APPENDIX B (CONFIDENTIAL) – FURTHER CONSIDERATIONS

The Exchange has identified songwriters, publishers, musical artists, music studios, record labels, social media platforms, streaming platforms, and retail market participants such as social media influencers and independent artists as having business lines that are materially affected by whether or not a new Kanye West album is released. After initial production costs have already been incurred, an album not being released by a given date can result in the loss of production investment, reducing net income. Members of the music-related economy can utilize the Contract to hedge the risk of an album release that they spent a large amount of advertising dollars promoting and targeting to their customer base not occurring by a given date. Investors can use the Contract to hedge the risk of music-facing transactions they may have participated in, such as the purchase of an artist's music rights.

Retail market participants can utilize the Contract to hedge the risk of a particular album not being released. One category of retail participants with a direct financial incentive to trade the Contract are social media influencers, who generate income through attention economy-driven advertising on platforms such as Instagram and TikTok. These influencers may be part of small and medium enterprises such as digital ads agencies but they are typically individuals operating their own online businesses that capitalize on promoting merchandise and content such as music videos and popular songs. Albums by Kanye West that have already been released are extremely popular, and a new one would have high virality potential. Creators use popular albums to generate follower engagement, leading to additional advertising revenue and merchandising agreements. However, there is also a significant amount of risk: if social media creators invest substantial time, effort and resources to promote albums that are never released/discussing only the hype surrounding a Kanye album that never comes, their engagement and revenue can suffer compared to a world where they focused on an album that *does* come out. Considering that a long delay of an album could result in decreased fan enthusiasm or fan frustration with the artist themselves, a delay or cancellation of the album has a strong relationship with the eventual commercial failure of the album. Thus, retail influencers can utilize the Contract to hedge the risk of poor musical content decision-making. The digital platform Pearpop pays social media influencers with cash compensation based on the number of views and impressions that their promotion of specific artists' music generates on social media. This means that an album's popularity (related to whether it is released, obviously) is directly connected to the financial interests of retail market participants such as social media influencers.[1] If influencers dependent on Pearpop for revenue choose to promote Kanye, who never follows up on his album promise, that could result in lost income for the influencer. The Contract thus allows such influencers to hedge the risk that the artist they choose is unpopular. Opportunities such as the Creator Fund, Pearpop, and other platforms connect the overall creator economy to the music industry. According to Rolling Stone, "in recent years, TikTok has proven a breeding ground for stars,

[1] https://pearpop.com/

with music labels prowling the app for promising acts to add into their ranks."[2] For example, a TikTok influencer that hopes and plans to generate engagement and advertising/merchandising revenue through alignment with a Kanye West content can utilize the contract to hedge against the risk of his album not being available for use in their content.

A second class of market participants that can utilize the Contract's hedging utility are individuals and companies involved in the marketing and sale of Kanye related merchandise, such as clothing, footwear, collectibles, and memorabilia. Merchandise is an important revenue-generating component of the overall music industry, and the sale of merchandise can often make or break an artist or musical group's bottom line. An estimate from the UK metalcore group While She Sleeps calculated that the sale of a single band T-shirt is equivalent to 5,000 Spotify streams in monetary terms.[3] Companies that specialize in music-related merchandising often strike exclusive deals with musical artists to supply their merchandise. For example, in June 2021, Sony Music UK's merchandising company Kontraband struck an exclusive deal with the George Michael Estate to supply his music-related merchandise worldwide.

Music merchandising enterprises such as Kontraband are thus exposed to the financial risk associated with the underlying artist's popularity at any given moment, including new opportunities for merchandise like a new album release. Artists with new albums are likely to sell more merchandise, and conversely, artists without are likely to see a decrease in their merchandise sales. These revenue declines pose a material financial risk not just to the merchandising enterprise itself, but also its suppliers, partners, and employees, who can purchase the "No" side of the Contract to hedge the risk that Kanye's album does not come out in a given period of time and results in material financial losses to the artist's merchandising operation. Furthermore, merchandising operations have to prepare products well in advance of need in order to ensure their ability to accommodate a surge in customer demand. Thus, any unexpected delayed release of an album would result in wasted resources and the loss of startup investments.

Moreover, the merchandising-related hedging utility of the Contract is not limited to large enterprises such as Sony Music UK and Kontraband. Retail market participants can also utilize the Contract to hedge risks associated with the correlation between Kanye's new album release and the sale of their merchandise. The rise of platforms such as Etsy and Shopify has led to millions of independent creators and SMEs creating online storefronts to offer unique merchandise directly to consumers. For context, Etsy had 4.3 million independent sellers on its platform in 2020, up from 2.7 million in 2019.[4] Many of these sellers focus on musical merchandise - searches on Etsy for merchandise related to "Beyonce" and "Drake" return close to 6,000 and 10,000 results, respectively, showing that there are thousands of independent retail sellers that generate revenue from the sale of musical artist-related merchandise.[5]

[2] https://www.rollingstone.com/pro/news/tiktok-creator-fund-1032824/.
[3] https://www.digitalmusicnews.com/2021/06/22/sony-music-kontraband-george-michael-merchandise/
[4] *https://www.statista.com/statistics/409374/etsy-active-sellers/*
[5] https://www.etsy.com/se-en/search?q=beyonce and https://www.etsy.com/se-en/search?q=drake

Like larger merchandising companies such as Kontraband, the revenue of these creators and SMEs is tightly linked to the relevance/popularity of the musical artists that inspire their merchandise - participants in this independent creator economy can purchase the “No” side of the Contract to hedge the risk of no new album, reducing Kanye’s relevance and the resulting impact it may have on their merchandise sales.

More generally, the roots of the derivatives industry lie in agriculture, and the first derivative products helped grain farmers manage their pricing risks. The modern American economy looks quite a bit different than it did back then. Computing and the Internet have revolutionized almost every aspect of commerce, and the music industry is no exception. Platforms such as Etsy are allowing retail market participants to sell merchandise directly to consumers through online storefronts, and digital streaming consumption is the dominant force in music revenue generation today. Just as grain farmers took advantage of novel derivative products to usher in a new era of price stability, the participants of today’s new-age media economy need risk hedging tools to protect their revenue and material financial interests from a new set of risks that are constantly evolving.[6]

The various use cases for the Contract discussed above demonstrate that a music artist’s consumption popularity affects a diverse array of market participants, from the largest record labels to a retail independent seller who generates income from the sale of their custom-made Beyonce coffee mugs. The Contract will allow these market participants to make future economic decisions with more confidence than ever before. Instead of making highly risky investments beholden to the erratic release schedule of West, independent artists, record labels, social media influencers, and e-commerce merchants can use the Contract to cover their potential downside and allocate capital and effort more intelligently. Within the context of the music industry and creator economy, the Contract can expand the horizon of risk-hedging by extending the benefits of derivatives that grain farmers have enjoyed for decades to a new class of participants in the American economy.

Price basing/price discovery utility of the Contract: The Contract will provide a market-based probability of the album launching in a given time period. Economists and academics can utilize the market data to inform forward-looking models of the music industry. In particular, independent artists may use the market-based probability to make decisions surrounding the timing of their own release--whether because they want to ride a wave of momentum in the genre of an album’s music or because they fear that the coverage surrounding his album’s release might overshadow their own. Getting high week-one sales can be make-or-break for an artist--having a market-based probability could thus allow them to make informed decisions with important implications for their eventual career success.

[6] https://www.cftc.gov/PressRoom/SpeechesTestimony/opastump9

Similarly, music platforms like Spotify and Apple Music can utilize the market data to optimize recommendations, advertisements, etc., in order to increase revenue. If a certain artist's album is expected to be released in that week, the aforementioned platforms (along with others) will be able to feature that artist's album more prominently in order to capitalize on their popularity, and also recommend it more often to users of their service.

As described in detail above, the Contract has important risk mitigation and price basing/price discovery utility. The Contract does not relate to the enumerated categories of contracts listed in Section 5c(c)(i) of the Act. Additionally, the Exchange has not determined such contracts to be contrary to the public interest and there has been no determination by the Commission that such contracts would be contrary to the public interest. The Contract provides a means for managing and assuming price risks, discovering prices, and disseminating price information on the Exchange's fair and financially secure trading facility.

The Contract has bona fide risk mitigation and price basing utility for participants with underlying economic exposure, as described above. The Contract is not merely recreational, as the discussion of risk mitigation and price basing/price discovery utility demonstrates. The outcome of the Contract is not predominantly determined by chance and depends on a variety of factors. Finally, it is possible for traders to use skill and effort to gain knowledge and information about the likelihood of the event. For example, traders can gain information about the likelihood of the event by following communications from the music press.

APPENDIX C (CONFIDENTIAL) – SOURCE AGENCY

Spotify is a digital music streaming service that offers users access to millions of songs, podcasts, and videos from artists all around the world; it is the most used music streaming platform, with more than 200 million paid users. If an artist were to release an album in a given period, it would be listed on Spotify in tandem. Spotify operates as a neutral platform, providing a service to both artists and listeners without typically engaging in manipulation of content. Their business model relies on trust and transparency. The Exchange will obtain this data directly from Spotify's music platform.

APPENDIX D (CONFIDENTIAL) – COMPLIANCE WITH CORE PRINCIPLES

Compliance with Core Principles

The Exchange has conducted a comprehensive analysis of the designated contract market core principles ("Core Principles") as set forth in Part 38 of the Act. The Core Principles relevant to the Contract are outlined and discussed in further detail below:

Core Principle 2 - Compliance with Rules and Impartial Access: The Exchange has adopted the Rulebook, which provides the requirements for accessing and trading on the Exchange. Pursuant to Chapter 3 of the Rulebook, Members must utilize the Exchange's services in a responsible manner, comply with the rules of the Rulebook ("Rules"), cooperate with Exchange investigations, inquiries, audits, examinations and proceedings, and observe high standards of integrity, market conduct, commercial honor, fair dealing, and equitable principles of trade. Chapter 3 of the Rulebook also provides clear and transparent access criteria and requirements for Exchange Members. Trading the Contract will be subject to all the rules established in the Rulebook, which are aimed at enforcing market integrity and customer protection.

In particular, Chapter 5 of the Rulebook sets forth the Exchange's Prohibited Transactions and Activities and specifically prescribes the methods by which Members trade contracts, including the Contract. Pursuant to Rule 3.2, the Exchange has the right to inspect Members and is required to provide information concerning its business, as well as contracts executed on the Exchange and in related markets. Chapter 9 of the Rulebook sets forth the Exchange's Discipline and Rule Enforcement regime. Pursuant to Rule 9.2, each Member is required to cooperate with an Exchange investigation by making their books and records available to the Exchange. The Exchange's Market Regulation Department performs trade practice surveillance, market surveillance, and real-time market monitoring to ensure that Members adhere to the Rules of the Exchange. The Market Surveillance Department reserves the authority to exercise its investigatory and enforcement power where potential rule violations are identified.

Core Principle 2 also stipulates that an exchange shall establish means to provide market participants with impartial access to the market. Chapter 3 of the Rulebook, and Rule 3.1 in particular, provides clear and transparent access criteria and requirements for Members. The Exchange will apply access criteria in an impartial manner, including through the application process described in Rule 3.1.

Core Principle 3 - Contract not Readily Subject to Manipulation:

Core Principle 3 and Rule 38.200 provide that a DCM shall not list for trading contracts that are readily susceptible to manipulation. The Exchange's marketplace and contracts, including this

Contract, have been designed in accordance with this fundamental principle. The Exchange maintains various safeguards against outcome manipulation and other forms of manipulation, including, (i) automatic trade surveillance and suspicious behavior detection, (ii) Rulebook prohibition, Member certification, and notification, (iii) Member monitoring and know-your-customer verification, and (iv) sanctions. These safeguards render the Contract not readily susceptible to manipulation.

(i) **Automatic trade surveillance and suspicious behavior detection**: The Exchange's trade monitoring and market surveillance systems compute statistics using information from all trades that occur on the Exchange over a range of timeframes, ranging from per trade to the full history of trading activity. These statistics are geared towards identifying unusual trading activity and outlier behaviors. If the trade monitoring and market surveillance system identifies behavior deemed to be unusual, the Exchange's compliance personnel have the ability to investigate and determine applicable sanctions, including limits to or suspension of a Member's access to the Exchange.

(ii) **Rulebook prohibition, member certification and notification:** The Exchange's Rulebook includes various provisions that prohibit manipulative behaviors. As noted above in the discussion of Core Principle 2, the Exchange's Rulebook gives the Exchange the authority to investigate potential violations of its rules. Pursuant to Rule 3.2, the Exchange has the right to inspect Members' books and records, as well as contracts executed on the Exchange and in related markets. Pursuant to Rule 9.2, each member is required to cooperate with an Exchange investigation by making their books and records available to the Exchange for investigation. The Exchange's Market Regulation Department performs trade practice surveillance, market surveillance, and real-time market monitoring to ensure that Members adhere to the Exchange's rules. The Rulebook also imposes sanctions on Members who break rules. Potential penalties include fines, disgorgement, and revocation of membership in Kalshi. Only Members are allowed to trade on the Exchange, and the Exchange requires its Members to strictly comply with the Rulebook. Members cannot complete the account creation process and trade on the Exchange until they certify that they have read the Exchange's rules and agree to be bound by them.

In addition, the Exchange requires applicants for membership to represent and covenant that the applicant will not trade on any contract where they have access to material non-public information, may exert influence on the market outcome, or are an employee or affiliate of the Source Agency. In order to further reduce the potential for manipulation, the Exchange maintains a dedicated page on the trading portal that lists all the source agencies and their associated contracts, together with a warning that employees of those companies, persons with access to material non-public information, and persons with an ability to exert influence on the underlying of a contract are prohibited from trading on those contracts. This page is intended to serve as an effective means of raising Members' awareness of these rules and prohibitions, further reducing the potential for manipulation. Similarly, the Exchange places a prominent notice on each contract page that notifies Members of the prohibition on trading the Contract while employed by its Source Agency, trading the Contract on the basis of non-public information, and trading the Contract while having the ability to exert influence on the Contract's Market Outcome.

(iii) **Member monitoring and know-your-customer verification ("KYC")**: The Exchange has a robust KYC process. The KYC process is an important tool that helps flag and uncover higher risk traders before they become Members of the platform. The Exchange's KYC process leverages technology to develop a clear and proper understanding of its members, and the various risks they may pose with respect to market integrity and fairness, including manipulation. During the application process, applicants are required to share personally identifiable information, such as their full legal name, identification number, date of birth, and address with the Exchange. Applicant information is run through a comprehensive set of databases that are actively compiled and maintained by an independent third party. The databases are utilized by the Exchange to identify applicants that are employees or affiliates of various governments and other agencies. Moreover, the databases can identify known close relatives and associates of such people as well. Applicants that are flagged go through enhanced due diligence, including manual review, as part of the onboarding process.

Additionally, as part of the KYC process, the Exchange runs applicants through adverse media databases. The adverse media dataset is a real-time structured data feed of companies and individuals subject to adverse media. Monitoring thousands of news sources, business and trade journals, in addition to local, regional and national newspapers, the adverse media feed isolates and highlights any entities or individuals subject to a range of adverse media. The Exchange utilizes the database to trigger enhanced due diligence, because applicants with adverse media may be more likely to engage in certain types of unlawful activity including market manipulation.

The Exchange engages in active and continuing KYC checks. The KYC checks are initially performed upon application, and the Exchange then monitors its Members on an ongoing basis by running member information through the KYC databases. If material new information concerning an existing Member is at some point added to a database, the Exchange's system will flag the Member even if the cause for the flag was not extant at the time of the Member's application. That Member will then go through enhanced due diligence.

(iv) **Sanctions**: Exchange Members must agree to the terms and conditions of the Exchange's Rulebook before being allowed to trade. As a result, Members are subject to disciplinary actions and fines for engaging in improper market conduct that is prohibited by the Exchange's Rulebook. In the event that suspicious trading activity is detected and results in an investigation initiated by the Exchange, market participants are required to provide the Exchange with information relevant to the scope of the investigation under Rule 3.2. Chapter 9 of the Exchange's Rulebook details the process for discipline and rule enforcement. Disciplinary action can range from a letter of warning to fines to referral to governmental authorities that can result in criminal prosecution.

In addition to these global policies and safeguards, there are a number of contract specific attributes and considerations that render the Contract not readily susceptible to manipulation.

It is not plausible for Spotify to manipulate the value of the Contract by, for example, not listing a Kanye West album that has been released. Any manipulation or withholding of high-profile content like a Kanye West album would pose a significant reputational risk to Spotify, potentially damaging its relationships with both artists and users. It would also be a massive risk competitively, as other platforms list his new album. West is a massively successful artist and a new album by him could command billions of streams. The only other actor who could affect the value of the Contract is West himself, who is prohibited from trading.

Core Principle 4 - Prevention of Market Disruption: Trading in the Contracts will be subject to the Rules of the Exchange, which include prohibitions on manipulation, price distortion, and disruption to the cash settlement process. Trading activity in the Contract will be subject to monitoring and surveillance by the Exchange's Market Surveillance Department. In particular, the Exchange's trade surveillance system monitors the trading on the Exchange to detect and prevent activities that threaten market integrity and market fairness including manipulation, price distortion, and disruptions of the settlement process. The Exchange also performs real-time market surveillance. The Exchange sets position limits, maintains both a trade practice and market surveillance program to monitor for market abuses, including manipulation, and has disciplinary procedures for violations of the Rulebook.

Core Principles 7 and 8 - Availability of General Information and Daily Publication of Trading Information: Core Principles 7 and 8, implemented by Regulations Sections Subsections 38.400, 38.401, 38.450, and 38.451, require a DCM to make available to the public accurate information regarding the contract terms and conditions, daily information on contracts such as settlement price, volume, open interest, and opening and closing ranges, the rules, regulations, and mechanisms for executing transactions on or through the facilities of the contract market, and the rules and specifications describing the operation of the contract market's electronic matching platform.

Rule 2.17 of the Rulebook sets forth the rules for publicizing information. The Rulebook and the specifications of each contract are made public on the Exchange website and remain accessible via the platform. The Exchange will post non-confidential materials associated with regulatory filings, including the Rulebook, at the time the Exchange submits such filings to the

Commission. Consistent with Rule 2.17 of the Rulebook, the Exchange website will publish contract specifications, terms, and conditions, as well as daily trading volume and open interest for the Contract. Each contract has a dedicated "Market Page" on the Kalshi Exchange platform, which will contain the information described above as well as a link to the Underlying used to determine the Expiration Value of the Contract. Chapter 5 sets forth the rules, regulations and mechanisms for executing transactions, and the rules and specifications for Kalshi's trading systems.

Core Principle 11 - Financial Integrity of Transactions: Each Member must be in good standing and in compliance with the Member eligibility standards set forth in Chapter 3 of the Rulebook. All contracts offered by the Exchange, including the Contract, are cleared through the Clearinghouse, a Derivatives Clearing Organization ("DCO") registered with the CFTC and subject to all CFTC Regulations related thereto. The Exchange requires that all trading be fully cash collateralized. As a result, no margin or leverage is permitted, and accounts must be pre-funded. The protection of customer funds is monitored by the Exchange and ensured by the Clearinghouse as "Member Property."

All Remaining Requirements: All remaining Core Principles are satisfied through operation of the Exchange's Rules, processes, and policies applicable to the other contracts traded thereon. Nothing in this contract requires any change from current rules, policies, or operational processes.