pub. L. No. 102-546, 106 Stat. 3590.

2/ Commission regulations referred to herein are found at 17 C.F.R. Ch. I (1992).

contracts ensures that the "X" does not realize financial profit or suffer loss as a result of transactions in such contracts.[3/]

The "X" is operated by three professors on the faculty of the University (designated as the "Governors"), through the Departments of Accounting and Economics and the College of Business Administration. There are various so-called "Directors" of the "X", who also are on the faculty of the University, who assist in its operation and teach classes that use the "X". Neither the Governors nor Directors receive any compensation or other payment, directly or indirectly, for operating the "X". In addition, "Market Administrators," who are graduate students at the University, assist in operating the "X" and a "System Programmer" is employed by the University to assist in the technological operation of the "X". (Collectively, the Governors, Directors and Market Administrators may be referred to as the "Operators").

You represent that none of the Operators is otherwise required to register with the Commission nor is any of the Operators a business affiliate of any person required to register with the Commission. You also represent that none of the Operators is subject to a statutory disqualification under Sections 8a(2) or 8a(3) of the Act.[4/] In addition, none of the Operators or any other person involved with the "X" will engage in any advertising in connection therewith. The written materials concerning the "X" will prominently disclose that the "X" is an experimental market that is being operated for academic purposes and it is not regulated by, nor are its operators registered with, the Commodity Futures Trading Commission or any other regulatory authority.

You estimate that at least 20 universities will participate in the "X", including the University of California at Los Angeles, the California Institute of Technology, Northwestern University, the University of Indiana, the University of Arizona and the University of Virginia.[5/]

---

[3/] The "X" does not currently charge participants in the "X" any enrollment fee. It anticipates that it will implement an enrollment fee of between $5-20 per participant to cover basic costs for the program such as photocopying of materials and supplemental handouts.

[4/] 7 U.S.C. §§ 12a(2) or 12a(3) (1988).

[5/] You anticipate that more than 20 universities will eventually participate in the "X".

The "X" currently is composed of three submarkets, known as the "Political Market,"[6/] the "Earnings Market" and the "Economic Indicator Market" (collectively the "Submarkets"). Each of the Submarkets permits trading in various contracts. The traders participating in the Political Markets will not exceed 2000 in number for any particular election for which a Political Market is operated and will be primarily, but not exclusively, students, faculty and staff at the various universities. Currently, no Political Markets are in operation. The number of traders participating in the Earnings Market and the Economic Indicator Market will not exceed 1000 for each such Submarket and participation will be restricted to students, faculty and staff at the various participating universities. The maximum investment by any single participant in any one Submarket is five hundred dollars, but typically participants invest no more than fifty dollars.

The "X" operates on a PC network in the College of Business Administration of the University with local access from PCs or terminals on many University networks and remote access via the Internet and telephone dial-up lines. Participants execute their own trades and no brokerage service is available or allowed. Participants invest their own funds, buy and sell listed contracts, and bear the risk of loss.

While the operations of the Submarkets share many characteristics, each market trades different products. For purposes of the relief requested herein, each Submarket will be addressed separately.

THE POLITICAL MARKET

We understand that the facts with respect to the Political Market are as follows. The Political Market's purpose is to determine whether markets can aggregate information and predict election outcomes more accurately than the alternative technology of public opinion polling. In the Political Market, participants purchase a portfolio of shares in political candidates and returns are determined by the share of the popular vote won by each candidate.

By letter dated December 5, 1991, you sought approval by the Commission for operation of political markets on the 1992 presidential election and the 1992 Democratic Party nomination (collectively, those markets will be referred to as the "1992 Markets"). In its February 5, 1992 response to your request, the Division

---

6/ Prior to this time, the Political Market was referred to as the "A."

stated that it would not recommend that the Commission take any enforcement action in connection with the operation of the 1992 Markets based upon the Operators of those markets not seeking designation as a contract market, registering under the Act or otherwise complying with the Act or Commission regulations. The Division's position was based upon the facts set forth in your letter, including that the operation of the 1992 Markets was limited solely to academic and experimental purposes and that the persons operating the 1992 Markets received no compensation.

We note that the Division's February 1992 letter was expressly limited to the 1992 Markets and included a request that you notify the Division immediately if the relevant facts or circumstances changed. Thus, operation of any other markets was not addressed by the Division's letter and in this letter we are addressing your request for relief with respect to markets other than the 1992 Markets on a prospective basis only.

You now request that the Division expand the scope of its prior relief to include other political markets which you operate or intend to operate. For example, you intend to operate a political market on the Canadian elections in 1993 and on the U.S. House and Senate races in 1994. Consequently, you seek confirmation that the operation of the prospective Political Markets will not be within the purview of the Act and the regulations promulgated thereunder.

As with the 1992 Markets, participants in the prospective Political Markets will purchase a portfolio of shares in political candidates. Individual investors will invest their own money to participate, and returns will be determined by the share of the popular vote won by each candidate.

Based upon your representations concerning the purposes and manner of operation of the Political Markets of the "X" and, among other facts, that the operation of these markets is limited to academic research and experimental purposes and that the "X", the Governors and the Directors do not receive any profit or compensation for its operation,[7/] the Division of Trading and Markets will not recommend that the Commission take any enforcement action in connection with the operation of the Political Markets based

---

7/ As previously noted, the "X" does not currently charge participants in the "X" (which includes the Political Markets) any enrollment fee. The Operators anticipate that an enrollment fee of between $5-20 per participant will be implemented to cover basic costs for the program, such as photocopying of materials and the distribution of supplemental handouts.

solely upon the Operators not seeking designation as a contract market, registering under the Act or otherwise complying with the Act or Commission regulations.

We do not render any opinion as to whether the operation of the Political Markets violates the provisions of any state law and our position does not excuse non-compliance with any such law. You must independently confirm whether or not participation by persons or institutions in other states is permitted.

EARNINGS MARKET

Based upon the representations in your letter, as supplemented, we understand that the facts with respect to the Earnings Market are as follows. The Earnings Market is a market composed of contracts on the projected earnings of several corporate stocks. Currently, the corporations for which such contracts are available are "B", "C", "D", "E", and "F". You have described the contracts as a forecast of whether the earnings of a corporation will increase or decrease in a particular quarter.

Based upon our review, 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 Act,[8/] but which may be subject to the jurisdiction of the Securities and Exchange Commission ("SEC"). Accordingly, we have forwarded the information you have provided us regarding the "X" to the SEC and we suggest that you contact Brandon C. Becker, Acting Director of the SEC's Division of Market Regulation, concerning your request.

ECONOMIC INDICATOR MARKET

Based upon your representations, we understand that the Economic Indicator Market ("EIM") became operational on January 14, 1993.[9/] It currently trades contracts in two products, forecasts with respect to changes in the "G" and forecasts with respect to the end-of-month exchange rate between the "H" and the United States dollar. As previously noted, participation in this market is limited to students, faculty and staff at the various participating universities.

---

[8/] 7 U.S.C. § 2a (1988).

[9/] As noted above, the relief granted in this letter is only applicable on a prospective basis.

You anticipate that additional contracts on other economic indicator products will be added, such as contracts involving the exchange rate between other currencies and the United States dollar. You represent however, that in no event will more than five economic indicator products be traded in this Market at any time. In addition, to the extent that other currency-type contracts are added, you represent that they will involve currencies that are not traded on any United States securities or futures exchange (i.e., you may trade contracts involving the Italian lira or the Greek drachma vis-a-vis the United States dollar, but not contracts involving the yen vis-a-vis the United States dollar).

You represent that the EIM is used as a teaching device in economic, accounting and business administration classes, that participation in the EIM allows students to become better informed about the measurement issues relevant to predicting the ultimate value of the contracts being traded, such as the inflation rate, and that data collected from the operation of the EIM will provide insights into market and trader behavior. All contracts in the EIM are listed in pairs called "unit portfolios" and each unit portfolio is composed of a so-called "up" contract and a "down" contract. The value of any unit portfolio is formulated so that it is always equal to one dollar. The liquidation values of all contracts are formulated so that the payoff for any one contract is guaranteed to fall between zero and one dollar. These formulations ensure that the "X" does not realize financial profits or suffer losses from operating the EIM.

Based upon your representations concerning the purposes and manner of operation of the EIM, including, among other facts, that the operation of the EIM is limited solely to academic research and experimental purposes, and the "X", the Governors and the Directors do not receive any profit or compensation for its operation, the Division of Trading and Markets will not recommend that the Commission take any enforcement action in connection with the "X"'s operation of the EIM based solely upon the Operators not seeking designation as a contract market, registering under the Act or otherwise complying with the Act or Commission regulations.

We do not render any opinion as to whether the operation of the EIM (or the operation of the "X" as a whole) violates the provisions of any state law and our position does not excuse any failure to comply with any such law. You must independently confirm whether or not participation by institutions and individuals in other states is permitted.

This letter is based upon the information that has been provided to us. Any different, changed or omitted facts or conditions might require us to reach a different conclusion. In

this regard, we request that you notify us immediately in the event that the operations of the "X" or any Submarkets thereof change in any way from those as represented to us. Finally, this position is that of the Division of Trading and Markets only and does not necessarily represent the views of the Commission or any other office or division of the Commission.

If you have any questions concerning this correspondence, please contact me or Susan C. Ervin, the Division's Chief Counsel, at (202) 254-8955.

Very truly yours,

Andrea M. Corcoran
Director