

Public Statements & Remarks

Dissenting Statement of Commissioner Caroline D. Pham Regarding the Review and Stay of KalshiEX LLC's Political Event Contracts

August 26, 2022

I respectfully dissent from the Commission's decision pursuant to CFTC Rule 40.11 to require a review and impose a stay of up to 90 days on KalshiEX LLC's (Kalshi) Congressional control political event contracts, because Rule 40.11 does not apply to the contracts and because the appropriate process is to review the contracts under Rule 40.3.

I would like to first thank staff in the Division of Market Oversight for their hard work and diligence on this matter. The CFTC is able to effectively oversee our markets due to the experience and expertise of our staff, and they are to be commended for their dedication and faithful service.

I. BACKGROUND

A. **Kalshi voluntarily submitted political event contracts for Commission approval pursuant to CFTC Rule 40.3.**

Kalshi, a CFTC-registered Designated Contract Market (DCM), voluntarily submitted^[1] the political event contracts for approval by the Commission pursuant to CFTC Rule 40.3^[2] on July 20, 2022, after engaging in approximately 36 meetings with the Commission and staff over nearly a year (since late 2021), and numerous meetings with members of Congress.

Kalshi states that the political event contracts are permitted under the Commodity Exchange Act (CEA) and CFTC rules because, among other things: 1) Section 5c(c)(5)(C) and Rule 40.11 do not apply to the contracts because the underlying event of political control of Congress is neither gaming nor illegal under Federal or State law; 2) the contracts can be used to hedge predictable financial, economic, and commercial consequences; 3) the contracts would not negatively affect election integrity or the perception of election integrity; and 4) similar contracts can already be accessed by U.S. persons on other markets that are not registered or otherwise regulated by the Commission.

II. DISCUSSION

A. **CEA section 5c(c)(5)(C) and CFTC Rule 40.11 apply only to certain event contracts based upon specifically enumerated activities.**

Section 5c(c)(5)(C) provides that certain event contracts may be prohibited from being listed or made available for clearing or trading if the Commission determines such event contracts to be “contrary to the public interest” because they “involve” certain enumerated activities: an “(I) activity that is unlawful under any Federal or State law; (II) terrorism; (III) assassination; (IV) war; (V) gaming; or (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”[3]

The Commission exercised its discretion under Section 5c(c)(5)(C) (i.e., “may determine”) to promulgate its implementing Rule 40.11.[4] Rule 40.11(a) sets forth a prohibition on the trading and clearing of any event contract[5] that “involves, relates to, or references” (1) “terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law”[6]; or (2) “an activity that is similar to an activity enumerated in 40.11(a)(1) of this part, **and** that the Commission determines, **by rule or regulation**, to be contrary to the public interest” (emphasis added).[7] Rule 40.11(b) is reserved.[8]

Rule 40.11(c) provides that the Commission may require a 90-day review if the event contract “may involve, relate to, or reference an activity enumerated in 40.11(a)(1) or 40.11(a)(2).”[9] Rule 40.11(c) (1) requires that the listing or trading of the event contract be suspended (stayed) during the 90-day review period.[10] Rule 40.11(c)(2) requires that the Commission issue an order approving or disapproving the contract at the end of the 90-day review period (or such other extended time period as agreed to by the registered entity (for example, a DCM)).

In promulgating Rule 40.11(a)(1) pursuant to Section 5c(c)(5)(C), the Commission determined that an event contract that “involves, relates to, or references” terrorism, assassination, war, gaming, or illegal activity is prohibited because it is contrary to the public interest.[11] There is no further public interest test in Rule 40.11(a)(1); per the operation of the statute, the Commission must have *already* made its determination that the event contract is contrary to the public interest in order to prohibit its being listed for trading or accepted for clearing.[12] Therefore, the Commission has no discretion to infer an additional case-by-case public interest test[13] under Rule 40.11(a)(1) because the plain meaning of both the statutory text and the rule text is clear and unambiguous. An event contract is only prohibited under Rule 40.11(a)(1) if it is based upon the underlying activity of terrorism, assassination, war, or gaming, or an activity that is unlawful under any State or Federal law.[14]

Further, Rule 40.11(a)(2) prohibits an event contract that “involves, relates to, or references an activity that is similar to an activity enumerated in 40.11(a)(1),” *only if* the Commission has already promulgated a rule or regulation to determine that such activity is contrary to the public interest.[15] Indeed, the preamble to the final rulemaking for Rule 40.11 explicitly states, “[The Commission] has determined not to propose such regulations at this time.”[16] Therefore, Rule 40.11(a)(2) is not operative because the Commission has never satisfied the predicate condition of promulgating a rule or regulation in order to determine an activity that is similar to an enumerated activity is contrary to the public interest.[17] Further, the rule text is clear on its face that the public interest test in Rule 40.11(a)(2) can only be applied through a rulemaking, and can only be applied to the underlying activity that is similar to an enumerated activity, as provided by Section 5c(c)(5)(C)(VI).[18]

B. The political event contracts are not based on any enumerated activities under Rule 40.11(a)(1), and the contracts are not subject to Rule 40.11(a)(2) because it is not operative.

Both Section 5c(c)(5)(C) and Rule 40.11 set forth language that refers to contracts that are based upon an event that involves an enumerated activity.[19] And in the preamble to the final rulemaking for Rule 40.11, the Commission describes the rule as applicable to “contracts *based upon* the [enumerated activities] . . .” (emphasis added).[20] The preamble shows that whether an event contract is prohibited by Rule 40.11 depends on the underlying activity that the contract is based upon—the underlying activity that the contract “involves, relates to, or references.”[21] With respect to the political event contracts here, the underlying activity is political control.

The Commission must apply the same Congressional intent to each of the enumerated activities, including an “activity that is unlawful under any Federal or State law” and “gaming.” Otherwise, Section 5c(c)(5)(C)(i) would be internally inconsistent and in conflict with “‘traditional tools’ of statutory construction.”[22]

Accordingly, because “political control” is neither terrorism, assassination, war, gaming, nor unlawful under any Federal or State law, Rule 40.11(a)(1) does not apply to the political event contracts. And, as discussed in II.A., Rule 40.11(a)(2) is not operative until the Commission promulgates a rule or regulation to determine that an activity that is “similar to” an enumerated activity is contrary to the public interest,[23] therefore, Rule 40.11(a)(2) does not apply to the political event contracts.

C. The Commission must apply principles of fair competition and fair treatment to similar contract markets.

We must apply our rules fairly. Congress has mandated that the CFTC promote responsible innovation and fair competition.[24] The Commission is already allowing an unregistered event contract market, PredictIt, to continue to operate its political control markets through the November 2022 election cycle and until Feb. 15, 2023.[25] But the Commission has not taken any action on Kalshi's contracts, even though Kalshi submitted their request for voluntary approval over a month ago, and have been discussing it with the CFTC for almost a year.

In the interest of fair competition and fair treatment, Kalshi, a CFTC registered entity, should be allowed to operate their political control markets as well. Although the Commission's notification letter acknowledges that this issue is “time-sensitive” and that the Commission “will endeavor” to make a decision on the political event contracts by October 28, 2022, the Commission does not actually have to stick to that date.

And even *if* the Commission does make a decision by October 28 (and the decision is to approve—not deny—the contracts), Kalshi would only be able to realistically operate its political control markets for a couple of days before the November midterm elections.

The outcome is the same: the Commission's action to impose a stay will essentially run out the clock on Kalshi's ability to list contracts for the November 2022 elections. I believe that it is only fair for either both exchanges to list the political control contracts, or neither of them should.

D. The 2012 Nadex order is not binding precedent on the Commission with respect to the Kalshi political event contracts.

In addition, the Commission should evaluate the issues presented by the Kalshi political event contracts as a matter of first impression. The Commission's 2012 order prohibiting North American Derivatives Exchange's (Nadex) political event contracts was specific to Nadex's contracts and did not create a broad limitation or rule of general applicability.[26]

III. CONCLUSION

Rule 40.11(a)(1) does not apply to the political event contracts here because they are based upon the underlying activity of political control, which is not an enumerated activity, and there is no additional required public interest test. Rule 40.11(a)(2) is not operative because the Commission has not determined by rule or regulation that similar activity is contrary to the public interest.

Therefore, the Commission cannot exercise Rule 40.11(c) to require a review and impose a stay of Kalshi's contracts. However, the Commission can review the political event contracts pursuant to the process set forth under Rule 40.2 or 40.3, as applicable.

Further, when the Commission reviews a contract under Rule 40.2 or 40.3, it includes review for compliance with the CEA and Commission regulations—including section 5c(c)(5)(C) and Rule 40.11.[27] Indeed, the preamble to the final rulemaking for Rule 40.11 states that the Commission will “consider individual product submissions on a case-by-case basis under § 40.2 or § 40.3,” including the applicability of § 40.11(a).[28] In addition, the Commission can request comment from the public at any time and does not need to use Rule 40.11 to do so.

The Commission should engage with the public in a transparent manner. Kalshi has proactively and extensively discussed the political event contracts with the Commission and staff over the course of approximately 36 meetings for nearly a year. Not only that, but Kalshi has also had many meetings with members of Congress. In all that time, if the Commission had a concern that the political event contracts violate CEA section 5c(c)(5)(C) and CFTC Rule 40.11, or if the Commission did not ever intend to allow the contracts to be traded, then the Commission should have said so. We should say what we mean and mean what we say.

Businesses make material strategic and commercial decisions that have material impacts on their operations and performance, based on regulatory engagement with the Commission. Lost opportunities may never be regained. The “regulatory burn rate” is real, and we should be transparent so that businesses can get the information they need to move forward and redeploy capital to more productive use.

I look forward to receiving comments from the public on these important issues.

[1] Kalshi is not prevented from withdrawing the request for approval and self-certifying the contracts pursuant to CFTC Rule 40.2.

[2] 17 C.F.R. § 40.3(a).

[3] 7 U.S.C. § 7a–2(c)(5)(C)(i)(I)-(VI).

[4] Provisions Common to Registered Entities, 76 Fed. Reg. 44776, 44786 (July 27, 2011).

[5] Rule 40.11 defines an event contract as “[a]n agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the [CEA].” 17 C.F.R. § 40.11(a)(1).

[6] 17 C.F.R. § 40.11(a)(1).

[7] 17 C.F.R. § 40.11(a)(2).

[8] 17 C.F.R. § 40.11(b).

[9] 17 C.F.R. § 40.11(c).

[10] 17 C.F.R. § 40.11(c)(1).

[11] See 76 Fed. Reg. at 44786 (“[T]he Commission would like to note that its prohibition of certain ‘gaming’ contracts is . . . to ‘protect the public interest from gaming and other event contracts.’”) and at 44786, FN 35 (“[T]he Commission ‘needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling through supposed event contracts.’”); see also 7 U.S.C. § 7a–2(c)(5)(C)(i) (“[T]he Commission may determine that such [event contracts] are contrary to the public interest if the [event contracts] involve [the enumerated activities].”).

[12] See 7 U.S.C. § 7a–2(c)(5)(C)(ii) (“**Prohibition.** No [event contract] determined by the Commission to be contrary to the public interest [because it involves an enumerated activity] may be listed or made available for clearing or trading”).

[13] The preamble to the final rulemaking for Rule 40.11 states that the Commission will “consider individual product submissions on a case-by-case basis under § 40.2 or § 40.3,” including the applicability of § 40.11(a). However, this does not mean that the Commission will apply a public interest test on a case-by-case basis, which is not provided for under Rule 40.11(a)(1), and may only be applied through a rulemaking under Rule 40.11(a)(2).

[14] See 76 Fed. Reg. at 44785 (“[T]he Commission has determined to prohibit contracts based upon the [enumerated activities].”). Cf. FN 15, *infra* (“prohibit products that are based upon activities. . . .”).

[15] See FN 7, *supra*.

[16] 76 Fed. Reg. at 44786 (“The Commission may, at some future time, adopt regulations that prohibit products that are *based upon activities* ‘similar to’ [the enumerated activities]. It has determined not to propose such regulations at this time.”) (emphasis added).

[17] *Id.*

[18] 17 C.F.R. § 40.11(a)(2).

[19] 7 U.S.C. § 7a–2(c)(5)(C)(i) (“In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are *based upon* the occurrence, extent of an occurrence, or contingency [*i.e.*, event] . . . if the agreements, contracts, or transactions involve [an enumerated *activity*]”) (emphasis added), 17 C.F.R. § 40.11(a)(1)–(2) (“An agreement, contract, transaction, or swap *based upon* an [event], that involves, relates to, or references [an enumerated *activity* or similar *activity*]”) (emphasis added).

[20] See FN 13, *supra*.

[21] As an example, terrorism, assassination, and war are three of the activities enumerated by Section 5c(c)(5)(C)(i) and Rule 40.11(c)(1). Trading an event contract based upon one of these activities is not in itself an act of terrorism, assassination, or war. It is clear that Congress intended the prohibition to apply to event contracts where the activity underlying the contract is one of the enumerated activities.

[22] *Kisor v. Wilkie*, 139 S. Ct. 2408, 2415 (2019) (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843, n. 9 (1984)).

[23] See FN 15, *supra*.

[24] 7 U.S.C. § 5(b).

[25] CFTC Letter No. 22-08, Withdrawal of CFTC Letter No. 14-130 (Aug. 4, 2022). As of August 15, 2022, PredictIt lists contracts on whether the Democrat or Republican party will control the Senate after 2022, and whether the Democrat or Republican party will win the House in 2022.

[26] 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 (Apr. 2, 2012), *available at*

<https://www.cftc.gov/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf>

[\(/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf\)](https://www.cftc.gov/sites/default/files/idc/groups/public/%40rulesandproducts/documents/ifdocs/nadexorder040212.pdf). *Cf.* 5 U.S.C. §

553.

[27] *See* FN 13, *supra*.

[28] *Id.*

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