

Response to CFTC Request for Comment on the Prediction Markets Roundtable

Regulation of event contract markets is an important matter with far-reaching economic and societal implications. Careful consideration by the Commodity Futures Trading Commission (“CFTC” or “Commission”) is critical to ensure that the benefits of event contract markets are fully realized, and the potential harms of such markets are mitigated.

Gaining a well-rounded perspective on the various issues at play is challenged by the lobbying of several special interests, including casino advocacy groups, state regulators, sports leagues, and other organizations, whose vested interest in preserving the *status quo* contributes to comments that exaggerate the benefits and downplay the harms of the current state-regulated approach to sports betting. I urge the Commission to carefully consider input from a wide range of participants, especially from those who can provide a balanced perspective on the pros and cons of both the current state-regulated sports betting landscape and nationally-regulated exchanges.

The importance of event contract markets and the tension between state and federal regulatory authorities spans a wide range of event types, including weather and climate, news and current events, cultural and societal events, sports, politics, and more. While much of the commentary below applies broadly to event contract markets in general, the most controversial issues facing the Commission relate to markets on politics and sporting events. Political event contracts were the focus of an earlier period of comments, and I refer the Commission to my earlier comment (Crane, 2024), cited below, for specific commentary on political event contracts. On the topic of sporting event markets, I focus here on two core questions:

- (i) Do sporting event contracts serve the public interest?
- (ii) If so, how should sporting event contract markets be regulated to best serve the public interest?

The public interest benefits of sporting event contracts. Sporting event contracts serve the public interest in two complementary ways: (i) by offering a vehicle to hedge risk and (ii) by aggregating diffuse information through its publicly visible price signal. Given the economic and social significance of sports to the American culture and economy, these are not merely fringe benefits of an otherwise recreational or frivolous endeavor. The size of the American professional sports industry is estimated at \$120 billion annually, with another \$300-\$500 billion of activity generated from sports-related behaviors, such as dining and travel. With such a large segment of the economy and societal interest driven from sports-related activity, financial risks associated with sporting events reach far beyond professional sports organizations to entire industries (e.g., travel, restaurant and hospitality industries), small businesses, and individual citizens. The ability to hedge sports-related risk has substantial value for many individuals and businesses, which are otherwise left exposed to unwanted risk due to the lack of robust, liquid markets on relevant events.

Real world hedging case studies underscore the potential economic value of these markets:

1. During the 2022 baseball season, Texas-based Gallery Furniture ran a promotion by which all customers would receive a \$3,000 refund on furniture purchases if the Houston Astros were to win the 2022 World Series. The promotion exposed Jim McIngvale, Gallery Furniture’s owner, to a \$50 million loss if the Astros were to win. To hedge this risk, McIngvale placed a bet of \$10 million on the Astros to win the World Series at 7.5-to-1 odds. More details of the story are covered by Porterfield (*Forbes*, 2022).

2. Professional sports teams often structure player contracts around both individual and team-based incentives. One such incentive, for example, could be that every player on an NFL team roster receives a \$1 million bonus if the team wins the Super Bowl. While such incentives align the interests of the organization, players, and fans, they also expose the team's ownership to potential losses in excess of \$50 million if the team were to win. As such events can be hard to price, insurance companies may be unwilling to insure such a large loss for a reasonable premium. With a liquid, accessible exchange, however, team ownership can easily hedge their exposure at a fair price with minimal fees.
3. In some cities, the short-term economic outlook of many restaurants is driven by the performance of local professional sports teams. To capitalize on a successful playoff run by one of the city's teams, businesses in these cities must train additional staff months in advance in order to meet potential demand. While putting the business in a position to succeed, such decisions also expose the business to substantial loss if the team fails to make the playoffs. These risks are not unique to any one city: restaurants and bars in every city with a professional team are exposed to the risk of their own team's performance. Businesses in different cities, therefore, have offsetting risks, which could easily be hedged against each other in a nationwide sports event contract exchange. State-level exchanges cannot offer this benefit, because the restricted participant pool both decreases liquidity and eliminates participation from traders with opposing risk profiles. Without a national exchange these businesses are forced to either take on the excess risk or pass on the potentially lucrative business opportunity.

These are just a few examples of how sports event contract exchanges could and would be used to drive economic growth, if properly regulated and made widely available. Beyond the direct economic use of these markets, the aggregation of information across a large, diverse group of traders through the market price signal can provide important insights for impactful business decisions. For example, before the trade deadline, management of a professional sport teams is often faced with the decision to either trade away young prospects in exchange for players who can help the team win right away or save those prospects and trade away veterans for more prospects who will help the team win in the future. Such decisions are risky, with severe financial and economic implications for the organization and the city it represents. These decisions are made all the more difficult by psychological biases and public pressure from the fan base. Neglecting to make a trade when the team has a 35% chance to win this year is as bad as trading away prospects and mortgaging the future when the team has only a 3% chance to win. Market odds from a liquid, well-operated exchange offer an objective, third-party perspective that can help guide these decisions.

Exchange operators' incentives align with the public, sportsbook operators' incentives do not. Advancing the above public interest in sporting event contracts requires transparent, liquid, and open markets and an alignment of incentives between operators and the general public. These objectives are best and most easily achieved through a nationwide exchange, not through state-based sportsbooks.

Exchanges differ from sportsbooks in a number of fundamental ways. These differences make clear that exchanges do not act as or resemble sportsbooks, as some state regulators have claimed. They also demonstrate how federally regulated sports event contract exchanges would improve significantly upon the exploitative approach to sports wagering currently scattered across the individual states. I catalog a few of these key differences below.

Incentives. Sportsbooks and exchanges are driven by very different incentives. Sportsbooks act as both platform operator and counterparty to each wager. The incentives of sportsbooks, which profit from the losses of their own customers, and state legislatures, for whom tax revenue is the primary motivation for legalizing sports betting, are, therefore, in direct opposition to the customers' and constituents'.

Exchange operators have no such conflict. Unlike sportsbooks, which act as both platform operator and counterparty to its customers' wagers, exchanges merely provide the platform that matches traders on either side of an outcome. For providing this service, exchanges charge a commission on profitable trades, and nothing on losing trades. Therefore, in contrast to sportsbook operators, which profit when customers lose, exchange platforms only profit from winning trades.

Conflicts of interest. As the counterparty of each wager, sportsbooks are in direct competition with their customers, and have a vested interest in their customers losing money. This conflict of interest causes sportsbooks to act against the public interest, unless regulators intervene to ensure all customers and individuals under their jurisdiction are treated fairly and equally. Though regulators have a duty to enforce such fairness, state gaming regulators have so far neglected this duty.¹ As both the operator and the counterparty, the licensed sportsbook also has a substantial competitive advantage in seeing how all customers on its platform are betting on a given event. I am aware of no other regulatory framework that creates such a clear and deleterious conflict of interest between regulators and licensed operators on one side and the general public on the other.

Bets placed vs. Tradeable assets. When a wager is placed at a sportsbook, the customer is generally unable to exit that position at fair value before the outcome is resolved.² The inability to trade in and out of positions both reduces the economic value of the proposition and eliminates an important skill element from event contract trading. Contracts executed on an exchange are tradeable assets. Consumer-friendly exchanges assess commissions at the market-level, so that a customer who trades some contracts profitably and some at a loss only pays commission on the net proceeds in a given market.³

Mechanics of trading. The mechanics that drive pricing and enable betting (in the case of a sportsbook) and trading (in the case of an exchange) are very different. At a sportsbook, a wager of, say, \$100 on a given outcome at a given price is executed because the sportsbook (i.e., the operator) agreed to take the bet on that outcome at that price. The operator, therefore, decides which outcomes to offer bets on, sets the price, determines the maximum size of a bet that it is willing to take, and ultimately chooses which customers to accept bets from and which to deny. It is not uncommon for a sportsbook to only accept wagers on one side of an event (so-called "one-sided markets") or for a sportsbook to be willing to accept a bet of, say, \$10,000 from one customer but only \$10 from another. This issue highlights not only the lack of fairness prevalent

¹Although some states, such as New Jersey, have laws that prohibit gaming operators from banning a player for "skilled play", such laws are easily circumvented by reducing a player's limit to small amounts, in some cases pennies, without technically refusing the player's business.

²The commonly offered "cash out" option does not contradict this claim, as the cash out option is not akin to trading in and out of positions on an exchange. It is instead a vehicle by which the sportsbook extract additional vigorish from a customer on a single wager. When a customer places an initial wager, the odds are reduced by an amount (the "vig") which represents the sportsbook's built-in margin. When a customer later goes to "cash out", whether for a win or a loss, the payout offered is also reduced (by an amount equal to or exceeding the vig).

³As the Commission solidifies its regulatory position on event contract markets of all kinds (sports, politics, and otherwise), I urge it to codify into its regulations these basic pro-consumer practices, such as commissions imposed at the market-level.

in state-regulated sportsbooks but also the lack of transparency inherent in how these sportsbooks operate. These attributes of sportsbook wagering both contribute to exploitation of customers (i.e., the citizens whom the regulators have a duty to protect) and create conditions that are ripe for market manipulation or worse. It is important to note that these and other nefarious practices of state-regulated sportsbooks are not fundamental aspects of regulated sports betting. They are, instead, a byproduct of poorly implemented, anti-consumer regulations and enforcement at the state level.

The mechanics of trading on an exchange differ in a way that prevents the above issues. On an exchange, a customer can only place a wager of \$100 at a given price if there is another customer or customers willing to back the other side of the outcome at that price. For simplicity, consider a bet on “Team A to win” at even money⁴ for a stake of \$100. Such a bet can only be placed on an exchange if there is at least \$100 of interest among other customers to back “Team A not to win” at even money. In this way, exchanges act as a marketplace in which participants can *exchange* risks on future, uncertain outcomes.

At any given time, a customer of the exchange can view the order book to see what the current offerings are (amount staked and odds) on each side of an event. If there is sufficient liquidity available at a given price for the side the customer wants, the customer is able to execute the trade. Unlike sportsbooks, the available price and stake is transparent prior to the wager, and the identities of either side of a trade are not known at any time to exchange participants. Every participant has equal access to the same pricing, for the same available volume.

Pro-consumer resources. Because exchanges only profit from winning trades, it is in the operator’s interest to provide its customers with the best available trading resources, which may include education, data, and API access to facilitate trading. Such resources are commonly offered by exchange operators, yet I am not aware of one U.S.-based sportsbook operator who offers these basic resources to its customers. Instead, the vast majority of sportsbook operators employ a “ban or bankrupt” model, in which competent customers are banned from participating while losing customers are exploited and enticed to bet to the point of bankruptcy. Despite claims by the National Problem Gambling Council and American Gaming Association about the importance of consumer protection and player health, the “ban or bankrupt” approach is anything but. What those organizations are seeking to protect is not the customer but the *status quo*, which represents an industry built on the opportunity to exploit members of the public for profit.

The above points lay out several ways in which exchanges better serve the customer and the public. They also make clear that exchange operators, acting as a neutral third-party to facilitate trading, in no way resemble sportsbook operators, who act as a sole counterparty with a vested interest in direct conflict with their customers.

The public interest is best served by transparent, liquid, open markets. The public interest benefits and related case studies discussed above can only be realized if sporting event markets are transparent, liquid, and open to all participants.

Transparency in pricing gives participants assurance that they are receiving a price based on fair market-value at the time of a trade. Transparency is important both to those hedging in the market, who want a fair price, as well as those who use the market price signal for information, as a

⁴A \$10 bet placed at even money pays back \$20 (initial stake of \$10 plus profit of \$10) if it wins, and \$0 if it loses. Even money is denoted as -100 in American odds, 2.0 in decimal odds, or 1/1 in fractional/traditional odds.

transparent price signal gives assurance that the price is based on real trading activity rather than arbitrary price movements often observed at sportsbooks.⁵

Liquidity enables participants to hedge substantial positions without moving the market price. A market without capacity to handle moderate or large trades without significant price movements severely limits the hedging and economic use case. Liquidity also factors into the informational value of markets, as liquid markets attract knowledgeable, profit-seeking participants. These profit-seekers, in turn, sharpen market prices to make them more reliable for other uses.

Openness ensures that any eligible participant is able to realize the benefits of these markets, without undue restriction. Open markets generate a more reliable price signal by allowing participants with diverse information to help shape the market price. Openness also contributes to liquidity, as more market participation leads to higher liquidity, and diversity of participation and opinion. All of the above contribute to a healthy market ecosystem, as the nature of exchange trading requires participants with different opinions or opposing economic needs.

Of the two primary operator models under discussion, exchanges promote the above three objectives, sportsbooks do not. Exchanges are inherently transparent in pricing, as all pricing is driven by the order book and publicly observable market participation. Sportsbook prices, on the other hand, are derived by proprietary software and inside information. The dual role of sportsbook as both platform operator and wagering counterparty creates a conflict of interest that precludes transparency in sportsbook pricing, and therefore prevents sportsbooks from serving the public interest in the above described way.

Sportsbooks' conflict of interest also contributes to the lack of openness in participation. Because sportsbooks profit directly from customer losses, it is common practice across sportsbooks in the United States to ban or severely limit participation from customers who are classified as "sharp" (i.e., smart or knowledgeable). As a sportsbook gains more knowledge about each of its customers, it picks and chooses which customers to accept business from, by promoting increased business from losing customers and refusing business from winning customers. This practice not only shuts down access to legally eligible participants and distorts the information reflected in sportsbook pricing but also acts directly against the interest of the citizens whom regulations are supposed to protect. Despite this clear act against the public's interest, state regulators across the board have allowed sportsbooks to continue this practice.

Exchanges, on the other hand, do not have a stake in the outcome of any given event. The exchange's only incentive is to facilitate as much trading activity as possible, through open participation and substantial liquidity. These interests of the exchange align with the interests of the public. Exchange operators have no incentive, nor should they be legally permitted, to restrict trading from eligible participants who follow the rules.

State regulators and their licensed sportsbooks have betrayed the public trust, and are acting in conflict to the public interest. State regulators and their licensed operators have had ample opportunity to demonstrate their ability to serve the public, and they have failed

⁵Because most sportsbooks ban competent customers from using their platform, these operators do not often receive important pricing information in a timely manner. It is a common practice of many sportsbook operators to watch how the odds at other operators change, and to essentially copy others' prices when they deviate from their own. Because of this well known practice, a small amount of money bet at the right time at an offshore book in Asia can cause a wave of market movements worth tens of millions of dollars in the United States market. Such practices make sportsbooks prone to manipulation and chaotic price movements in a way that exchanges are not.

Issue	Sportsbook	Exchange
Incentives	Misaligned with public	Aligned with public
Conflict of interest	Yes	No
Financial model	Profits from losing customers	Profits from winning customers
Fairness	Bans unwanted customers	Open to all customers
Economic Benefit	Tax revenue (generated from losers)	Hedging, insurance
Consumer Protection	Anti-consumer	Pro-consumer
Main purpose	State tax revenue	Economic and societal benefits

Table 1: Summary of core differences between sportsbooks and exchanges.

decisively. By repeatedly and systematically enacting policies that favor large corporations at the expense of their constituents, state regulators have shown that they cannot be trusted to advance the public interest. Simply put, the perverse incentives of the current regulatory and operator practices in the states is the reason why the above benefits of sports event contract markets have not yet been realized. And these benefits will never be realized under the current state-regulated sportsbook model.

The public interest is best served by nationwide, regulated exchanges. Federal regulation of a nationwide exchange is necessary to promote the liquidity and broad participation required for robust markets and to ensure that the benefits of sports event markets are made available to all citizens equally. To be explicit, exchanges cannot be restricted on a state by state basis. Such state-limited exchanges have been tried and failed. The most notable failure of a state-regulated exchange is Betfair, the world’s most successful sports exchange, which was forced to close its New Jersey operation due to lack of liquidity (Conneller, 2020). So far, the same fate has been shared by others which have attempted to make the exchange model work at the state level (Danzis, 2024).

I cannot stress enough: state-based exchanges simply cannot work. The failures of Betfair and others have proven what should be common sense: exchange trading requires liquidity, and liquidity requires a large participant pool. Without sufficient liquidity, pricing is less reliable and hedging is limited to small, insignificant positions. An open-for-all, national exchange would promote liquidity while making the benefits of these platforms equally and fairly available to all eligible participants.

The fact that sportsbooks can succeed at the state level but exchanges cannot highlights yet another difference between the two that calls for a different regulatory approach. Such different approaches are not without precedent. The Interstate Horse Racing Act of 1978 (IHRA) is a federal law that recognized that the success of simulcast wagering markets requires the commingling of parimutuel pools across state lines. Just as the IHRA acknowledges the necessity of nationwide participation of parimutuel pools, so too must the Commission acknowledge and enact policy that ensures exchange activity is permitted nationwide.

Conclusion Table 1 summarizes the major differences between sportsbooks and exchanges. These differences highlight the significant benefits that federally-regulated sports exchanges offer over state-regulated sportsbooks. Simply put, exchanges are not sportsbooks. They have different incentives, different objectives, and offer new and substantial benefits to the public. They should, therefore, be regulated differently than sportsbooks, with a keen eye on policies that serve the

public, rather than corporate interests. If done right, nationwide exchanges can and will succeed where state-run sportsbooks have failed.

I thank the Commission for carefully considering this important issue. If the Commission would benefit from additional information, I would be happy to participate in the upcoming roundtable or to correspond privately.

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April 23, 2025

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