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APPENDIX C (CONFIDENTIAL) – RISK MITIGATION AND PRICE BASING UTILITIES

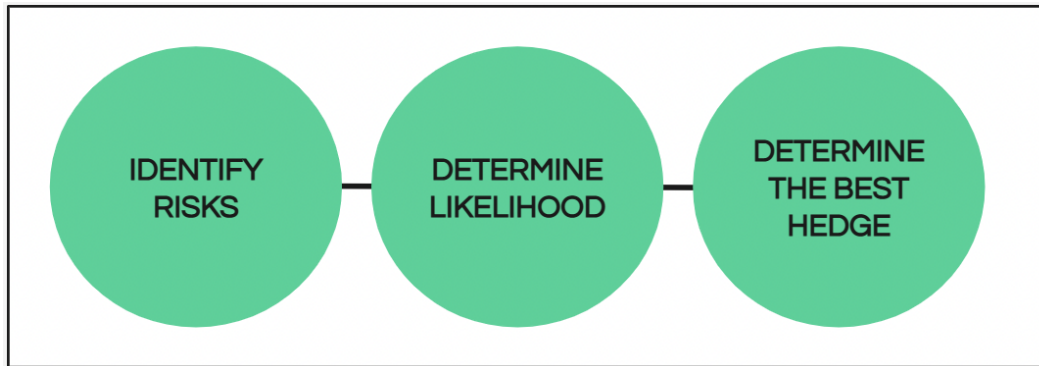
The following sections will provide an explanation of the hedging utility of this contract.

- First, in section A, we will establish how firms generally make risk management decisions and how hedging fits into those decisions;
- Section B sets forth contract specific analysis, which will establish how political control contracts fit into the risk management framework described in section A. Section B also presents an analogy to climate risk hedging;
- Section C highlights the extensive evidence that demonstrates the impacts of elections are not merely hypothetical, but an actual phenomenon that presents tangible financial risk for firms;
- Section D presents several extensive illustrations of how the CONTROL contract will be used for hedging;
- Section E offers analogies to similar products;
- Section F explains how the Contract's specifications enhance its hedging utility for many market participants;
- Section G discusses the price basing utility of the contract; and
- Section H addresses miscellaneous comments that touch on the contract's hedging and price basing functions.

A. General risk management

Businesses face a panoply of potential harms that will affect and impact their value. These potential harms are risks. Risks include valuation risk (the value of the business's services or asset's decline), funding risk (access to credit or other funding declines), and operational risks (possible disruptions or errors in the production process that undermine their earnings), among many others. Each one of these general categories of risk will manifest and impact each business according to the business's unique activities, profile, composition, *et cetera*. In addition to these examples, there are many more categories of risks, including strategic risks (e.g., getting outcompeted by a competitor), reputation risks, liability risks and beyond.

There are three steps that businesses generally follow when they are managing the risk of harm. The first step is to identify the risk's impact, meaning the various places where the business can suffer, such as its income or valuation. The second step is for the business to assess how likely it is that the potential harms will materialize, and how severe or acute will the impacts of these harms be. In order to do that, the business must consider the factors that can affect the likelihood and severity of the risks. These include market conditions and all related factors that can have a bearing on the potential harm.



This three-step process characterizes an appropriate risk management framework. It works for all manners of risks.

To illustrate, a business might identify that a decline in profit margin is a harm that it faces. One of the many factors that could cause this harm is changes in demand for its product that will change what it can charge. The business won't stop there, though. It will identify what trends or events will create a change in demand for its product. For example, the business will consider what market forces impact its core customer base. A slowdown in that sector might have a corresponding downward impact on the demand for the business's product. To illustrate, consider a builder of extra-large river barges in the upper Midwest. They know that "changes in demand" impact their risk, but they need to know what affects demand. Naturally, they look to key factors such as lower grain yield in the upper Mississippi River Valley (as lower grain yield may mean lower need for river barges). Both of these are factors that will impact the acuteness of the risk, *i.e.*, whether the harm is likely to happen and how severe it will be if it does happen. As a result, they may purchase short contracts on grain futures in order to hedge their risk.

Similarly, many businesses face potential harms that are impacted by inflation. Inflation can impact nearly all term contracts, impacting the business's real costs. For instance, a firm locked into a 10-year commercial lease on their office space will see lower real costs as a result of inflation than with a shorter lease. However, if the company is also a supplier and has locked in their sales contracts (e.g., they have agreed to sell 100,000 tons of fertilizer at \$900/ton), then the real value of those sales decline and inflation will harm them. Of course, inflation affects many other risks as well. Higher inflation raises the probability that the Federal Reserve raises its target interest rates, which tends to substantially reduce stock valuations and the value of assets.¹ Inflation is just one of many examples of factors that impact the likelihood and severity of

¹ The price of a stock is often considered the "discounted present value of future dividends". When the interest rate (a.k.a. the discount rate) goes up, then the present value of future dividends declines and thus the stock value declines. In simpler terms, when the interest rate goes up, it raises the relative value of present money over future profit. So an asset that incurs costs in the short-run but profits in the long-run is less valuable when interest rates are higher. A stock—which costs money in the short run but may generate dividends in the long-run—is thus less valuable when interest rates rise. That's doubly true for "growth stocks" that may be generating no profits now, but may generate them 5-10 years from now.

potential harms. To mitigate those risks, they may seek to purchase any one of many inflation hedges, such as inflation swaps, inflation-protected Treasuries, or inflation event contracts.

B. Application to political control contracts

Political control represents another factor that could impact a company's risk profile, much like inflation. Firms use the same risk management strategy as before. A company first identifies harms—operational, reputational, valuation, credit, and more—and then identifies the ways those risks could change. The aforementioned fertilizer company may be purchasing fertilizer inputs like potash from other countries (potash is often found in Russia, Belarus, and China) and identify their largest operational risk as disruption in the global potash supply chain. They further identify that changes in congressional political control could increase the probability that the supply chain is disrupted since different Congresses may take different approaches to tariffs, sanctions and other trade-related policies. The election of a new Congress skeptical about status quo policy will immediately impact their business by reducing the expected revenues of current investments, new investments, and making partners and investors skittish. As a result, changes in political control directly increases (or decreases) the firm's operational risks.

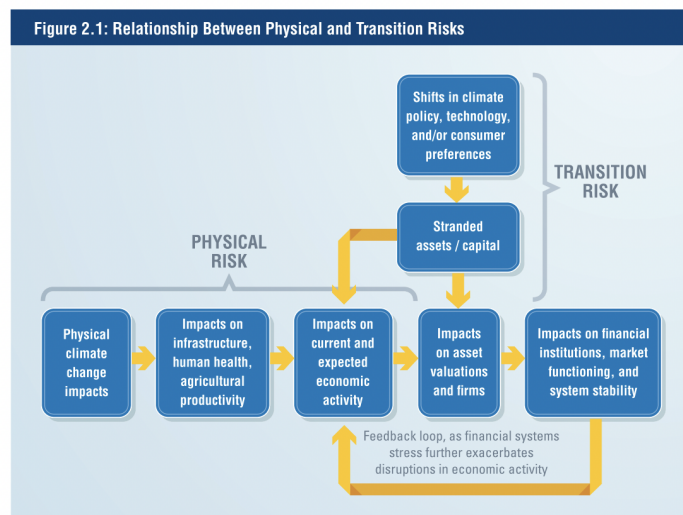
Perhaps the clearest example of this description of risk management comes from the CFTC's report "Managing Climate Risk in the U.S. Financial System" ("CFTC Climate Report").² In Figure 2.1 (shown below) and expounded upon at length in Chapter 2 of the report, the report discusses transition risk, which is defined as the "risk associated with the uncertain financial impacts that could result from a transition to a net-zero emissions economy". They note that transition risk implicates "market, credit, policy, legal, technological, and reputational risks" for firms and must be a part of any honest risk assessment. Most importantly, the report specifically identifies how transition risks "could arise, for example, from changes in policy" along with other factors such as "technological breakthroughs, and shifts in consumer preferences and social norms".

As the Financial Stability Oversight Council corroborates, policy changes (along with technological change and consumer preference changes) "especially if delayed or uneven in application and therefore requiring more abrupt economic shifts—may lead to sharp changes in the values of certain assets or liabilities, impacting nonfinancial activity and the financial sector."³ As a draft rule from the Federal Reserve Board states, "Financial institutions with sound risk management practices employ a comprehensive process to identify emerging and material

² Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System". <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

³ Financial Stability Oversight Council. 2021. "Report on Climate-Related Financial Risk" <https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf>

risks related to the financial institution's business activities. The risk identification process should include input from stakeholders across the organization with relevant expertise (e.g., business units, independent risk management, internal audit, and legal). Risk identification includes assessment of climate-related financial risks across a range of plausible scenarios and under various time horizons.”⁴ As both reports show, firms *must* consider all of the risks facing their businesses, and the only honest and accurate way to do so is to consider the way changes in policy affect those risks. This analogy is drawn out further in Appendix L.



Commodity Futures Trading Commission. 2020. “Managing Climate Risk in the U.S. Financial System”. Page 12

C. Evidence of election risk and hedging need

Elections clearly impact myriad cash flows and assets. Political parties vie for office with credible commitments to affect public policy. As a consequence, elections portend risk for many firms with politically exposed cash flows and assets. The financial press frequently reports on how elections (and even changes in election polling) affect the prices of financial assets well before a new Congress has even been seated.⁵ Election hedging specifically is also often referenced in the financial press.⁶ Below, we present evidence from academic and private

⁴ Board of Governors of the Federal Reserve System. 2022. “Principles of Climate-Related Financial Risk Management for Large Financial Institutions.”

<https://www.federalregister.gov/documents/2022/12/08/2022-26648/principles-for-climate-related-financial-risk-management-for-large-financial-institutions>

⁵ There are scores of articles which could serve as examples, but some are: Noel Randewich. 2020. “S&P 500 futures rise as U.S. election suggests less regulatory risk.” *Reuters*; Myra P. Saefong. 2020. “Here’s how the U.S. presidential election could shake up the oil market.” *Marketwatch*; Matthew Weaver. 2020. “Congressional elections could impact commodity prices most, expert says.” *Capital Press*.

⁶ There are scores of articles which could serve as examples, but some are: Weismann, Jordan. “Wall Street Says You Should Short Mexico to Prepare for Trump.” 2016. *Slate*; Brice, Jessica, and Cota, Isabella. “How Hedging and a Certain Someone Upended the Year of the Peso.” 2016. *Bloomberg*.

research, firm testimony, and the comment file on Kalshi's previous submission detailing the existence of election risk and a core use case for Kalshi's Contract .

Academic research has consistently found that changes in political control result in changes to the prices of traded assets. For example, researchers Erik Snowberg, Justin Wolfers, and Eric Zitzewitz used a variety of prediction markets (including one permitted by the Commission, Iowa Electronic Markets) to establish a relationship between the odds of a given party's success in Congressional midterms and financial markets/indicators.⁷ They found that there was a consistent link between changes in expectations of who would control Congress and the prices of equities, government bonds, and the exchange rates between the U.S. dollar and foreign currencies. The fact that financial markets utilize political control as a pricing factor demonstrates that not only are elections something that should be hedged, but that firms are already hedging and repricing assets on public markets. If this is the case, there is no case to argue that elections are not "sufficiently predictable" events to hedge; the market is already doing so.

That same team looked at high-frequency trading data immediately following the release of (what turned out to be inaccurate) exit poll data which briefly caused a major change in the odds of a Democratic victory in 2004. Such a sudden spike during what is normally a quiet trading period allowed the researchers to isolate the effects of the changes in political expectations from other economic events during the same period. They concluded that markets expected a Republican victory to result in higher equity prices, interest rates, oil prices, and a stronger dollar than a Democratic one.⁸ They reperformed that analysis in 2016, where they found that markets anticipated that a Republican victory would reduce the value of the S&P 500, foreign stock markets, reduce oil prices, and lead to a significant decline in the Mexican Peso, while also increasing future market volatility compared to a Democratic win.⁹ A similar study in 2008 found that Democratic politicians polling higher than Republican ones was better for equity markets.¹⁰

Similarly, Northwestern professor Seema Jayachandran used a natural experiment to study the effects of changes in the partisan control of Congress.¹¹ In 2001, Vermont Senator James Jeffords switched parties from Republican to Democrat, shifting control of the Senate. In what she called "the Jeffords effect", the equity valuations of firms that donated to Republicans decreased by 0.4%, while the equity valuations of firms that donated to Democrats increased by 0.1%, again indicating the marketplace's belief that Congressional control has real, predictable consequences

⁷ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Party Influence in Congress and the Economy." 2007.

⁸ Erik Snowberg, Justin Wolfers and Eric Zitzewitz. "Partisan Impact on the Economy". *Journal of Economic Perspectives*. 2004.

⁹ Justin Wolfers and Eric Zitzewitz. 2016. "What do financial markets think of the 2016 election?"

¹⁰ Demissew Diro Ejara, Raja Nag, and Kamal P. Upadhyaya, 2012. "Opinion polls and the stock market: evidence from the 2008 US presidential election." *Applied Financial Economics*.

¹¹ Seema Jayachandran. 2006. "The Jeffords Effect". *Journal of Law and Economics*.

on firm valuations. Brown University economist Brian Knight found that “under a Bush administration, relative to a counterfactual Gore administration, Bush-favored firms are worth 3% more and Gore-favored firms are worth 6% less, implying a statistically significant differential return of 9%”.¹² Economist Andrea Mattozi found by regressing Bush- or Gore-affiliated portfolios against surprising poll results, “an increase in the probability of a Bush victory from 50 to 51 percent, increases the annual expected excess return of the Bush portfolio by 25 percent and decrease[s] the annual expected excess return of the Gore portfolio by 35 percent”.¹³ This finding—that changes in the expectations of who controls government affects the prices of assets—have been replicated time and time again.¹⁴

Financial assets are derivatives of real economic cash flows and commodities. For example, the stock of a company is representative of that company’s value, a function of its costs and cash flows. Thus, market participants are imputing elections’ impacts into those assets, suggesting markets believe that elections create economic risks, but those impacts are predictable enough to spend money repricing assets and hedging even in advance of policy decisions.

Consequently, banks regularly inform their clients as to how Congressional elections may impact their clients’ extant risks. In 2020, investment bank research divisions offered projections about the economic and financial impacts of various political outcomes. For example,

- Goldman Sachs’s chief economist stated publicly that full Democratic control of government would cause the bank to upgrade their earnings forecast by sharply increasing the probability that a large fiscal stimulus bill would become law.¹⁵ Full Democratic control would also, according to the bank’s insights, “likely include a stimulus package in Q1, followed by infrastructure and climate legislation. In this scenario, we would expect legislation expanding health and other benefits, financed by tax increases, to pass.”¹⁶

¹² Brian Knight. 2006. “Are policy platforms capitalized into equity prices? Evidence from the Bush/Gore 2000 Presidential Election” *Journal of Public Economics*.

¹³ Andrea Mattozzi. 2005. “Can we insure against political uncertainty? Evidence from the U.S. stock market”.

¹⁴ Examples abound, but also include, in addition to the research already discussed: Frederico Belo, Vito D. Gala, and Jun Li. 2013. “Government spending, political cycles, and the cross section of stock returns.” *Journal of Financial Economics*; and Kyle Handley and Nuno Limao. 2015. “Trade and investment under policy uncertainty: theory and firm. evidence.” *American Economic Journal: Economic Policy*; Bryan Kelly, Lubos Pastor, and Pietro Veronesi. 2016. “The price of political uncertainty: Theory and evidence from the option market.” *The Journal of Finance*.

¹⁵ Matthew Fox. 2020. “Goldman’s chief economist breaks down why a Biden-led blue wave would prompt an upgrade in growth forecasts”. *Business Insider*.

¹⁶ Thomas Franck. 2020. “Goldman Sachs says Democratic sweep would unleash ‘substantially’ more stimulus.” CNBC.

- Morgan Stanley also cited the chance of stimulus along with infrastructure spending and corporate tax changes as a vehicle for a “blue wave” leading to a weaker dollar, lower interest rates, stronger GDP growth and lower bond prices.¹⁷¹⁸
- JP Morgan Chase projected that a Democratic victory would lead to a rally in ‘left-behind’ equities, such as “European cyclicals, value, China-exposed stocks and renewables.”¹⁹
- Bank of America provided roadmaps for each type of partisan outcome (e.g. one party controls all of government, divided government, et cetera). They wrote that full Democratic control of government would lead to \$2-2.5 trillion in stimulus compared to a Biden win with a divided Congress (\$0.5-1 trillion) or a Trump win with a divided Congress (\$1.5-2 trillion). They also detailed impacts to specific sectors, like businesses exposed to Chinese trade, in each scenario.²⁰
- UBS published a report noting partisan outcomes for policy and the economy, and recommended investors specifically focus on candidates’ policy commitments with regards to politically-sensitive industries like energy, health care, financials, and the environment. They noted that their investors should consider how the S&P 500 has performed best in environments where Republicans win, and their clients should make portfolio appropriate adjustments.
- Moody Analytics—not an investment bank, but a credit rating agency with a market research division—explicitly estimated that Democratic control of government would result in 4.2% growth between 2020-2024, compared to 3.1% under a Republican control scenario.²¹ They similarly projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.

This research is distributed, at great cost, to major financial institutions, especially capital pools like hedge funds and pension funds. This behavior strongly suggests that firms care a great deal about the specific impacts of elections on their assets, and take action to hedge their positions in advance. This was corroborated in a comment letter provided by a Managing Director of JPMorgan Chase. He wrote,

At JPMorgan, election risk is one of the largest risks our clients face, and they frequently engage us proactively on how to minimize it (hedge it, in other words). We work with and advise our clients on how to avoid that risk in their portfolios, especially when a client’s cash flows or investments are very politically sensitive (for example, those in the coal industry are very concerned regarding election outcomes and policy expectations).

¹⁷ Morgan Stanley. 2020. “A Revised Guide to Economic Policy Paths & Market Impacts”.

¹⁸ Morgan Stanley. 2020. “2020 US Election Preview: 5 Themes to Watch for Investors.”

¹⁹ Ksenia Galouchko. 2020. “JPMorgan Says Biden Victory Could Mark a Stock Market Shift.” Bloomberg.

²⁰ Bérengère Sim. 2020. “Bank of America wrote a massive 92-page report on the election's impact — here’s what investors need to know.” Financial News.

²¹ Moody’s Analytics. 2020. “The Macroeconomic Consequences: Trump vs. Biden”.

Since clients have different risk profiles, we do extensive research to fine-tune how these risks add up in our clients' positions. Our division employs a team of economists, at service to our partners, whose role in election years is heavily to research election probabilities as well as the impact election outcomes will have on equities and other investment products. We frequently host discussions with experts and clients on the relevant risks (including one coming up this week!) and publish research for both clients and the public.²²

In addition, businesses themselves often note electoral outcomes as an important factor in their value. In Q3 2020, more than one-third of company quarterly earnings conference calls used the term 'election' in the context of their financial assessments and projections.²³ On these calls, concerns were most frequently raised regarding regulatory changes that would impact business, as well as tax reform and additional potential fiscal stimulus. Earnings calls also frequently included discussions regarding the economic and business impacts of different political control outcomes (e.g., a "blue wave", divided government, et cetera). Consider this fall 2020 testimony from Thomas Peterffy, Chairman of Interactive Brokers, a brokerage firm:

Well, in the last couple of weeks, we do notice some moderation in activity, and -- which would be expected as we come up to the election. And then, of course, I think it will pick up when the results come out, especially if the Senate goes Democratic, I expect that people will start taking the long-term gains because of the expected 43% long-term capital gains tax rate. And then of course, we are looking further down the road, more and more spending that will result in asset inflation, including higher and higher stock prices.

The marketplace's expectations of the impacts of changes in political control are so credible that the Federal Reserve uses them when making monetary policy decisions. For example, during the December 2012 Federal Open Market Committee meeting, Simon Potter, the Federal Reserve's Head of Economic Research said:

The outcome of the election reinforced investors' expectations for a continuation of highly accommodative monetary policy...Some market participants also believe that there is an increased chance of housing policy changes following the election, which would increase refinance activity and origination volumes associated with credit-constrained borrowers.²⁴

Commenters on Kalshi's previous submission overwhelmingly argued in favor of the Contract's risk mitigation value. This included industry leaders (such as Jorge Paulo Lemann, Christopher Hehmeyer, Ron Conway, Seth Weinstein) and owners of politically sensitive businesses (such as those of Continental Grain Company, Nabis, Greenwork, Upsolve) who specifically discussed

²² Public Comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

²³ John Butters. 2020. "More than one third of S&P 500 companies are discussing the election on Q3 earnings calls." Factset.

²⁴ Meeting of the Federal Open Market Committee. December 11–12, 2012.

hedging use cases for their companies.²⁵ This included Greg Sirotek, the co-founder and CEO of Moneytree Power, a startup dedicated to installing solar power:

Congress has an incredible influence over the future of the zero-carbon energy industry, particularly the solar industry...Given the respective differences in the two parties' positions on the importance of climate change mitigation, renewable energy development and the deficit, the risk profiles depending on which party is in power is vast. An event contract which pays out on the basis of Congressional control would allow our business to manage this previously unhedged risk.²⁶

Jorge Paulo Lemann, a founder at 3G Capital and a Board member of firms like AB-InBev and Kraft Heinz (some of the largest participants in traditional agricultural futures), wrote:

These statements [claims that there are no hedging or price basing use cases for election contracts] are inconsistent with the preponderance of the academic research on the subject and is inconsistent with the actual experience of anyone who has ever operated a business in or with the United States or traded on the global commodity markets. Experience and empirical observation show that elections have consequences, and these consequences directly create risk that can be hedged, and are factored into pricing commodities, financial assets, and services.²⁷

Hehmeyer, former Chair of the National Futures Association and Board Member of the Futures Industry Association, added that many are affected regardless of policy outcomes:

For example, media personalities and companies face risk from Congressional control and elections. Early professionals hoping to work on Capitol Hill know there are far more positions available if their preferred party is victorious, as there are more Congressional offices and committee positions for them to staff. A consultancy that specializes in specific topic areas (for example, a green energy consultancy) may know the demand for their services will decline in anticipation that their issue of expertise is less likely to be operative under a split Congress. These risks occur regardless of the legislation that actually passes. There are billions of dollars at risk surrounding the outcome of Congressional control and elections. These risks can reasonably be expected to be managed through this contract on Congressional control.²⁸

Although some commenters claimed election outcomes aren't predictable enough to be a useful hedge, that in no way contradicts or even diminishes those who say the opposite. At most, those commenters do not see hedging utility for themselves. They cannot credibly say that all the firms who identified how they would use the contracts for hedging and managing their risk are mistaken or deficient in their ability to recognize risk and potential tools to manage or mitigate that risk. It would be arbitrary for the Commission to listen only to the few who assert that there

²⁵ Public comments 69668, 69715, 69667, 69683, 69678, 69619, 69684, 69717, 69714, 69718, 69727, 69707, 69677, 69655.

²⁶ Public Comment by Greg Sirotek. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70751>.

²⁷ Public Comment by Jorge Paulo Lemann. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69684>.

²⁸ Public Comment by Christopher Hehmeyer. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69717&SearchText=christopher>.

is no hedging use case for anyone when most others who state that they would use the product for themselves or their business.

Thus, it is clear that businesses consider political control an important risk to be hedged. This reality is recognized by the CFTC in the CFTC's Climate Report and the aforementioned FSOC report. It noted that, "uncertainty associated with policy risk is already penalizing oil companies that are investing in undeveloped fossil fuel reserves" and "financial market participants are already looking for ways to manage transition risk in their investment portfolios."²⁹ The partisan makeup of Congress is a critical factor of policy risk that Kalshi's Contract addresses.

Even if the above evidence was not clear, the market is best positioned to make that determination, not the Commission or Kalshi. If that risk is too tangential, then the product will be a commercial failure. With a contract designed for hedging, such as this contract with its minimum order size and increased position limits, the market and market participants will be able to determine their own risk management strategies, and whether the contract is a necessary component of their strategies or not. That is a decision that is appropriately left to the participants to decide for themselves.

D. How the CONTROL contract can be used to hedge political risk in practice

Note that the CONTROL contract is not a panacea that can hedge all risks. It is not appropriate for all market participants, and it is not appropriate for all risks. The CONTROL contract is appropriate for businesses that face risk impacted by partisan political control of Congress. For those businesses, the CONTROL contract can be an important hedge and part of their overall risk management process. A typical business that has risks that are impacted by political control will have risks that are appropriately hedged by the CONTROL contract, as well as risks that are not. The following examples illustrate the risk management analysis a typical business will follow, with risks that are impacted by political control and risks that are not, in order to illustrate how the contract fits into a broader risk management strategy that a firm may undertake.

Though the comment file (and other evidence discussed in Section C above) provide many tangible examples of firms describing the risks they are subject to and would use the Contract to mitigate, Section D will include detailed descriptions of firms' hedging. Consider an enhanced geothermal systems company producing process heat for industrial processes (e.g. paper mills). The business will identify the potential harms that the company faces. Naturally, there are many operational risks (what if a rig breaks?), but those are hardly the only risks they face. Some other risks are enumerated below:

²⁹ Commodity Futures Trading Commission. 2020. "Managing Climate Risk in the U.S. Financial System".

- Increases in transportation costs, which could affect the cost of transporting specialized boring equipment. This may occur due to increases in trucking rates or changes in gas/diesel prices. For illustration, let us say that every 1% increase in transportation costs costs the firm \$200,000.
- Changes in the price they can sell their goods, which could occur due to rising energy prices or government rebates. For example, suppose a 1% increase in energy costs increases firm profits by \$500,000.
- A shift in the demand curve for their services. There is a subtle but important distinction between changes in services demand due to lower prices (which in economic terms would be considered a move along the same demand curve) and a shift in the demand curve, whereby demand is different even if the price remains the same as before. This scenario could occur due to changes in environmental rules inducing more industrial firms to purchase zero-carbon electricity or changes in subsidies and tax credits that makes their product more affordable for firms when compared to fossil fuel services. Suppose a *ceteris paribus* 1% increase in demand would increase firm profits by \$300,000.
- Changes in retained profits. This could occur due to changing revenues, changing costs, but also changing corporate tax rates—including marginal rates and depreciation treatment. Suppose reversing the 2017 tax cuts would, all else equal, increase firm costs by \$5 million.
- Changes in expansion opportunities. This could occur due to changes in permitting standards that may affect the speed at which the firm can develop new geothermal sites or changes in environmental standards may affect which sites can be developed.
- Changes in expansion costs. This may occur due to changes in interest rates may affect the cost of financing new rigs and sites or changes litigation costs from NEPA rules that affect whether local groups can sue to stop a new site development.

The firm will assess what are the factors that will impact each of their potential harms, factors that can impact the likelihood of harms materializing, and factors that can impact the severity of harms should they materialize. Not every harm will be directly impacted by elections and political control, and the contract will not be a part of every hedging strategy. Looking at the transportation cost variable, for instance, the firm may decide that trucking rates are likely unaffected by changes in Congressional control (though in 2022, Congress's vote on the freight rail strike did likely affect trucking prices, a firm may not consider this frequent enough to be worth calculating) and gas prices—while related to political variables—is not easily anticipated by changes in Congressional majorities. Regarding their output price, while wholesale energy prices are certainly influenced by political variables, the firm may determine that the relationship to elections are too attenuated to evaluate. Likewise, while permitting standards under the National Environmental Policy Act is a top priority for the 118th Congress, it's widely viewed as a bipartisan priority and thus unlikely to change regardless of how political conditions evolve.

But the business may determine that other potential harms will be directly impacted by elections and political control. For example, retained profits and shifts in the demand curve are influenced by which party wins Congress, as parties have substantially different positions on corporate taxes, zero-carbon subsidies, and emission standards for industrial processes.³⁰ As a result, depending on how the Congressional election plays out, certain risks become more salient. Mitigatory actions may be insufficient—the firm cannot cost-efficiently diversify into fossil fuels to reduce their exposure to clean energy subsidy policy in the same way a corn farmer cannot cost-efficiently diversify into an uncorrelated domain in order to reduce their exposure to agriculture prices. A firm may conduct some simple math: a given party winning may increase the probability of beneficial tax changes by 20%, creating an expectation of \$1 million (\$5 million * 20%) more in retained profits, but have a 50% chance of enacting environmental rules that reduce demand by 10%, creating an expectation of loss of \$1.5 million (50% * 10%/1% * \$300,000). As a result, a financial hedging product may be more appropriate. Suppose the probability of Party X winning control of Congress was 33.3% and the price of the \$5000 contract was thus \$1,666.67. In that case, they would purchase 60 contracts for a total of \$100,000. If the adverse event does occur, the firm would be paid \$300,000 to compensate for their expected losses. If the adverse event does not occur, they would not be paid, but they would reap the benefits of the more favorable event occurring.

The chart below summarizes this process. **Green-colored rows** indicate risks that can be mitigated using the CONTROL contract, whereas **magenta-colored rows** indicate risks that would not be hedged by the CONTROL contract.

Potential Harm (Risk)	Factors that could affect the likelihood and severity of the risk	How these risks could be hedged
Transportation cost increases	<ol style="list-style-type: none"> 1. A potential labor strike on the railroads increases trucking rates as rail freight shippers must all now shift to trucking temporarily 2. Russia’s war in Ukraine increases the global price of gasoline and diesel fuel 	There is a relationship to Congressional control, but it’s likely too attenuated for the Contract to be a useful hedge. Instead, the firm purchases short-contracts on WTI oil and buys long-term trucking contracts

³⁰ This is not just rates. The tax code is filled with numerous and interrelated provisions that impact businesses in different ways. The business may have a number of different provisions that, while seemingly minor to the average citizen, impact them deeply. For instance, while millions of companies are affected by the headline marginal tax rates (making marginal tax rates a good candidate for a policy-specific event contract), a small number are affected by individual provisions such as the treatment of carried interest (for hedge funds) or easements for wetland protection. However, for the firms for which those “minor” provisions matter, they matter a great deal. In order to get enough liquidity, those firms would essentially pool their liquidity on a general Congressional control contract, where the firms who care about each of the thousands of minor provisions all might participate.

<p>Sales price decreases</p>	<ol style="list-style-type: none"> 1. Large-scale technological advances in hydraulic fracturing technology decreases the price of natural gas, lowering the price by which energy can be sold competitively to industrial users 2. New Congress decreases government zero-carbon energy subsidies previously authorized under the Inflation Reduction Act that were given directly to zero-carbon producers 	<p>Similarly to transportation, the relationship to energy price changes is real but better hedged through oil futures. However, the subsidy risk remains real, and the forms it takes are too manifold to hedge using a specific policy-product, and instead the firm buys Contracts that hedge against a subsidy-hostile Congress winning power</p>
<p>Loss of demand</p>	<ol style="list-style-type: none"> 1. Changes to the overall federal legislative and regulatory approach to energy policy that no longer encourage industrial users to use zero-carbon electricity in the same way 2. Recession results in decreased manufacturing in the business's service area 	<p>Recession risk is best hedged using other instruments—such as shorts on the S&P 500 or a recession-specific event contract. But changes to the overall legislative approach to energy policy is best hedged using a contract that pays out on the basis of Congressional control</p>
<p>Loss of retained profits</p>	<ol style="list-style-type: none"> 1. New Congress reverses the marginal corporate tax rate cuts and bonus depreciation provisions authorized under the Tax Cut and Jobs Act of 2017 2. New Congress introduces new surtaxes and surcharges onto large corporations as part of an effort to reduce the deficit 	<p>TCJA reversal may be able to be hedged using a specific policy-level event contract. However, the second channel is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a tax-friendly Congress taking power</p>
<p>Higher input costs</p>	<ol style="list-style-type: none"> 1. New Congress has a more protectionist stance, and has various proposals to—among other things—renegotiate existing trade agreements, reject newly proposed agreements, impose new tariffs on foreign goods, increase regulatory scrutiny on foreign investments, and globally signal a new attitude on trade policy 	<p>The trade uncertainty channel is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a more protectionist Congress taking power</p>

<p>Loss of demand</p>	<ol style="list-style-type: none"> 1. A new Congress has a more restrictive view on antitrust policy and will work to reduce the number and size of mergers and acquisitions through a combination of new legislation, changing personnel in relevant bureaucratic agencies (such as the Federal Trade Commission), and asking those bodies for new regulations 	<p>The decline in M&A activity, as well as general uncertainty in the sector, is too broad or general for a policy-specific contract, and instead the firm would buy a contract that pays out on the basis of a more anti-M&A Congress taking power</p>
<p>Business model regulated or destroyed</p>	<ol style="list-style-type: none"> 1. A new Congress believes that a particular industry or business is socially harmful and decides to ban it, either directly or indirectly through regulation and bureaucratic appointments. Congress has considered doing so with many firms and industries, such as TikTok and e-cigarettes 	<p>A business model being regulated in a punishing way is too broad or general for a policy-specific contract, and instead it would make more sense for the firm to to buy a contract that pays out on the basis of a hostile Congress taking power</p>
<p>Loss of expansion opportunities</p>	<ol style="list-style-type: none"> 1. Judicial action strikes down modifications to state-level permitting law reforms, thereby allowing frequent NEPA litigation over site development 2. Interest rates, monetary policy, and tax changes make venture capital markets go tighter, and reducing the access to capital markets 	<p>There are no good hedges to state-level judicial action, and instead the firm should “self-insure” by maintaining a capital buffer. Changes in interest rates and monetary policy can be hedged using other financial instruments, such as interest rate swaps</p>
<p>Increase in expansion costs</p>	<ol style="list-style-type: none"> 1. An unexpected surge in inflation causes the Federal Reserve to hike interest rates, thereby raising the cost of borrowing money to build new rigs 	<p>Increases in inflation and interest rates can be hedged using inflation-protected treasuries or interest rate swaps</p>

Or consider a firm specializing in providing specialized lab-developed tests (LDTs) for certain genomic conditions. They regularly take stock of their company’s biggest risk factors. They include:

- Changes in research and development financing costs. Three major factors include changes in funding to the National Science Foundation (NSF) and National Institutes of Health (NIH), changes in interest rates, and research and development tax breaks. They

estimate that every 1 percentage point increase in interest rates increases their costs by \$5 million.

- Changes in regulatory approval costs. One major contributor to the risk is the probability that Congress changes the law such that LDTs are treated the same as all commercial-use diagnostic tests, thereby changing from the regulatory remit of the Center for Medicare Services (CMS) to the Food and Drug Administration (FDA), where approval timelines are typically substantially longer. They estimate that change would add an additional six months to their approval process, which could cost them roughly \$25 million per year.
- Changes in revenue and profit, which could be affected by changes in Medicare reimbursement rates, which may affect the willingness of hospitals to offer their tests. They estimate that a reduction of 1% in the Medicare reimbursement rate change would cost them \$10 million per year. Another factor related to this risk is changes in corporate taxes, including marginal rates, which may affect overall profitability. They estimate reversing the 2017 corporate tax reductions could cost their company \$3 million.

The firm may determine that NSF/NIH funding remains a bipartisan priority and is unlikely to change regardless of the results of the Congressional elections. Likewise, the effect on interest rates from Congress may be too attenuated to effectively assess; but they determine that legislation to change the regulatory treatment of LDTs is more likely under one political coalition than another. Since they are a firm specializing in LDTs, this risk could be quite severe. As a result, they may wish to purchase a financial product that mitigates their risk exposure.

The relationship between the election and their risks is sufficiently direct that a financial hedge may be valuable. For instance, suppose they believe that Party X winning the midterm election would result in a 16 percentage point increase in the probability that LDT reform legislation becomes law. As a result, the election of Party X creates \$4 million in risk through that channel alone ($0.16 * 25m$). However, Party X winning also reduces the probability of costly corporate tax changes by 33%, thereby reducing the expected loss by \$1 million. As a result, they may wish to purchase \$3 million of hedging products to zero out their extant election risks, which they could do so by purchasing 3,000,000 contracts. They may also wish to only partially hedge by purchasing less than that. Critically, even though the election is not deterministic on their bottom line, it has clear and unambiguous effects on risks to their profitability that can be hedged.

How hedging political risk works

Kalshi

Example of how a lab-developed test company will hedge

Step 1: Identify risks to businesses

1. Changes in R&D financing costs
2. Changes in approval costs
3. Changes to net revenue and profit, including tax rates

Step 2:

Determine likelihood of risks

- The firm determines that Risk 1 is unlikely to be affected by the partisan control of Congress, but Party X has committed to affect Risk 2 in a negative way for the firm. Party X has also committed to tax policy that would benefit the firm.

Step 3: Determine the hedge

- I determine that those risks represent \$3 million of potential loss on net if party X wins.
- I determine that a \$3 million dollar hedge is appropriate to zero out that risk.

Hedging example ECP (cont.)

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Risk	Magnitude	Probability if Party X has control
Adverse change in regulatory regime	\$25 million	16% higher
Beneficial tax reduction	\$1 million	33% higher

Hedge: If Party X wins, the increase in risk to the company is \$3 million (-\$4 million from regulatory changes and \$1 million from the tax changes). They may look at the prices of the contract, and may decide to hedge against that risk fully, purchasing contracts that in total payout \$3 million if Party X wins. If Party X loses, they lose the money they spent but they benefit from Party X being out of power.

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E. Similarities to existing products

Many products listed on Commission-regulated exchanges mitigate risk in a similar manner to Kalshi's proposal. For instance, the CME Case-Shiller futures, which pay out based on an index that tracks the overall housing market, does not perfectly map onto any real estate portfolio. It is nonetheless a useful hedging product. Below we have assembled a table that highlights relevant characteristics of existing self-certified products.

Self-certified contract	Relevant characteristics	Comparison to Political Control Contracts
Micro Bitcoin futures	<ul style="list-style-type: none"> ● Geared towards retail participants ● The micro size itself does not hedge real economic activity ● Does not have price-basing value for other goods and services 	<ul style="list-style-type: none"> ● Geared towards retail/firms (original Kalshi submission) or just entities (current submission)³¹ ● Allows for hedging real economic activity, even if not 1:1 ● Provides valuable price-basing for pricing other assets such as oil, currencies and equities
Cooling and Heating Degrees futures (there are many dozen variations of these, for particular areas and seasons)	<ul style="list-style-type: none"> ● Does not perfectly hedge 1:1 anyone's risk, since the primary purchasers (natural gas companies, air conditioner companies) are exposed to energy consumption, but that does not line up either 1:1 with weather or with CDD/HDD 	<ul style="list-style-type: none"> ● Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Case-Shiller Housing Price Index futures (and other real estate futures products)	<ul style="list-style-type: none"> ● Does not perfectly hedge 1:1 anyone's risk, since the primary purchasers (real estate investors) have risk that is correlated, but not perfectly correlated, with the overall real estate market and any index in particular 	<ul style="list-style-type: none"> ● Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Hurricane contracts	<ul style="list-style-type: none"> ● Does not perfectly hedge 1:1 anyone's risk, since it is uncertain whether a hurricane of a given speed hitting a given area will cause any amount of damage at all, let alone damage to the user, and to what severity 	<ul style="list-style-type: none"> ● Similar hedging value proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated
Equity index	<ul style="list-style-type: none"> ● At their inception, equity 	<ul style="list-style-type: none"> ● Similar hedging value

³¹ Although the contract will be available to all Exchange members, as required by the CEA and Core Principle 2.

<p>futures (there are many dozen variations of these live on commodity futures exchanges, e.g. CME's E-mini Utilities Select Sector Futures)</p>	<p>index futures were designed to capture the risks investors faced from the market as a whole. However, the particular indices (such as the S&P 500) do not perfectly capture and hedge 1:1 anyone's risk. Their risk is correlated, but not perfectly correlated, with the overall market. Though some index futures have products that directly reflect them (e.g. S&P 500 ETFs) today this is not true of all index products listed, nor true of any hypothetical product</p>	<p>proposition: primary purchasers' risk is correlated strongly with elections, even if not perfectly correlated</p> <ul style="list-style-type: none"> • Many iterations (e.g. e-Minis, Micros) are targeted and used heavily by retail (original Kalshi submission) or by institutions (current submission)
<p>Consumer Price Index futures</p>	<ul style="list-style-type: none"> • Though individuals and firms are subject to inflation risk, their particular inflation risk is not generally not perfectly correlated with the consumer price index, which chooses a particular set of goods in a particular composition in order to measure inflation 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly, though not perfectly with the derivative product in question
<p>CBOE's Volatility Index (VIX)</p>	<ul style="list-style-type: none"> • Though individuals are affected by the risk associated with the stock market, they are not perfectly affected by the risk implied by S&P 500 options 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated strongly, though not perfectly with the derivative product in question
<p>Environmental offset futures</p>	<ul style="list-style-type: none"> • In this case, purchasers are not even offsetting personal risk. They are offsetting social risk, risk to society that is caused by their operations; as well as the marginal risk caused to 	<ul style="list-style-type: none"> • Similar hedging value proposition: primary purchasers' risk is correlated, though not perfectly with the derivative product in question

	them by increased carbon output	
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F. Focus on large-scale hedging

Class	Bona fide hedgers	Everyone else
Individual	\$250K	\$125K
Entity	\$10M	\$5M
ECP	\$100M	\$50M

Position limits for different users of Kalshi’s CONTROL contract

Critically, this product is designed for firms, ECPs, and other large-scaled hedgers, although of course individuals are not prohibited from trading, as required by Core Principle 2. The contract order size (multiples of 5,000 contracts) is appropriate for large scale financial hedging activity.

While it is true that not all participants will be hedgers (as with other futures, there need to be some non-hedgers to provide liquidity), with the high contract order size and larger position limits for ECPs and entities, it is highly likely that these non-hedging participants will be sophisticated firms and specialized liquidity providers, which is a dynamic found in many CFTC-regulated markets.

G. Price basing and price discovery utilities

There is extensive price basing utility for the Contract. As discussed earlier, the market frequently reprices assets on the basis of changes in election expectations and election outcomes.³² Investment banks and other research divisions provide clients and the public with recommendations on how Congressional outcomes will change the price of financial assets; an event contract on election outcomes would help price discovery for those products. For example, in 2020, projected a one percentage point lower unemployment rate and a 0.6 percentage point higher S&P 500 under a Democratic sweep.³³

³² There are scores of articles which could serve as examples, but some are: Noel Randewich. 2020. “S&P 500 futures rise as U.S. election suggests less regulatory risk.” *Reuters*; Myra P. Saefong. 2020. “Here’s how the U.S. presidential election could shake up the oil market.” *Marketwatch*; Matthew Weaver. 2020. “Congressional elections could impact commodity prices most, expert says.” *Capital Press*.

³³ Moody’s Analytics. 2020. “The Macroeconomic Consequences: Trump vs. Biden”.

In 2012, more than two dozen economists signed a letter to the Commission supporting arguing as much. Led by the late Nobel Laureate Kenneth Arrow in that 2012 letter, they wrote:

Political event futures facilitate price discovery in other asset markets. One of the findings of [our] research is that firms and industries are exposed to political and policy risk. Political event futures provide investors with a market-based assessment of outcome probabilities, which reduces investors' uncertainty when trading other assets.³⁴

Many economists have done the same for Kalshi's previous submission, including Nobel Laureate Robert J. Shiller, Phillip Tetlock, Justin Wolfers, Scott Sumner, Michael Abramowicz, Joseph Grundfest, Alex Tabarrok, Michael Gibbs, Jason Furman, David Pennock, Harry Crane, David Rothschild, Koleman Strumpf, Ryan Oprea, and others.³⁵ A letter signed by Pennock, Crane, Rothschild, and Strumpf argued,

Prediction market prices in political and policy events would help facilitate price discovery in a wide-range of asset markets, affecting the entire economy (note that pricing is freely available to non-traders). Political and policy events matter: they expose a wide-variety of businesses to risk that traditional financial markets have trouble pricing. A robust set of markets for political and policy events could price that risk, and, if they were allowed to flourish, could eventually grow to provide hedges where uncertainty is particularly acute.³⁶

The contracts can also be used to price MGEX's corporate tax futures and Kalshi's other political event markets related to bills passing, government shutdowns, and the debt ceiling. They can also be used to price other nonpolitical products, like equities and bonds. For example, imagine a junior investment bank has been instructed to price a security. That price is reflective of the stocks' net present value, itself a reflection of future expected profits. This includes political risk. If that banker knew with certainty that Republicans will take control of Congress, for example, and corporate taxes are thus less likely to be raised, she would price the security higher than otherwise. Kalshi's contracts would help her in doing so.

Many other members of industry and businesses stated as much in public comments, including Angelo Lisboa, Peter Kempthorne, Seth Weinstein, David Pollard, David Trinh, Eriz Zitzewitz, James Cust, Caesar Tabet, Jorge Paulo Lemann, Sebastian Strauss, Christopher Hehmeyer, and Ron Conway.³⁷ Margaret Stumpp, a senior vice president at Prudential Financial and a co-founder of Quantitative Management Associates, wrote,

³⁴ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

³⁵ See public comments 70761, 69708, and 69735.

³⁶ Public Comment by David Rothschild. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

³⁷ See public comments 69662, 69703, 69718, 70743, 70763, 70747, 70753, 70765, 69684, 69721, 69717, and 69714.

...a well functioning market for contingent political outcomes should improve the prices at which other securities (eg, stocks, bonds, options, etc...) trade. This reduces uncertainty, enhances capital market liquidity, and improves the efficiency by lowering uncertainty.³⁸

On the standard for price basing

One commenter argued that there is no hedging or price basing use case for the Contract because there is no underlying cash market, unlike with traditional agricultural and energy derivatives.³⁹

This is not the standard that the Commission should apply in its decision. It is not the standard applied in *Nadex* (which considered whether Nadex's proposal could base the price of a physical commodity, financial asset, or service); it is also not the standard that the Commission asked the public to use in judging Kalshi's original submission (which uses the same test as *Nadex*). To do otherwise and limit price basing to only contracts with an underlying cash market would be arbitrary.

It would also essentially invalidate the existence of price basing, or price discovery, for the vast majority of event contracts, which do not have underlying cash markets. This is inconsistent with Commission precedent and would upend myriad products listed with the Commission in the last two decades. Many derivatives products currently listed with Commission-registered Designated Contract Markets do not have underlying cash markets, such as:

- Macroeconomic indicator derivatives (e.g. Gross Domestic Product contracts)
- Tax rate derivatives (e.g. MGEX's corporate tax rate futures)
- Weather derivatives (e.g. hurricane and heating/cooling degree days contracts)
- Carbon offset futures (e.g. CME's CBL Global Emissions Offset Futures)
- Housing price index futures (e.g. CME's futures based on Case-Shiller house price indices)

Because of the permissionless nature of self-certification, the Commission has not *specifically* stated that the above contracts have hedging or price basing utilities; the Commission did so implicitly by permitting their registration for decades. However, in some cases, the Commission has been specific. For example, the Commission actively determined that futures which pay off based on the amount of box office revenue a motion picture produces has price basing utility, even though it has no cash commodity market.⁴⁰

³⁸ Public Comment by Margaret Stumpp. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69722>.

³⁹ Public Comment by Steve Suppan. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70791>.

⁴⁰ "The Commission found that the contracts can perform hedging and price discovery purposes... The Commission analysis applied three tests to determine whether or not these contracts could be used by an identifiable segment of an industry or industries for hedging or price basing on more than an occasional basis."

The price basing value of Kalshi's proposal is no different. A market-based determination of the probability of a given party taking control of a given chamber of Congress would be helpful in basing the price of politically sensitive commodities (such as oil), assets (such as politically sensitive stocks, like cannabis and energy firms), and services (such as investments in politically sensitive sectors).

There is no hard and fast rule defining when price basing does and doesn't occur in a manner sufficient to justify a CFTC-listed derivative. In some cases, the Commission/Commission staff indicated that price basing is when a commodity future specifically bases the price of its underlying commodity; in other cases, also related commodities;⁴¹ in other cases (including Kalshi's), also non-commodities.⁴²

Several Commissioners have indicated in statements they believe that intangible event contracts, sans cash markets, have price basing utility. This includes Commissioners Brian Quintenz and Dan Berkovitz in the case of ErisX's proposed NFL Futures Contracts; Commissioner Sharon Brown-Hruska when discussing how event contracts may have primarily price discovery as opposed to hedging functions; as well as Commissioners Quintenz and Mark Wetjen on election contracts themselves.⁴³⁴⁴⁴⁵⁴⁶ In fact, in its release discussing event contracts in 2008, Commission

<https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/ifdocs/mdexcommissionstatement061410.pdf>.

⁴¹ For example, the CFTC's rule on Exempt Commercial Markets describes price basing this way at some points, as does the definition provided on the Commission's website; at other points, the rule refers to price basing as being about only the underlying commodity itself.

⁴² For example, the Commission's decision in *Nadex* or the Commission's questions for the public in Kalshi's original submission specifically discuss whether the contracts can be used for basing the price of a physical commodity, financial asset, or service. The Commodity Exchange Act also does not specify what derivatives must or should be managing price risk/discovering prices/price basing for.

⁴³ Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, April 7, 2021, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721#_ftn27 *Note*: Commissioner Berkovitz argues that, although he does not believe ErisX demonstrated price basing utility, he does clarify that it could have such utility, and is open to being shown that.

⁴⁴ The Functions of Derivative Markets and the Role of the Market Regulator, May 18, 2006. Dr. Sharon Brown-Hruska, Commissioner, available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/opabrownhruska-45>

⁴⁵ See Public Comment on Kalshi Contract from Brian D. Quintenz, available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

⁴⁶ See Public Comment on Kalshi Contract from Mark Wetjen, available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70771>

staff used election markets to describe how price discovery in event contracts could work.⁴⁷ This utility was true then, and it remains true today.⁴⁸

The law, similarly, does not restrict price basing to specifically the commodity upon which the derivative is based. Specifically, the CEA says, “transactions subject to this Act are entered into regularly in interstate and international commerce and are affected with a national public interest by providing a means for managing and assuming price risks, discovery prices, or disseminating pricing information through trading in liquid, fair and financially secure trading facilities.”

Even if the Commission had used the standard whereby price basing only applies to an underlying cash market (and it has not) at one point, why should it continue to do so in the future? The fact that a derivative can provide price discovery for a different commodity, asset, or service is consistent with the CEA’s price discovery goals; stopping a derivative from being listed on that basis is inconsistent with it. Moreover, the fact that a derivative could be used for price discovery for another kind of product or service suggests relation, falling within one of the common definitions Commission staff use in describing price basing.

That being said, if the standard was “related” commodity, election markets are patently related to major commodity markets, such as energy and agricultural markets. The United States government is a major participant in such markets, both directly trading in them and providing significant industry subsidies. In addition, research has consistently found a link between elections and changes in oil prices, demonstrating that the market is using election probabilities to base the price of commodities and commodity futures.⁴⁹

H. Other comments on hedging and pricing issues

A few commenters disputed the hedging and/or price basing utilities of the contract in ways that are not addressed by the above. They said:

⁴⁷ As noted above, the Commission’s release stated that “The trading of such contracts can facilitate the discovery of information by assigning probabilities, through market-derived prices, to discrete eventualities. For example, a binary contract based on whether a particular person will run for the presidency in 2012, can pay a fixed \$100 to its buyer if and only if that individual runs for the presidency in 2012. If the contract's traders believe that the likelihood of the individual's candidacy in 2012 is around 17 percent, the price of the contract will be around \$17, and will approximate the market's consensus expectation of the individual's candidacy.”
<https://www.federalregister.gov/documents/2008/05/07/E8-9981/concept-release-on-the-appropriate-regulatory-treatment-of-event-contracts>

⁴⁸ The fact that the concept release predated Dodd-Frank is of no consequence. The point is that the contract has obvious price basing utility, and even if Dodd-Frank, *arguendo*, reincarnated the economic utility test, the contract passes because of its price basing utility.

⁴⁹ *E.g.* Erik Snowberg, Justin Wolfers and Eric Zitzewitz. “Partisan Impact on the Economy”. *Journal of Economic Perspectives*. 2004.

- The \$25,000 position limit was not enough to constitute hedging for most businesses and institutions. In Kalshi's new submission, the position limits have been raised, with an emphasis on those with established hedging needs.
- Election outcomes are not sufficiently predictable in order to justify a hedging product. Above, evidence is provided that market participants extensively discuss, hedge, and price election risk well before a new Congress is even seated. If the market is already doing so, then there is no place to say otherwise.
- Election risk can be de-risked through other equities and derivatives products. However, other products are insufficient to hedge electoral risk, which is a unique risk that could flow through many different parts of a firm's business. Moreover, there is no "uniqueness" requirement that hedging products have.
- One commenter, Richard Q. Wendt, argued that hedging behavior would reduce the Contract's informational utility, since hedgers are less price sensitive than speculators. However, large, liquid markets with hedgers, speculators, and liquidity dealers are broadly able to simultaneously provide accurate pricing information and hedging opportunities. For example, when the price of an oil future is pushed down below fair market value by a price insensitive hedger, speculators come in and push the price back up to take advantage of the discrepancy between the current price and the fair price.
- The Commission, in its questions, questioned whether it should be considering what percentage of a given market must be made of hedgers versus speculators; as well as whether hedging needs can be merely theoretical or need "evidence". These standards were not applied against Nadex, ErisX, or any other contract proposed to the Commission. They are not found in law, rule, or regulation; although Kalshi's contract clearly does have established hedging utility, it would be arbitrary for the Commission to impose novel burdens on it.

APPENDIX D (CONFIDENTIAL) – COMMISSION JURISDICTION AND THE SPECIAL RULE FOR EVENT CONTRACTS

In addition to the details discussed below, Kalshi has attached letters on the matter from former Commission General Counsel Daniel Davis and Jonathan Marcus, as well Commissioner Caroline Pham’s dissent on whether to impose a stay and review pursuant to Regulation 40.11 of Kalshi’s original submission. Additional commenters on this point include, but are not limited to, former Nadex CEO Timothy McDermott, former Commissioner Brian Quintenz, former Commissioner Mark Wetjen, “father of futures” Dr. Richard Sandor, Gregory Kuserk, who led the Product Review branch in DMO, former MPD Director Josh Sterling, Daniel Gorfine, Lewis Cohen, Jeremy Weinstein, Susquehanna International Group, Tabet DiVito & Rothstein, and Railbird Technologies.⁵⁰ Kalshi has adopted these comments and they form part of the basis on which Kalshi determined that this contract is consistent with the CEA. Rather than attach all the comments here, which would consume a fair bit of paper, Kalshi has referenced them in the prior footnotes and notes that these comments are all in the Commission’s possession and available on the Commission’s website. However, should the Commission find it convenient to have all of these comments attached, Kalshi will supply them to the Commission.

Commission jurisdiction

Section 2(c)(2)(A)(ii) of the Act provides that the Commission has jurisdiction over swaps. Swaps are defined in section 1a(47)(ii) of the Act to include, among other things, “any agreement, contract, or transaction . . . that provides for any purchase, sale, payment, or delivery (other than a dividend on an equity security) that is dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence.” The Contract provides for payments that are dependent on the occurrence, nonoccurrence, or the extent of an event. The Contract is therefore a swap, and the listing and trading of the contract on Kalshi are therefore under the Commission’s jurisdiction. Section 5c(c)(5)(B) and Commission Regulation 40.2(b) create a presumption in favor of approving contracts.

Special rule for the review and approval of event contracts

Section 5c(c)(5)(C) of the Act provides a special rule for the review and approval of event contracts. Under this special rule, the “Commission *may* determine” (emphasis added) that event contracts or swaps (“based upon the occurrence, extent of an occurrence, or contingency”) are “contrary to the public interest” if those contracts “involve” certain enumerated activities.⁵¹ 7

⁵⁰ Public comments 70786, 70771, 69687, 70754, 69737, 70755, 69736, 69723, 70743, 70765, 70752.

⁵¹ The relevant language of “involve, relate to, or reference” comes from Commission regulation 40.11. This language cannot be broader than the statutory language that is simply “involves”. By definition, if the regulation applied more broadly than the statute, it would *per se* violate the APA and be invalid.

U.S.C § 7a-2(c)(5)(C)(i).⁵² Those enumerated activities are: 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.” *Id.* The discretionary use of this special rule for event contracts is implemented in the Commission’s Regulations. 17 C.F.R. § 40.11, which provides that “the Commission *may determine*” that a certain contract “may involve” one of the enumerated activities and subject that contract to a 90-day review period after which it “shall issue an order” with its determination.⁵³ 17 C.F.R. § 40.11(c).

The CEA’s special rule for event contracts applies to contracts that “involve” one of the six 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.” 7 U.S.C § 7a-2(c)(5)(C)(i)(I)-(VI). These specific examples demonstrate that the term “involves” in the statute (and application of the special rule) refers to the actual “occurrence, extent of occurrence, or contingency” that forms the underlying basis for the contract to be traded; and not the trading of the contract itself.

The statute’s second enumerated activity is “terrorism,” and thus, a contract that “involves” terrorism is subject to the CEA’s special rule for event contracts. An event contract will involve terrorism if the underlying event that forms the basis of the contract is terrorism; the act of trading on a contract itself is not terrorism. The same is true for the third and fourth enumerated activities. An event contract will “involve” assassination when the underlying event that forms the basis of the contract is assassination; the act of trading itself is obviously not assassination. An event contract will “involve” war when the underlying event that forms the basis of the contract is war; the act of trading itself is obviously not war. This common sense understanding is explicit in the statute. The statute’s first and the sixth enumerated activities are an “*activity* that is unlawful under any Federal or State law” and “other similar *activity* determined by the Commission, by rule or regulation, to be contrary to the public interest.” (emphasis added) The noun “activity” makes it clear that the statute is referring to the underlying event, not to the *activity* of trading on the contract.⁵⁴ Thus, the statute is clear that an event contract “involves” an

⁵² If the Commission chooses to review an event contract to determine whether it is contrary to the public interest and finds that a listed event contract is “contrary to the public interest,” that contract may not be “listed or made available for clearing or trading on or through a registered entity.” 7 U.S.C § 7a-2(c)(5)(C)(ii).

⁵³ As interpreted by former Commissioner Dan Berkovitz, regulation 40.11 mirrors the statute, 7a-2(c)(5)(C), and sets forth the process for the Commission to determine whether a specific event contract is contrary to the public interest. Statement of Commissioner Dan M. Berkovitz Related to Review of ErisX Certification of NFL Futures Contracts, April 7, 2021, available at https://www.cftc.gov/PressRoom/SpeechesTestimony/berkovitzstatement040721#_ftn27 (“Berkovitz Statement”).

⁵⁴ Although this is abundantly clear with regard to five of the six enumerated events, an argument might be mounted that it is not true with regard to the fifth of the enumerated activities, gaming. This argument fails, as it is a basic tenet of both semantic and substantive statutory interpretation that a single usage of a word, in this case “involve”,

enumerated activity when the underlying event that forms the basis of the contract, not the trading on the contract, involves the activity.

The statute's first enumerated activity ("activities that are illegal under federal or state law") further buttresses the conclusion that it is the underlying event that forms the basis of the contract that is relevant to the special rule and not the act of trading itself. If "involves" means that the trading on the contract is the enumerated event, that would mean that CEA's special rule applies to trading on a contract *when the trading on the contract itself already violates federal law*. Recall that the special rule does not prohibit such contracts, it merely authorizes the Commission to make that determination. It would be odd for Congress to make a federal law that makes trading on a certain contract illegal, but nonetheless say listing that contract is prohibited only if the CFTC determines that it is against the public interest. Once Congress made it illegal, it is unlikely it would have turned around and allowed it unless the CFTC agrees that the activity is disfavored.

Instead, it is abundantly clear that the enumerated activity of "illegal under federal law" means that the underlying event that forms the basis of the contract is illegal under federal law, not that the trading on that contract is illegal under federal law. An example of a contract that would fall under this first enumerated activity is a contract on the number of people that commit tax evasion. Tax evasion is a felony under I.R.C. § 7201. Trading on the contract is obviously not tax evasion. Nonetheless, that does not matter. The event in that contract is an activity that is illegal under federal law. The fact that trading on the contract is not illegal under federal law is irrelevant, because whether the CEA's special rule for event contracts applies to an event contract is determined based on whether the underlying event that forms the basis of the contract is an enumerated activity, not the act of trading on the contract.⁵⁵

Because it is the underlying event that forms the basis of the contract that is the only trigger of the CEA's special rule for event contract review, political control event contracts are clearly not included in that rule. The event that underlies these contracts is the political control of the United States Congress by a political party. Political control of government by a political party is obviously not illegal under federal or state law. It is not an activity that the Commission has determined to be contrary to the public interest. Nor is it terrorism, assassination, war, or a game. As such, political control contracts are not included in the narrow reach of the CEA's special rule

will not have two meanings, one for items 1, 2, 3, 4, and 6 on a list, and a second meaning for item 5 on that same list.

⁵⁵ The rare exception to this would be when the act of trading a contract itself is prohibited, as is the case for contracts "for the sale of motion picture box office receipts (or any index, measure, value, or data related to such receipts) or onions for future delivery" which are expressly prohibited in the Act. 7 U.S.C § 13-1. Trading a political control contract, however, is not prohibited by the Act nor is the underlying event illegal.

for certain, enumerated activities and the rule and relevant regulations (17 C.F.R. § 40.11) does not apply.⁵⁶

Additionally, the activities that are enumerated can be seen as all involving an undesirable activity. Terrorism, war, assassination, illegal activity, and gaming are activities that can be considered “undesirable”. The sixth activity too is essentially any other activity that the Commission considers to be undesirable. Political control is not one of those activities.

However, even if one did believe that the Commission should consider whether trading on the contract itself is part of “involve”, the Contracts would still not involve either gaming or illegal activity.

A. Gaming

Elections and political control are not games

Unlike games, in which the underlying activity has no inherent economic value apart from the money wagered on it, political control has an obvious and large economic impact, as it heavily influences expectations and the likelihood of public policy change. As Gregory Kuserk noted, unlike games, “Elections are events that are very important to the public, and there is a very strong public interest in having accurate data regarding elections.”⁵⁷ Kalshi detailed as much in dozens of pages of evidence provided to the Commission, drawing on private and university research, policymaker and industry testimony, and the financial press.⁵⁸ Many public comments by retail, industry, and academia have confirmed as much.⁵⁹

Kalshi’s contracts do not involve gaming. It involves the partisan affiliation of the Speaker of the U.S. House of Representatives and the U.S. Senate’s President *pro tempore*, which are not

⁵⁶ The Commission in the Nadex order took a very expansive view of the authority that the CEA conferred on it with the special rule for event contracts. The Nadex Order stated simply “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.” However, the legislative history that the Commission pointed to back then is of the weakest kind, a simple colloquy between two senators about preventing contracts on game outcomes, and certainly not enough to override the clear semantic and substantive indications in the statute itself as to what it means. The Commission should not reinforce a flawed legal position from a decade ago.

⁵⁷ Public Comment by Gregory Kuserk. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70754>.

⁵⁸ Memorandum in Support of Kalshi’s Political Control Contracts, submitted to Division of Market Oversight (DMO) March 28, 2022.

⁵⁹ See, for example, public comments by Chicago Booth school Professor Michael Gibbs and Susquehanna International Group Special Counsel David Pollard. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69704> and <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70743>.

determined through or relate to games of chance, or games of skill.⁶⁰ Elections are not games, full stop. Indeed, the *Nadex Order* did not identify political elections themselves—the core of American democracy—as being a game.⁶¹

Trading on Congressional control is not gaming

The *Nadex Order* asserted that gaming is equivalent to placing a wager or bet, and it cited a federal statute that defined 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.”⁶² It further concluded that this is the same as taking a position on a Congressional control contract. If taking a position on a Congressional control contract is equivalent to a ‘wager’ or ‘bet’ because it places money on an event’s outcome, that would imply that taking a position in any event contract is also equivalent to a ‘wager’ or ‘bet’.⁶³ This would imply that event contracts themselves violate state gambling laws. This is incorrect. While gambling is illegal in many states and interstate betting is prohibited, event contracts are legal in all jurisdictions. Political control is also not a “contest” even if it indirectly involves competition. Trading on an event contract is also not the same as a “bet” in practice; as former Commissioner Quintenz wrote:

Gaming describes wagering money on an occurrence that has no inherent economic value itself other than the money wagered on its outcome. For instance, wagering money on roulette or blackjack should be considered gaming because there is no economic significance of the activity apart from the wager itself. Speculation, on the contrary, is risking value where the underlying activity has economic consequences, which then means the speculative activity creates valuable societal and economic benefit from a price-discovery and risk transfer function for those exposed to the risk of that underlying activity.⁶⁴

B. Illegal activity under federal or state law

Kalshi’s Contract does not involve illegal activity. Taking a position in an event contract is not equivalent to, as states or the federal government may define it, “gaming” “gambling” or “wagering”. This is not true legally (interstate betting is illegal, and betting is illegal in many states; event contracts are legal in all jurisdictions) or in practice. As then Commissioner Quintenz wrote in his *ErisX* statement,

⁶⁰ Kalshi’s Congressional control submission, available at:

<https://www.cftc.gov/sites/default/files/filings/ptc/22/08/ptc082422kexdcm001.pdf>. See page 9.

⁶¹ 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 (April 2, 2012), available at:

<https://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/nadexorder040212.pdf>.

⁶² *Nadex Order* at 3

⁶³ Some commentators appear to equate speculation with gaming and do not sympathize with the important role speculation plays in price discovery and risk transfer. Many commodity futures markets, such as those in oil, often feature large amounts of speculative behavior yet clearly do not constitute “gaming” contracts.

⁶⁴ See Public Comment on Kalshi Contracts from Brian D. Quintenz, available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70786>

Whereas bettors participate in games of pure chance, whose sole purpose is to completely reward the winner and punish the loser for an outcome that would otherwise provide no economic utility (think roulette), speculators in the derivatives market participate in non-chance driven outcomes that have price forming impacts upon which legitimate businesses can hedge their activities and cash flows.⁶⁵

Taking a position in an event contract is also not equivalent to gaming, as defined by those laws, because such laws are not operative on CFTC-regulated products. Federal law definitions of gaming, betting, and wagering (such as the Wire or Unlawful Internet Gambling Enforcement Act) carve out exemptions for CFTC-regulated products.⁶⁶ This includes the definition of gaming cited by the *Nadex Order*. Many states' gaming provisions also include such exemptions.⁶⁷ States' gaming provisions are preempted explicitly as well by the Commodity Futures Modernization Act ("CFMA").⁶⁸ Congress has repeatedly recognized that futures and other derivative contracts serve economic purposes and, therefore, state laws that purport to prohibit or regulate futures or derivative contracts (including gaming laws) do not violate the CEA and are preempted. There is a critical distinction between betting and legitimate, federally recognized and regulated financial activity. Election contracts that are designed for price formation and hedging on a derivative exchange constitute legitimate financial activity. Therefore, it would be incorrect to give consideration of the definitions under state and federal gambling laws. As these laws themselves recognize, they do not apply to contracts like Kalshi's.

Indeed, a key purpose of the CEA and granting the CFTC exclusive jurisdiction over futures was to authorize and promote trading of futures contracts notwithstanding state laws that might purport to prohibit them as gambling. The only way in which state law is relevant is if the activity underlying the event contract violates state law, such as a contract on murder or state income tax evasion. In that case, Congress wanted to make sure that a futures contract would not legitimize that activity without the Commission considering whether trading the contract would be contrary to the public interest.⁶⁹

⁶⁵ See Statement of Commissioner Brian D. Quintenz on ErisX RSBIX NFL Contracts and Certain Event Contracts, "Any Given Sunday in the Futures Market" (Mar. 25, 2021), available at <https://www.cftc.gov/PressRoom/SpeechesTestimony/quintenzstatement032521>

⁶⁶ The Unlawful Internet Gambling Enforcement Act of 2006 "do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act". 31 U.S.C. § 5362(1)(E) (2006).

⁶⁷ For example, Washington state RCW 21.30.030 clarifies that CFTC-regulated transactions are not affected by its anti-bucket shop provisions.

⁶⁸ 7 USC 2(a)(1) covers exclusive CFTC jurisdiction over futures and swaps, so any state laws that would purport to regulate or prohibit futures or swaps would be preempted.. The CEA also preempts state gaming laws with respect to derivative products that are excluded or exempt from the CEA. *See* 7 USC 16(e)(2) ("This Act shall supersede and preempt the application of any State or local law that prohibits or regulates gaming or the operation of bucket shops . . . in the case of --- (A) an electronic trading facility excluded under section 2(e) of this Act; and (B) an agreement, contract, or transaction that is excluded from this Act under [provisions of] the Commodity Futures Modernization Act of 2000, or exempted under section 4(c) of this Act.").

⁶⁹ Congress obviously would not be concerned about legitimizing elections. Even if the focus comes to legitimizing the trading on elections as part of the ultimate public interest analysis, the Commission has already crossed that

Additionally, many broad state gambling laws would define *all* event contracts as gaming, as well as many other futures, swaps, and options. States like New Hampshire, for example, define gambling as having “to risk something of value upon a future contingent event not under one's control or influence.”⁷⁰ If the Commission were to find that the contracts involve gaming on the theory that New Hampshire state law prohibit gambling/wagering on elections, that would mean “wagering” is equivalent to taking a position on any event contract, which in turn would require that the Special Rule is triggered by *any* event contract because many New Hampshire's and many other state's gambling laws prohibit wagering on the outcome of *any* future event. That interpretation was clearly not Congress' intent. Instead, Congress narrowly defined a small number of event contracts whose underlying event involves an unsavory activity that Congress did not want the CFTC to legitimize without evaluating whether trading a contract on that activity would be contrary to the public interest (as per the text, which isolates a selected set of enumerated events to target).

Time and time again, Congress and states have indicated that the Commission has the decision making power over derivatives market issues, including event contracts, and approval of Kalshi's contract has no involvement with gaming any more than an event contract on the growth of Gross Domestic Product or whether a bill becomes law. If the Commission chooses to isolate these contracts as involving gaming but not those many others, it would be acting contrary to Commission precedent and in an arbitrary manner.

bridge by long permitting market participants to trade such contracts pursuant to no action letters awarded to unregulated markets, such to Iowa Electronic Markets and PredictIt. The notion that allowing a regulated exchange to offer the contracts is what changes the public interest analysis is insupportable.

⁷⁰ New Hampshire Rev Stat § 647:2(II)(d) (2017); see also Alaska Stat. § 11.66.280(3) (“gambling” means that a person stakes or risks something of value upon the outcome of a contest of chance or a future contingent event not under the person's control or influence, upon an agreement or understanding that that person or someone else will receive something of value in the event of a certain outcome”); Oregon Rev. Stat. § 167.117(7) (“‘Gambling’ means that a person stakes or risks something of value upon the outcome of a contests of chance or a future contingent event not under the control or influence of the person . . .”).

APPENDIX E - OTHER CONSIDERATIONS FOR THE PUBLIC INTEREST

This section will be split into two sections: first, why the Contract is affirmatively in the public interest; and second, addressing objections thereof from the comment file.

A: Kalshi's Contract will provide significant social value

The contracts have a strong economic purpose.

The hedging and price basing use cases are myriad and would allow individuals to take advantage of a product that is currently strongly in demand. Elections cause extremely large economic impacts and are some of the biggest risks that many businesses will encounter. This is detailed at great length in Appendix B and has been validated by dozens of public comments from retail, business, academia, and members of industry.

The contracts would serve as useful tools for voters, the media, and the public that would fight disinformation, improve election integrity, and improve decision making including policy making

The demand for accurate information surrounding elections is enormous—and valuable. This is why so many Americans turn to election models and updates offered by *FiveThirtyEight*, *The New York Times*, and *The Economist* around election time for advanced election models. Unregulated exchanges created by the Commission, such as PredictIt, are also very popular for this purpose. Its markets are consistently referenced as informative and useful by major, credible news organizations like *CNN*, *CNBC*, *Politico*, *Bloomberg*, *The Economist*, *The Wall Street Journal*, *The Washington Post*, and *The New York Times*, across sections like *The Upshot*, *DealBook*, opinion columns, and the technology section. In addition, PredictIt has repeatedly been cited by prominent political officials and thinkers. Examples include economists like Jason Furman, previously President Obama's Council of Economic Advisors Chair; Nobel Laureate Paul Krugman, a Professor at The Graduate Center and a columnist for *The New York Times*; and data scientists/reporters like Nate Silver, founder and editor-in-chief of *FiveThirtyEight*.⁷¹⁷²

In a public comment, Furman also emphasized the importance of election markets for policy making. As he wrote,

⁷¹ Examples of this include: La Monica, Paul R. "Joe Biden's Fed conundrum: Stick with Jerome Powell or let him go?" CNN. 2021; Heath, Thomas. "These gamblers are putting money on the outcome of the impeachment inquiry." Washington Post. 2019; Contrera, Jessica. "Here's how to legally gamble on the 2016 race." Washington Post. 2016; The New York Times search results: <https://www.nytimes.com/search?query=PredictIt>; <https://twitter.com/NateSilver538/status/1242845027014971394>; <https://twitter.com/jasonfurman/status/1460404350975680514>; and <https://twitter.com/paulkrugman/status/1177602108763316227?lang=en>.

⁷² Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

...in the White House I, along with other members of the economic team, would regularly refer to prediction markets on electoral outcomes and specific events to help inform our understanding of how political and economic developments would affect economic policymaking. In understanding the risks of a government shutdown or debt limit showdown, for example, it would be helpful to understand what informed traders with money at stake would expect—a method of understanding probabilities that research has consistently shown is superior to other ways of summarizing and updating based on information.⁷³

Professor Furman went on to detail the other benefits for the contract, including helping academic researchers and educational benefits, a point also made by others, including Sebastian Strauss. PredictIt also has been used to promote civic engagement by undergraduates. Berg and Chambers (2016) found that using prediction markets, including PredictIt, increased user interest in civics and user news consumption.⁷⁴

The preponderance of the academic literature suggests that existing media has misaligned incentives when it comes to reporting on a given party's chances of political control. This often results in bad reporting. For example, University of Pennsylvania professor Philip Tetlock evaluated the statements made by pundits and found that 15 percent of predictions claimed to be “impossible” did indeed occur and 27 percent of predictions claimed to be a “sure thing” did not.⁷⁵

By providing an instant check against pundits, a market-based price created by the contracts can aid information aggregation for the public. For the numerically-inclined or the financially-minded, a viewer can see that one commentator is asserting that party X is a “sure thing” but the Kalshi contract gives them only (e.g.) a 20% chance of winning. They now have a competing alternative to that pundit's information.

Markets tend to be more accurate than any pundit or forecasting alternatives. The efficient, price-discovering nature of markets in a wide range of contexts is a well-substantiated finding in academic research.⁷⁶⁷⁷⁷⁸⁷⁹ The collective wisdom of many people who have a direct monetary stake in the outcome results in a valuable price signal. Weather derivatives and agricultural

⁷³ *Ibid*

⁷⁴ Berg & Chambers. *Bet Out the Vote: Prediction Markets as a Tool to Promote Undergraduate Political Engagement*. 2018. Journal of Political Science Education.

⁷⁵ Philip Tetlock. “Expert Political Judgment”. 2005.

⁷⁶ Justin Wolfers and Eric Zitzewitz. 2004. “Prediction Markets.” *Journal of Economic Perspectives*.

⁷⁷ Kenneth J. Arrow, Robert Forsythe, Michael Gorham, Robert Hahn, Robin Hanson, John O. Ledyard, Saul Levmore, Robert Litan, Paul Milgrom, Forrest D. Nelson, George R. Neumann, Marco Ottaviani, I Thomas C. Schelling, I Robert J. Shiller, Vernon L. Smith, Erik Snowberg, Cass R. Sunstein, Paul C. Tetlock, Philip E. Tetlock, Hal R. Varian, Justin Wolfers, and Eric Zitzewitz. 2008. “The Promise of Prediction Markets.” *Science Magazine*.

⁷⁸ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2008. “Chapter 80 Results from a Dozen Years of Election Futures Markets Research.” *Handbook of Experimental Economics Results*.

⁷⁹ Georgios Tziralis and Ilias P. Tatsiopoulos. 2007. “Prediction Markets: An Extended Literature Review.” *The Journal of Prediction Markets*.

futures are better at predicting the weather than meteorologists.⁸⁰ Markets trading on the reproducibility of scientific research are better at discovering which papers will reproduce than experts, who do no better than chance.⁸² Most importantly, research studying IEM and PredictIt have confirmed that markets provide more accurate information than traditional forecasting methods.⁸³⁸⁴

Kalshi's contracts would provide a visible, well-trusted benchmark against which to evaluate a pundit's predictive power. As Professor Tetlock observed, "prudent consumers should become suspicious" when they confront a public record of poor performance relative to the market. In his words, "Unadjusted ex ante forecasting performance tells consumers in the media, business, and government what most want to know: how good are these guys in telling us what will happen next?"⁸⁵

The contracts would not serve as threats to either election integrity or the perception thereof; instead, it would improve them both (also discussed at length in Appendix G, as part of Core Principle 3 analysis)

It is important for the Commission to engage with the evidence on election integrity rather than speculate. The *Nadex Order*'s suggestion that voters could be incentivized to switch their votes, and thus harm election integrity, was outright speculative in 2012, and has since been disproven by the success of a Commission-sanctioned but unregulated market, PredictIt. PredictIt has grown to more than a billion shares traded—with little hedging participants because of the Contract's low position limits—without any claim of, let alone proof of, election impropriety driven by those markets.⁸⁶ Election trading is also common over-the-counter among the largest financial institutions and high net worth individuals.⁸⁷ Today, election trading remains alive and well in other democracies like the United Kingdom, Australia, Ireland, and New Zealand, without documented attempts at—let alone successful—distortion of the electoral process. Several commenters confirmed this, including Eric Crampton, the academic advisor to iPredict, a New Zealand based political prediction market:

⁸⁰ Richard Roll. 1984. "Orange Juice and Weather." *The American Economic Review*.

⁸¹ Matthias Ritter. 2012. "Can the market forecast the weather better than meteorologists?" *Economic Risk*.

⁸² Anne Dreber, Thomas Pfeiffer, Johan Almenberg, Siri Isaksson, Brad Wilson, Yiling Chen, Brain A. Nosek, and Magnus Johannesson. 2015. "Using prediction markets to estimate the reproducibility of scientific research." *PNAS*.

⁸³ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2008. "Chapter 80 Results from a Dozen Years of Election Futures Markets Research." *Handbook of Experimental Economics Results*.

⁸⁴ Joyce Berg, Forrest D. Nelson, and Thomas A. Reitz. 2006. "Prediction market accuracy in the long run." *International Journal of Forecasting*.

⁸⁵ *Ibid*

⁸⁶ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJlZGljdGFibGUtbmV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

⁸⁷ Public Comment by Angelo Lisboa. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

What experience we had with iPredict suggests CFTC really doesn't have anything substantial to worry about in allowing contracts on political events. If anything, they heightened voter engagement. The CE [Chief Executive] of iPredict even featured on the nightly news during the election, giving the latest on election market prices. And for that brief period, whenever blowhard partisans insisted that some outcome was going to happen, people could just point to the iPredict price on the event and ask them why they thought that price was wrong, and whether they'd actually put their money where their mouth was. It was a remarkable era. iPredict inflation forecasts (they also had markets on inflation going out several years - it was so very good) wound up being noted in our Reserve Bank's Monetary Policy Statements. I desperately miss it. I envy the opportunities Americans could have if CFTC takes a sensible approach to regulation.⁸⁸

Or Dustin Moskovitz, a co-founder of Facebook and founder of Asana:

Of course, it's important to validate that these contracts would not conflict with the public interest, and specifically the integrity of our elections. I am confident, however, they would not do so. Similar markets not only exist in many liberal democracies like the UK, but create a thriving scene that actually encourages voter participation and engagement.⁸⁹

The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. The marginal addition of Kalshi's contract will not change whether or not elections are events of enormous consequence, and thus not increase anyone's incentive meaningfully to attempt manipulation of several hundred elections across the United States. American elections are not readily susceptible to manipulation, full stop, thanks to their decentralized nature, strong political norms, and laws protecting the vote. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of these groups are extremely unlikely to attempt intentional manipulation of the leadership of their chambers merely to settle the contracts a certain way. Their finances are heavily monitored and subject to public disclosure and scrutiny, and Kalshi does not permit them, their close associates, or families to trade, along with numerous other related political actors. Kalshi is taking especially stringent action here, as detailed in Appendix B. Members of Congress also have a sworn duty to represent their constituents and have strong

⁸⁸ Public Comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

⁸⁹ Public Comment by Dustin Moskovitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

incentives not to manipulate electoral processes for private gain. This should clarify any claim that this could de-legitimize elections internal to Congress itself.

Other related officials (like election officials, vote counters) also take such oaths and are heavily monitored because of the strong public interest in maintaining election integrity. In practice, the information gained by being a vote counter is of near-zero marginal value to determining whether or not a given party wins a given chamber of Congress.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Koleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to “16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore.”⁹⁰ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.⁹²

Prices are not able to be manipulated to the give the false impression of momentum

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum,” thus potentially harming the democratic process. This concern has been tested several times by researchers on far smaller markets, who have concluded that all attempts at manipulation have failed.

Koleman and Strumpf in a later paper examined American political prediction markets and found that no previous effort at manipulation was capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”⁹³ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like one offered by a Designated Contract Market. As a result, manipulation on Kalshi’s market is even less plausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found, one major reason why political

⁹⁰ Paul Rhode and Koleman Strumpf. 2012. “The Long History of Political Betting Markets: An International Perspective.” Strumpf also was a signatory to a supportive public comment. *See* Public comment 69735. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735&SearchText>

⁹¹ Paul Rhode and Koleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

⁹² Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

⁹³ Paul Rhode and Koleman Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.⁹⁴ In fact, the greater the attempts to push up one side's prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz wrote regarding previous political contracts, "none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase."⁹⁵ This finding was also supported by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi's submission.⁹⁶⁹⁷

This information—that billions of dollars have been traded on contemporary political control contracts without triggering manipulation—was not available to the Commission the last time it considered similar event contracts in 2012. Although another political contract trading venue, the Iowa Electronics Market, received a no-action letter in 1992, IEM is smaller and harder to access by individuals not associated with the University of Iowa. Now, far more money is known to have been traded on election outcomes without any adverse consequences.

The contracts would combat illegal behavior, improving the perception of election integrity

Americans can also readily access offshore platforms using a virtual private network such as Betfair.⁹⁸ Betfair had more than \$500 million traded on the 2020 election.⁹⁹ These platforms are not registered with the Commission as DCMs, but frequently host such markets. There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation. However, if the Commission is concerned that election markets could nevertheless create election integrity threats, it is imperative to shift trading to an exchange compliant with the Core Principles, with insider trading protections, surveillance, and KYC. In this way, among others, approving the contracts would improve, not harm, election integrity and the perception of it.

The contracts would promote the public perception in election integrity by providing an accurate and competing tool for election forecasting

⁹⁴ Robin Hanson and Ryan Oprea. 2008. "A Manipulator Can Aid Prediction Market Accuracy." *Economica*.

⁹⁵ Justin Wolfers and Eric Zitzewitz. 2006. "Prediction Markets in Theory and Practice".

⁹⁶ Nadex public comment by Zitzewitz et al. Available at <https://www.cftc.gov/sites/default/files/stellent/groups/public/@rulesandproducts/documents/ifdocs/ericzitzewitzltr020312.pdf>.

⁹⁷ For example, the public comment by David Rothschild and company. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69735>.

⁹⁸ Comment letter by policy commentator Matt Bruenig. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69670>.

⁹⁹ Seen at this link:

<https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

Studies consistently show that polarization and partisanship has increased dramatically in the last few decades: every year, greater numbers of people say they believe people from the opposite party are “immoral” and express other hostile sentiments. More concerning than mere hostility is how partisan antipathy can create alternative sets of facts--voters from different parties simply believe two sets of facts about the world. It is from this miasma where conspiracy theories about stolen elections emerge that damage the electoral process.

Prediction markets can help remedy this problem. Economists John Bullock, Alan Gerber, Seth Hill, Gregory Huber conducted an experiment in 2013 and found that partisan gap in beliefs (e.g. if Republicans believe a statement is true with probability 80%, and Democrats believe it with probability 35%, then the partisan gap is 45 percentage points) shrunk by a shocking 55 percent when participants were given a financial incentive for being right.¹⁰⁰ If they were given a lesser financial prize for answering “unsure” (versus none for being wrong and a greater amount for getting it correct), the gap shrunk by about 80 percent.

The reasoning roughly tracks as follows: when no money is at stake, people conflate their beliefs as preferences. For example, a highly partisan liberal may say that a Democratic Party candidate is definitely going to win the 2024 presidential elections this year (a belief), when in reality they merely want the Democrat to win the championship (a preference). However, that same individual when challenged to trade money on that “definite” prediction will re-evaluate and calculate the odds and decide whether or not they should take that trade. In short, when no money is at stake, people express beliefs as mere signaling, lending itself to heavy partisan bias. When money is at stake, they are able to differentiate their beliefs from their preferences. In other words, the partisan reality gap shrinks, and individuals who trade on election markets become more attune to facts and less to partisan groupthink.

In conclusion, the Contract is not contrary to the public interest; rather, it strongly supports the public interest, as demonstrated by the evidence above. The Contract will improve asset pricing, provide risk management opportunities, enhance election integrity and trust, and shift trading activity to regulated exchanges.

B: Addressing objections

Commenters were overwhelmingly in support of Kalshi’s contract; nonetheless, the Exchange takes concerns seriously. Some commenters also raised concern that price manipulation is possible because of insider information. Kalshi maintains that there are near zero actors with inside information on the result of the totality of the elections in the United States House or Senate; nonetheless, in its new submission, Kalshi is proactively prohibiting a host of political

¹⁰⁰ John Bullock, Alan Gerber, Seth Hill, Gregory Huber. 2013. “Partisan Bias in Factual Beliefs about Politics.”

actors from participating in the markets along with additional surveillance, as listed in Appendix B.

Another concern raised was that, even if the contract does not genuinely make elections more manipulable, it may increase the perception that they are. The Commission must rely on evidence in this sort of deliberation rather than feeling. This perception problem is not an issue in other nations with large-scale election trading (such as the United Kingdom), and in fact, probabilities created by offshore and unregulated exchanges (and discussions of the hundreds of millions traded) are regularly reported on by the political and financial press.¹⁰¹ Election trading is already significant in the United States among large-scale institutions over the counter (as testified to by commenter Angelo Lisboa) and by Americans using offshore/unregulated exchanges as well as by trading indirectly through traditional asset classes.¹⁰² Rather, as discussed at length in Section A of this appendix, the contracts would promote election integrity rather than harm it

A small number of commenters argued that Kalshi's market could have its price manipulated, thus distorting the public perception of a race. The vast majority of these claims are unsubstantiated, though the letter provided by Dennis Kelleher of Better Markets does try and provide some evidence. Specifically, it argued:

The proposed event contract is readily susceptible to manipulation... In her 2009 Harvard Law Review article "Prediction Markets and Law: A Skeptical Account," Professor Rebecca Haw Allensworth detailed how bad actors might manipulate prediction markets: 'Prediction markets are vulnerable to manipulation... First, they could profit by artificially lowering the trading price temporarily and purchasing shares to be sold at a higher price when the market returns to 'normal'. Second, they could try to affect the informational value of the market. For example, a candidate's supporter could purchase his shares at an inflated value, raising the perceived odds that he would win the election, and (hopefully) getting more voters to jump on the putative bandwagon'.¹⁰³

There are several issues with this line of reasoning:

1. Critically, this is a misapplication of the cited research.
 - a. Allensworth only cites one incident of successful manipulation, on an online exchange called TradeSports, referencing the case study on the incident conducted by Paul W. Rhode & Koleman S. Strumpf's, "Manipulating Political Stock

¹⁰¹ There are scores of articles which could serve as examples, but some are: Mashayehki, Rey. "Betting markets called the presidential election more accurately than polls." *Fortune*. 2020. Kirshner, Alex. "How Offshore Oddsmakers Made a Killing off Gullible Trump Supporters." *Slate*. 2020; Yakowicz, Will. "Bettors Have Wagered More Money on Trump vs. Biden Than Nevada Collected During the Super Bowl." *Forbes*. 2020; Bumbuca, Chris. "2020 U.S. presidential election expected to involve more than \$1 billion in wagers." *USA Today*. 2020; Reuters Staff. "Betting markets give Trump slightly improved chances after debate." *Reuters*. 2020.

¹⁰² Public Comment by Angelo Lisboa. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

¹⁰³ Public Comment by Dennis Kelleher. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

Markets: A Field Experiment and a Century of Observational Data.” However, Rhode and Strumpf conclude the opposite of Allensworth/Better Markets: that even the attempt to manipulate TradeSports’ small, unregulated market only succeeded in changing prices briefly, and conclude, “In the cases studied here, the speculative attack initially moved prices, but these changes were quickly undone and prices returned close to their previous levels. We find little evidence that political stock markets can be systematically manipulated beyond short time periods.”

- b. The other study cited, by Deck et al., does find researchers successfully manipulate a small exchange of *their own creation, with made up assets, with a mere eight traders.*
2. The vast majority of research on this issue demonstrates how shockingly resilient such markets are to manipulation even in spite of no regulation. This is discussed at length also in Appendix G, which details how the Contract is in compliance with Core Principle 3.
 - a. Like Allensworth, Deck et al. acknowledge this.¹⁰⁴ They wrote, “Wolfers and Zitsewitz (2004, p. 119) assert that ‘The profit motive has usually proven sufficient to ensure that attempts at manipulating these [prediction] markets were unsuccessful.’ Failed attempts at manipulating markets include political candidates betting on themselves (Wolfers and Leigh 2002) and bettors placing large wagers at horse races (Camerer 1998). Hansen, et al. (2004) did successfully manipulate election prediction markets, but the effects were short lived. In fact, Rhode and Strumph (2009, p. 37) provide an extensive discussion of attempts to manipulate political markets and conclude that ‘In almost every speculative attack, prices experienced measurable initial changes. However, these movements were quickly reversed and prices returned close to their previous levels.’” They go on to cite more experiments that showed resilience to manipulation, including that of Ryan Oprea and Robin Hanson, two supportive commenters.¹⁰⁵ They do not find any research that shows any successful manipulation that is not short-lived.
3. The research cited by Better Markets only focused on small-scale, generally illiquid, unregulated online prediction markets. A highly regulated market that can onboard institutional clients is even less likely to be a victim of a particular manipulator, as markets incentivize speculators to reverse any potential price impact a manipulator could have. Indeed, Hanson and Oprea found, one major reason why political contracts are resistant to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market. In fact, the greater the attempts to jack up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist

¹⁰⁴ Deck, C., Lin, S., & Porter, D. (2010). Affecting policy by manipulating prediction markets: Experimental evidence. ESI Working Paper 10-17.

¹⁰⁵ Hanson, R. and Oprea, R. “A Manipulator Can Aid Prediction Market Accuracy,” *Economica*, 2009, 76, 304-314.

Eric Zitzewitz wrote regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.” This finding was also noted by over two dozen economists in their 2012 Nadex letter and by many letters supporting Kalshi’s submission.

APPENDIX F (CONFIDENTIAL) – SOURCE AGENCY

The data which is used to determine the Expiration Value of the Contract is published by the Library of Congress, the official government repository of information for the public since 1800.

Congress.gov is an affiliate of the Library of Congress and contains a record of all members of Congress, their leadership status, and party membership. It updates every weekday morning at 8:00 AM with the complete record of the previous day's activities.

As stated on the Congress.gov website:

Congress.gov is the official website for U.S. federal legislative information. The site provides access to accurate, timely, and complete legislative information for Members of Congress, legislative agencies, and the public. It is presented by the Library of Congress (LOC) using data from the Office of the Clerk of the U.S. House of Representatives, the Office of the Secretary of the Senate, the Government Publishing Office, Congressional Budget Office, and the LOC's Congressional Research Service.

Congress.gov is usually updated the morning after a session adjourns. Consult [Coverage Dates for Congress.gov Collections](#) for the specific update schedules and start date for each collection.

Congress.gov supersedes the THOMAS system which was retired on July 5, 2016. Congress.gov was released in beta in September 2012. The THOMAS URL was redirected to Congress.gov in 2013. The beta label was removed in 2014.

The scope of data collections and system functionality have continued to expand since THOMAS was launched in January 1995, when the 104th Congress convened. THOMAS was produced after Congressional leadership directed the Library of Congress to make federal legislative information freely available to the public.

Congressional documents from the first 100 years of the U.S. Congress (1774-1875) can be accessed through [A Century of Lawmaking](#).¹⁰⁶

¹⁰⁶ <https://www.congress.gov/about>

The information used to determine the Expiration Value of the Contract is highly visible. Any discrepancy between the true value and the reported values at the Source Agency would be swiftly detected and any individual who engaged in said manipulation of the Source Agency would likely be fired. Importantly, the Exchange has chosen to only use official government sources to determine the Expiration Value of the Contract. The Exchange understands that political control can often be hotly contested, with accusations that an election is improper. Moreover, the Exchange understands that news agencies frequently “call” the results of elections incorrectly. As a result, it does not use any news reporting in our determinations, nor the results of election certifications, as individuals may step down or resign prior to actually taking office. The Exchange thus relies on the official federal government report of who actually took office.

In summary, the data which will be used to determine the Expiration Value of the Contract is prepared by the Library of Congress, the official website of the United States Senate, and the official website of the Clerk of the House of Representatives, in a rigorous manner with multiple layers of checks in place to ensure the highest accuracy possible, and there are robust safeguards against any potential manipulation.

APPENDIX G (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.¹⁰⁷ 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

¹⁰⁷ CFTC Rule 40.2(a)(3)(v) requires a "concise explanation and analysis of the product and its compliance" with core principles. The rule also allows the DCM to incorporate information contained in documents supporting or relied upon to reach these conclusions. We note that we have relied significantly on the rulemaking record for CFTC Industry Filing 22-022: Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>. As a result, we incorporate the comment file for CFTC Industry Filing 22-022 into this submission.

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 Susceptible 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 direct 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. Additionally, applicants are required to provide a government issued photo ID (passport, drivers license, etc.) that is used to validate the personally identifiable information shared by the applicant during the application process. 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.

In addition, the Exchange shall engage in an additional three-step protection process.

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange's surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

(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.

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.

Congress.gov is a division of the U.S. Library of Congress with multiple checks on publishing data. For example, given that Congress.gov is publicly available for any Congressional official or member of the public to access, discrepancies between whether an individual has or has not been made leader on Congress.gov (and their party membership) would likely be detected quickly, making manipulation of the website unlikely. In addition to the general availability of Congress.gov, the Contract relates to a high-profile event, which is the subject of immense media coverage and interest. Thus, any attempt to publish incorrect data would be quickly noticed and identified. The negative consequences that Library of Congress staff would likely face for

publishing incorrect data in order to intentionally manipulate the market would also serve as a strong disincentive from attempting manipulation.

With regard to possible outcome manipulation, it is clear that the totality of U.S. Congressional elections are not readily susceptible to manipulation. The only groups that can directly affect the leadership decisions are the U.S. Senate and U.S. House of Representatives. Members of this group are extremely unlikely to attempt intentional manipulation of the leadership of their chambers to settle the Contract a certain way--the economic and political ramifications of which are far greater than the position limits on the Exchange. Instead of considering the potential outcome of the Contract on the Exchange, legislators involved with the confirmation are more likely to incorporate other factors into their decision-making process, such as political circumstances. The weight of these factors is much greater than any consideration of a market on the Exchange - thus manipulation for the sole purpose of influencing the outcome of the Contract is unlikely. The amount of media attention and financial reporting done on potential changes in leadership means that opportunistic attempts to manipulate reporting to affect prices is likely to be ignored given the amount of attention given to the subject. Members of Congress also have a sworn duty to represent their constituents and would not manipulate Congressional processes for private gain. Their finances are also heavily monitored and subject to public disclosure and scrutiny.

Moreover, election officials swear an oath to faithfully uphold the results of the elections. Tampering with federal elections is a serious federal crime and the consequences of violating would be quite severe. Vote counting is also supervised by trained members of both parties, whose incentive is to detect any deviation or error. In addition, any close election results in a recount, and therefore any manipulation by an individual or small group of individuals could reasonably be expected to be detected.

As further evidence, consider the history of political control contracts. University of Michigan professor Paul Rhode and Wake Forest professor Coleman Strumpf conducted a systematic review of the history of prediction markets both domestically and abroad, documenting their emergence back to “16th century Italy, 18th century Britain and Ireland, 19th century Canada and 20th century Australia and Singapore.”¹⁰⁸¹⁰⁹ In the United States, they were popular from the post-Civil War period until the Great Depression tarnished the image of Wall Street in the public imagination. They wrote,

Although vast sums of money were at stake, we are not aware of any evidence that the political process was seriously corrupted by the presence of a wagering market. This

¹⁰⁸ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹⁰⁹ Paul Rhode and Coleman Strumpf. 2012. “The Long History of Political Betting Markets: An International Perspective.”

analysis suggests many current concerns about the appropriateness of prediction markets are not well founded in the historical record.¹¹⁰

Today, election trading is alive and well in other democracies like the United Kingdom, without documented attempts at—let alone successful—manipulation. Any effort to coordinate votes for the sake of the Contract would take significant planning and coordination, and is unlikely to occur because none can know beforehand what the margin of victory is going to be. Accordingly, the organizers would have no way of knowing the size of the conspiracy they would need to orchestrate. Such an attempt would be implausible. Large-scale coordination of sufficient volume to affect an election of even a few hundred thousand voters (as exists in the smallest states or mid-size cities) would be too large to avoid scrutiny from market surveillance and counter-partisan mobilization. Nearly every commodity market can be altered if tens to hundreds of thousands of people all conspire simultaneously; however, it is nearly impossible to coordinate across tens of thousands of individuals without being visible. If this was a viable path, then highly motivated partisans would already attempt to do so and profit from the myriad ways they could profit by knowing the outcome of an election beforehand. The reason this type of criminal activity does not occur is that such a scheme would be readily detected.

One may also imagine that a coordinated group of individuals may conspire to manipulate market prices to give the false impression of candidate “momentum”, thus potentially harming the democratic process. This concern, too, is empirically implausible. Coleman and Strumpf in a later paper examined previous American political prediction markets and found that no previous effort at manipulation were capable of sustaining anything more than fleeting price movements. They wrote, “we find little evidence that political stock markets can be systematically manipulated beyond short time periods.”¹¹¹ Moreover, the markets examined were much smaller and thus even more prone to manipulation than a fully regulated, liquid market like a DCM. As a result, the probability of manipulation is implausible. Indeed, as George Mason University professor Robin Hanson and University of California at Santa Barbara professor Ryan Oprea found in one paper, one major reason why political contracts are rather invulnerable to manipulation attempts is that any attempt to manipulate prices induces informed counter-parties to enter on the other side of the market.¹¹² In fact, the greater the attempts to jazz up one side’s prices, the greater the returns to becoming an informed trader. As University of Michigan economist Justin Wolfers and Dartmouth economist Eric Zitzewitz write regarding previous political contracts, “none of these attempts at manipulation had a discernible effect on prices, except during a short transition phase.”¹¹³

¹¹⁰ Paul Rhode and Coleman Strumpf. 2003. “Historical Prediction Markets: Wagering on Presidential Elections”.

¹¹¹ Paul Rhode and Kolemian Strumpf. 2005. “Manipulating Political Stock Markets: A Field Experiment and a Century of Observational Data.”

¹¹² Robin Hanson and Ryan Oprea. 2008. “A Manipulator Can Aid Prediction Market Accuracy.” *Economica*.

¹¹³ Justin Wolfers and Eric Zitzewitz. 2006. “Prediction Markets in Theory and Practice”.

There are also legal protections against disrupting or pressuring the voting process of others. For example, the secret ballot is a guaranteed right in the vast majority of state constitutions, and statutorily protected in the rest.

The lack of substantiated attempts at manipulation of political control contracts by such methods is quite telling in the context of how much is already at stake in American elections. The economic impacts of elections themselves dwarf the value of Kalshi's contracts many, many times over. Likely trillions in stock value are deeply dependent on elections; entire sectors, firms, and places can be favored by a candidate for office; and almost every actor in the economy is directly affected by tax rates. The marginal addition of Kalshi's contract will not change whether or not elections are events of enormous consequence, and thus not increase anyone's incentive meaningfully to attempt manipulation of several hundred elections across the United States. American elections are not readily susceptible to manipulation, full stop, thanks to their decentralized nature, strong political norms, and laws protecting the vote. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

Importantly, the fact that these contracts have already been *trading* on venues in the United States by Americans should demonstrate that they do not cause manipulation and that the markets are safe. In 2014, the Commission granted PredictIt, a new unregistered trading venue dedicated to election and political event contracts, a no-action letter. Since then, PredictIt has traded more than one billion shares.¹¹⁴ This information--that billions of dollars can be traded on contemporary exchange-traded political control contracts without creating manipulation concerns--was not available to the Commission the last time it considered similar event contracts in 2012.¹¹⁵ Election trading is also common over-the-counter in the United States among the largest financial institutions and high net worth individuals.¹¹⁶

Americans can also readily access cryptocurrency-based decentralized exchanges (DEXes) which offer political control markets on platforms such as Polymarket and Omen.^{117,118}

¹¹⁴ PredictIt.

<https://www.predictit.org/insight/aHR0cHM6Ly9hbmFseXNpcy5wcmVkaWN0aXQub3JnL3Bvc3QvMTg4NzQ3ODgwMDQzL2EtcHJlZGljdGFibGUtbmV3c2xldHRlci0xMTEwOSNtb2JpbGU=>

¹¹⁵ Nadex order. 2012. CFTC.

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

¹¹⁶ Public Comment by Angelo Lisboa. Available at:

<https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69662>

¹¹⁷ Polymarket. <https://polymarket.com/market/will-gavin-newsom-be-governor-of-california-on-december-31-2021>

¹¹⁸ Omen.eth. <https://omen.eth.link/#/0x95b2271039b020aba31b933039e042b60b063800/finalize>

Polymarket's markets on Congressional control have traded millions.¹¹⁹ In total, more than half of volume ever traded on Polymarket (north of \$50,000,000) were traded on election-related markets. These platforms are not registered with the Commission as Designated Contract Markets (DCMs), but frequently host such markets. Despite the CFTC's January 2022 order against Polymarket, it is still readily accessible by Americans via VPN. Betfair had more than \$500 million traded on the 2020 election.¹²⁰ There are no indications that the markets caused or induced an attempt to manipulate elections, let alone a successful manipulation.

With regards to possible price manipulation, in practice, there are few actors who hold meaningful non-public information that could affect the value of the Contract. Nonetheless, Kalshi is taking a large step to prohibit a large number of political actors from participating in the contract. Further, as part of the Exchange's KYC verification and monitoring system, the Exchange also cross-checks applicants against comprehensive databases. In particular, the Exchange will check whether any Members trading on this Contract are on databases of Politically Engaged Persons. The Exchange further cross checks applicants against databases of family members and close associates of Politically Engaged Persons. These checks help to further reduce the potential for trading violations and further increase the integrity of this Contract.

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.

¹¹⁹ Polymarket. <https://polymarket.com/market/will-trump-win-the-2020-us-presidential-election>

¹²⁰ Seen at this link:

<https://www.actionnetwork.com/politics/2020-election-odds-trump-vs-biden-presidential-race-sportsbook-rovell>

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.

**APPENDIX H (CONFIDENTIAL) – COMPLIANCE WITH THE CONTRACT
VETTING FRAMEWORK**

As part of its registration as a Designated Contract Market, the Exchange submitted a Contract Vetting Framework (CVF) through which all contracts would have to be vetted against in order to be eligible for self-certification. At designation, the CVF prohibited contracts on the outcomes of United States political elections. Since then, Kalshi submitted an amendment to the CVF permitting it to self-certify contracts related to partisan political control of the House and Senate which was approved by the Commission.

APPENDIX I (CONFIDENTIAL) – DIRECTLY ADDRESSING COMMISSION QUESTIONS

The Commission asked for public input on seventeen questions. These seventeen questions can be broadly categorized into five distinct categories of questions. These are:

1. Whether Kalshi’s contract triggers one of the prongs of CFTC Regulation 40.11 or CEA 5c(c)(5)(C), in particular, “gaming” and “activity illegal under state law”; (questions 1-4)
2. Whether Kalshi’s contract is distinct from Nadex’s 2011 contract submission; (question 5)
3. Whether Kalshi’s contract would provide economic utility to market participants; (questions 6-11)
4. Whether Kalshi’s contract would serve the public interest; and (questions 12-14, 17)
5. Whether and how Kalshi’s contract can be readily subject to manipulation. (questions 15 and 16)

In developing the CONTROL contract, the Exchange carefully considered both the Commission’s questions on the prior submission, as well as the public’s input on the prior submission. The public’s input formed a bedrock of the Exchange’s determination, together with its own analysis, that the contracts are consistent with the CEA and valid Commission Regulations. The Exchange summarizes some of the comments below, and incorporates the entire comment file from the original submission by reference. (The CFTC’s comment file is available here: <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>).¹²¹ The Exchange considered all of the comments in full in developing this contract, and the comment record is an important part of this contract. The Exchange notes that all the comments are in the Commission’s possession, and are in fact electronically searchable on the Commission’s website.

One: does Kalshi’s contract trigger one of the prongs of CFTC Regulation 40.11 or CEA section 5c(c)(5)(C), in particular, gaming and unlawful activity? (questions 1-4)

The public comments largely stated that the answer is no, the proposed contract does not involve, relate to, or reference gaming, or any of the other prongs of CEA 5c(c)(5)(C) or Regulation 40.11. Commenters noted that elections do not involve, relate to, or reference gaming or gambling. Rather, elections are events of incredible and far-reaching economic impact. Kalshi’s

¹²¹ CFTC Rule 40.2(a)(3)(v) requires a “concise explanation and analysis of the product and its compliance” with core principles. The rule also allows the DCM to incorporate information contained in documents supporting or relied upon to reach these conclusions. We note that we have relied significantly on the rulemaking record for for CFTC Industry Filing 22-022: Review and Public Comment Period of KalshiEx Proposed Congressional Control Contracts Under CFTC Regulation 40.11, available at <https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7311>. As a result, we incorporate the comment file for CFTC Industry Filing 22-022 into this submission.

contract would also not involve, relate to, or reference unlawful activity. A contract on election outcomes would provide market participants with a powerful tool to hedge political risk.

The underlying assumption of the Commission's question is that in considering CEA 5c(c)(5)(C) or Regulation 40.11, one should consider not only whether the contract's subject involves gaming (e.g. a contract like "Will the roulette ball fall on white or red?"), but rather, whether the act trading on the contract *itself* constitutes gaming. The commenters noted that this is an incorrect application of the statute. This is evidenced by the fact that the other items of the list (assassination, murder, war) are clearly referring to the underlying event, not the act of trading. If that reading were correct, it would make the enumerated categories of terrorism, assassination or war superfluous, as clearly trading on such events would also be gaming. This argument, in particular, is made by comments from both of the last two General Counsels of the CFTC as well as other law firms such as Jones Day and Tabet DiVito & Rothstein.¹²²

With regard to unlawful activity, commenters noted that, unlike gambling offerings, Kalshi's contract is a federally regulated derivative product and is exempted from the federal interstate betting prohibition and state laws that prohibit gambling. Thus, the existence of state laws that prohibit 'gambling' on election outcomes does not confer an involvement with illegal activity on Kalshi's contract anymore than the existence of state laws that prohibit 'gambling' confer an involvement with illegal activity onto any event contract or derivatives product. The letter submitted by Better Markets, arguing that Kalshi's contract does trigger a prong of 40.11/5c(c)(5)(C), relies on the false idea that Kalshi's contracts certified with the Commission are subject to the Unlawful Internet Gambling Enforcement Act, when CFTC products are expressly carved out of such regulations.¹²³¹²⁴ The Exchange rejects this comment as being patently legally incorrect, and the Exchange's position is supported by the legal analysis of the Commission's most recent two general counsels attached as part of Appendix M.

Commenters further informed the Commission that it should not consider the presence of election outcomes in gaming venues such as casinos. They noted that the question is not relevant to the particular contracts as such contracts not available on any legal American sportsbook, and that the Commission precedent contradicts such consideration, as this standard was not even applied by the Commission when considering contracts on the outcomes of sports games in *ErisX* and was not considered in *Nadex*.

¹²² Public Comments 70781, 69737, and 70765.

¹²³ Public Comment by Dennis Kelleher, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=70788>

¹²⁴ The Unlawful Internet Gambling Enforcement Act of 2006 "do[es] not include...any transaction conducted on or subject to the rules of a registered entity or exempt board of trade under the Commodity Exchange Act". 31 U.S.C. § 5362(1)(E) (2006).

Commenters also pointed out that there is either a conflict between Regulation 40.11 and the CEA with respect to the breadth of the special rule, as former Commissioner Quintenz noted, or Regulation 40.11 does not prohibit any contracts, as former Commissioner Berkovitz assumed in his statement on *ErisX*.

Commenter Richard Sandor, the “father of futures” who developed the first interest rate products, informed the Commission that financial speculation is not the same as gambling. Gregory Kursek, who led the DMO’s Product Review Branch, did the same.

Some commenters argued that the contract is related to gaming because the contract would not serve an economic purpose. That is addressed in Appendix B.

The foregoing analysis and public comments support the conclusion that the question of CEA 5c(c)(5)(C) or Regulation 40.11 is answered in the negative. In Kalshi’s new submission, it increased the contract order size (to purchases in 5,000 contract multiples) and increased the position limits for parties with *bona fide* hedging need to reduce the ease of low-value speculative behavior relative to hedging behavior. Accordingly, the Exchange has determined that the contract is not inconsistent with either CEA 5c(c)(5)(C) or Regulation 40.11, a conclusion that is strongly supported by the information from the public that the Commission requested.

Two: is Kalshi’s contract distinct from Nadex’s 2011 contract submission? (question 5)

Kalshi has provided a separate document that details the distinctions between Nadex’s contract submission and Kalshi’s new contract. However, even with regards to Kalshi’s original submission, commenters such as former CFTC Chairman Mark Wetjen who was on the Commission when the *Nadex Order* was released, and former CFTC Deputy Director of Product Review Greg Kuserk, noted the changes in circumstances since Nadex’s 2011 submission that also justify looking and considering the contract, its public impact, and the role of gaming, differently. These circumstances include the success of other electoral markets that the Commission has approved of (PredictIt, hosted by Victoria University of Wellington) and the increasing salience of electoral risk on market participants. In light of these changes, they informed the Commission that it would be inappropriate to rotely prohibit the original submission on the grounds of a non-regulatory, contract specific conclusion from a decade ago. The correct conclusion now is for the contract to be allowed by the Commission. In light of these comments, and the material and significant economic differences between the contracts at the subject of the *Nadex Order* and the current contract, among other salient points of black-letter settled administrative law, the Exchange determined that the contract is consistent with the CEA and Regulations and is not in any way prohibited by *Nadex*.

Three: Would Kalshi’s contract provide economic utility to market participants? (questions 6-11)

In its submission, which is publicly available, Kalshi provided evidence—from decades of academic research, business testimony, the public press, and policymakers—that partisan election outcomes have consistent and predictable effects on the values of assets, prices of services, and economic activity more broadly. Commenters overwhelmingly agreed, including (though hardly limited to) academics such as Nobel Laureate Robert Shiller and former Chair of the Council of Economic Advisors Jason Furman; former policymakers former SEC Commissioner Joseph Grundfest and former CFTC Commissioner Mark Wetjen; and members of private industry, such as AB-inBev board member Jorge Paulo Lemann (a major participant in extant agricultural futures), the CEO of Continental Grain Company Paul Fribourg, and Susquehanna International Group Head of Strategic Planning David Pollard.¹²⁵ Angelo Lisboa, a Managing Director of J.P. Morgan argued that large institutions already trade such products over-the-counter.¹²⁶ The public press and private businesses routinely discuss how election outcomes are traded significantly through other exchange-traded assets, like stocks.

In the public comment process, many businesses and business leaders, in industries such as energy, cannabis, and finance, testified to their personal hedging needs and use cases for the contract.

Some commenters argued that the contract would not serve their own hedging needs, or speculated that it would not serve the needs of others. The fact that a contract would not help a particular commenter’s hedging needs is not relevant to whether it would serve those of others. The uninformed and speculative bets of commenters cannot form the basis of any reasoned decision making by a government agency. This would be black-letter administrative law in a vacuum. In the face of the overwhelming majority of commenters who informed the Commission about their own hedging utility and the overwhelming evidence that elections have economic consequences, these speculative comments contradict reality.

In one of its questions, the Commission asked specifically if election impacts are sufficiently predictable—even if they have a large impact—to justify a hedging product. Commenters argued that this is not a standard found in law, regulation, or in any previous decision or consideration. They further noted that the question of how to hedge is not the province of the Commission. The job of the Commission is not to determine whether a hedge is a “good” or not; that is for the market and its participants to decide. The Commission does not want to find itself in the business of grading participants’ hedging strategies. The Commission would never be called to testify in a

¹²⁵ Public Comments 70761, 69708, 69695, 70771, 69684, 69727, and 70743.

¹²⁶ Public Comment by Angelo Lisboa. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69666>.

shareholder suit against a company because the company's hedging strategy was unsuccessful. Rather, the market should determine whether a given contract is appropriate for their risk.

It is important to acknowledge that the comments did not at all agree that the notional value of the contract impacts the analysis at all, and this is for many reasons. These include the understanding that retail participants have economic needs that the Commission should not discriminate against. Also, the Commission has embraced contracts like micro bitcoin contracts and it is incongruous to assume a different economic reality for these contracts.

Commenters also noted that hedging does not require a 1:1 hedge against a specific asset; hedging is a means of risk management, and the contracts can be used to manage risk from elections. This hedging truth is recognized in the numerous contracts that the Commission has embraced such as weather and many other contracts that either do not have 1:1 hedging use or where 1:1 hedging is overwhelmingly not the primary use of the contract.

Commenters also noted that the contracts have economic utility well beyond hedging. Hedging, after all, is only one of the twin pillars of economic utility. The second pillar is price basing, and the contracts have significant price basing utility. It is high axiomatic that there is utility in pricing risk that affects assets, service agreements, and other economic utility. These contracts do exactly that.

Based on the information from the public, as well as the clear evidence of the impact of elections (just watch the news during elections), the Exchange concluded that the contract has economic utility, both hedging and price basing. This is certainly true for the current submission which has a significantly increased order size (to purchases in 5,000 contract multiples) and increased position limits for parties with *bona fide* hedging utility.

Four: Would Kalshi's contract serve the public interest? (questions 12-14, 17)

Commenters agreed that Kalshi's contract would serve the public interest. In addition to the public interest by virtue of its hedging and price basing functions, the Contract will generally provide a valuable forecasting tool that complements existing polling and other forecasting tools. Accurate data regarding the state of elections is very socially valuable and sought after, prompting the development of advanced polling and analytics publications like *FiveThirtyEight*. In addition, former Chair of the Council of Economic Advisors Jason Furman detailed in his comment how political markets, even on a limited basis, had informational value that were used even in the Obama White House.¹²⁷ Eric Crampton wrote about how New Zealand political

¹²⁷ Public comment letter by Jason Furman. Available at: <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69708>.

markets were used by their country's central bank.¹²⁸ By providing an alternative, and possibly more accurate (certainly faster) forecast of an election outcome to polls, Kalshi's contract would enrich the public discourse through an unbiased, decentralized prediction of the future. Others, such as OpenPhilanthropy founder Dustin Moskovitz, emphasized how he could use the market to help influence future decision making with regards to politics.¹²⁹

A small number of commenters argued that Kalshi's contract could distort the electoral process if the contracts were manipulated. These comments ignored PredictIt, which has traded more than a billion dollars—sans hedging—without any such issues; it ignores how banks and financial institutions already trade these products; and how many other nations (such as the United Kingdom, Canada, Ireland, Australia, and other liberal democracies) have large outright gambling on electoral outcomes without any documented harm. Importantly, they ignored both the evidence that markets like the Contract are very difficult to manipulate and the Exchange's surveillance system that would further make manipulation extremely unlikely. Further, as other commenters noted, the Contract would provide a source of information that is much less likely to be manipulated than polling, media, advertising, and social media.

The Exchange notes that the prior submission and the Commission's questions received significant press attention from many different news sites. The commenters included individuals, businesses of all sizes, and many experts in their fields. In light of the commenters support on the Contract's social value, highlighting the real world evidence and utilization of the contracts, and the defects with the few comments that speculated about a public harm, the Exchange has concluded that the public has spoken to its interests, and these contracts are in the public's interest.

Five: Would Kalshi's contract be readily susceptible to manipulation, and how should it protect against it? (questions 15 and 16)

Several commenters, including commenters with extensive expertise in the industry and in detecting fraud and manipulation, noted how there is little to no ability for individuals to either manipulate the outcomes of hundreds of Congressional elections or to manipulate the contract's price because of insider information. There are enormous incentives in the status quo for individuals to try and do so, without any success. American elections are not readily susceptible to manipulation, and neither is Kalshi's contract.

Kalshi, however, takes the threat of even a marginal or unexpected case seriously, and in its new submission has clarified how it will treat politically associated individuals. Kalshi preemptively

¹²⁸ Public Comment by Eric Crampton. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69738>.

¹²⁹ Public Comment by Dustin Moskovitz. Available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=69716>.

runs users through a list of politically exposed persons and will ban such individuals from trading. Before being allowed to participate on a political risk market, participants will be required to certify that they are not affiliated with any campaign, PAC, or political party, and do not have any insider information on the matter. Kalshi's surveillance team will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules. Kalshi will also provide the Commission with additional reporting that the Commission determines would assist with regulating this specific market.

The letter provided by Better Markets cites two studies which argue prediction markets can be manipulated (though not necessarily readily, which the Exchange notes is the standard of law). One of these cites a manipulation attempt on a small, online exchange in the early 2000s that is swiftly corrected by other traders. The other refers to a market created by academics with only eight participants and fake funds. Unlike many of the underlying markets the CFTC monitors, American elections have dedicated enforcement agencies (such as the Federal Election Commission) and have never been manipulated. Consequently, dozens of economists, including major policymakers and a Nobel Laureate, wrote comments arguing specifically that these contracts are not readily susceptible to either outcome or price manipulation.

In light of the many factual and analytical deficiencies in Better Markets' comment, and the overwhelming information from commenters with actual market and economic experience that the contracts are not readily susceptible to manipulation, and the extra protections that the Exchange will adopt to go above and beyond, the Exchange has determined that the contracts are not readily susceptible to manipulation.

APPENDIX J (CONFIDENTIAL) – COMPARISON WITH NADEX SUBMISSION

The proposed new terms of the Political Control contract differ significantly and materially from the *Nadex Order* contract, which was disallowed by Commission Order in 2012. The table below highlights those differences by comparing the Nadex contract, the withdrawn Political Control Contract (“CONGRESS”), and the proposed Political Control contract (“CONTROL”). The proposed new terms are designed to provide a tool to shift economic risk tied to political elections and to be utilized by firms, industry, and other traditional participants in derivatives markets.¹³⁰

Contract attribute	Nadex	CONGRESS contract	CONTROL contract
Order size	1 \$100 contract	1 \$1 contract	5,000 \$1 contracts; functionally \$5,000 notional value
Position limit	2,500 contracts	\$25,000	Tiered, up to \$100M for ECPs with a <i>bona fide</i> hedging need

These changes will significantly alter the way that the market will participate in the contract. Even though order sizes are not considered material with regard to the “equivalent swap” analysis under the Position Limits Rule, codified in Regulation 150.1, that analysis is not relevant to the analysis here. The policy and purpose of economic equivalency for position limits is stated by Congress as being necessary to “to (i) Diminish, eliminate, or prevent excessive speculation; (ii) deter and prevent market manipulation, squeezes, and corners; (iii) ensure sufficient market liquidity for *bona fide* hedgers; and (iv) ensure that the price discovery function of the underlying market is not disrupted.” Those factors are very different from the factors that were considered in *Nadex*, namely the application of CEA section 5c(c)(5)(C) and Regulation 40.11. The relevant factors that the Commission considered in *Nadex* were the nature of how market participants will use the contract, and the economic attributes of a contract such as notional size is highly material to that question.

In fact, the Commission intuited that economic attributes such as notional size are important to the analysis and specifically asked a number of questions directly and indirectly to the public about the Contract’s size in its questions regarding Kalshi’s CONGRESS submission. The comments in response to the Commission’s question all indicated that the economic attributes of the contract *should* be considered (most argued that the original contract passed any economic

¹³⁰ Although the contract is available for trading by all Exchange members, as required under the CEA and Core Principle 2.

utility test, of course; *a fortiori* the new contract passes the same tests). Accordingly, the Exchange notes that the current submission is distinguishable from the contracts that were the subject of the *Nadex* order, a point that is strongly buttressed by the public comments that the Commission requested.

APPENDIX K (CONFIDENTIAL) – ADDITIONAL CORE PRINCIPLE 3 CONSIDERATIONS

The CONTROL contract is not readily susceptible to manipulation. There are robust protections against manipulation. The Exchange has rules that prohibit manipulative trading, and the Exchange performs surveillance to detect manipulation. This serves as a deterrent to attempts to manipulate the market via manipulative trading. In addition, the Exchange’s rules also prohibit trading on non-public information, and the Exchange performs surveillance to detect violations of this rule. The Exchange is also adopting contract specific gating rules that further buttress this rule. Specifically:

- a. Before being allowed to participate, market participants must certify that they are not implicated by the prohibition list in Appendix B
- b. Before being allowed to participate, market participants must certify that they do not have access to material nonpublic information
- c. The Exchange’s surveillance staff will conduct manual background checks and interviews with the top traders in a market, as well as randomly selected participants, to monitor and enforce the gating rules

The Exchange will be surveilling its market for any sign of trading that is indicative of manipulative or fraudulent behavior. The Commission will have all of the necessary data to do the same, should it so wish.

As discussed at length in Appendices E and F, American elections are not readily susceptible to manipulation. In fact, manipulation of which party controls the U.S. Congress has never occurred. This is in contrast to existing markets that the CFTC regulates. Indeed, the CFTC has brought numerous enforcement actions against market participants who either manipulated or attempted to manipulate markets in oil, precious metals, cattle, and other commodity spot and futures markets. The Commission regularly brings almost a hundred enforcement actions per year and orders billions in monetary relief. Then, of course, there are digital asset markets, where the Commission has brought dozens of actions in an incredibly short time. Contrast that with elections, where election or voter fraud is extremely rare, and never succeeds at flipping the outcome of which party controls Congress. Even in cases where election manipulation has been attempted, it has only succeeded in affecting extremely small, local elections.¹³¹

Election manipulation is a crime.¹³² There are law enforcement agencies who police elections, and elections are policed much more effectively than other markets that have CFTC derivative products trading on them. Any attempt to manipulate the contract would most certainly involve a high degree of speculation; the contract is in regard to the sum of hundreds of elections. It is not

¹³¹ <https://www.brennancenter.org/our-work/research-reports/truth-about-voter-fraud>

¹³² <https://www.fbi.gov/how-we-can-help-you/safety-resources/scams-and-safety/common-scams-and-crimes/election-crimes-and-security#:~:text=Intentionally%20deceiving%20qualified%20voters%20to,%2Fhow%2Dto%2Dvote.>

even possible to determine which elections will be the closest (and thus easiest to affect) in advance, even if some races are understood to be more close than others. As detailed in Appendix F, a large-scale conspiracy to coerce many individuals to vote a particular way across many different jurisdictions without being detected. A fraud of sufficient size would mean that this fraud is no *Ocean's 8*, or even *Ocean's 11*. You'd be looking at Ocean's-well-into-the-hundreds-if-not-hundreds-of-thousands. Manipulation of polling machines themselves is equally quixotic.¹³³ Taken all in all, it is very unlikely that a fraud pertaining to this contract will be attempted, and considerably less likely than in other areas that fall under the Commission's enforcement authority.

Additionally, concerns regarding policing election fraud are absent from, and foreign to, the CEA's goal of fostering innovation and trading on American markets. The Commission is not the only "cop on the beat" with regard to election fraud. Elections, unlike many other reference markets or events that have CFTC-derivatives trading on them, are governed by multiple law enforcement agencies whose very existence is to prevent and detect election manipulation and fraud. This includes the Federal Election Commission, the federal Department of Justice, state election commissions, state Secretaries of State, and state ethics commissions. History has shown that these agencies are very good at their job.

Critically, there are already enormous stakes in U.S. elections, creating incentives for outcome manipulation; this contract will not change that fact. As discussed in extensive detail in Appendix B, in the public comments, and to anyone involved in industry, elections move prices and it is specious to presume that they do not. Wall Street firms and global finance all trade elections. The contract before the Commission is not novel in that regard; rather, it is a more efficient instrument than what firms currently use to take positions on elections.

¹³³ <https://www.washingtonpost.com/politics/2022/11/01/truth-about-election-fraud-its-rare/>

APPENDIX L (CONFIDENTIAL) – THE IMPORTANCE AND SALIENCE OF CLIMATE RISK TO POLITICAL RISK CONTRACTS

Climate Risk Exposure

The CFTC’s Market Risk Advisory Committee published a seminal report on managing climate risk in the United State’s financial system (“Report”).¹³⁴ The Report cogently described the urgency for the financial markets, and financial regulators, to enhance the existing climate risk management framework, in part because of the impossibility of predicting with any precision how climate change will impact participants, including economically. The Report explains how participants should translate climate risk into economic terms, and then once translated, derivatives can be used to manage that risk.

As the Report explains, risk is a composite measure of exposure, sensitivity and, in this case, the adaptive capacity of a firm to manage the climate risks of a particular asset. Exposure reflects the presence of financial assets coinciding with climate impacts—namely acute extreme events or recognizable patterns of stress, which includes the likelihood of an economically harmful incident occurring. Exposure is the prerequisite to the transmission of climate risks to financially relevant metrics. Sensitivity reflects a measure of the responsiveness of exposed assets to any given shock or stress. In other words, risk is the product of the potential economic impact of an event and the likelihood of that event occurring. Because risk is technically a probabilistic function of sensitivity and exposure, the novelty of climate change means that there is greater uncertainty and ignorance about the range of possible outcomes and the Report recommends the use of a variety of tools to overcome this uncertainty, such as scenario analysis. This method of risk management is key to effectively managing climate risk. If market participants would wait until they can precisely, or even broadly, quantify the *expected impact* of climate change to manage risk, it would likely be too late. Instead of managing expected impact, market participants manage their *risk*, which is the “what if”, not the “most likely.”

Managing Climate Risk

Based on the understanding of risk as a probabilistic function of the product of two metrics (i) sensitivity of a financial interest to climate change, and (ii) exposure of the financial interest to a climate change event or the likelihood of that event occurring, the Report suggests two methods for managing risk. One method is to decrease exposure, which can be done for example by reducing carbon output or ideally achieving carbon net-neutrality. The decrease in exposure will have the effect of reducing the overall risk. The second method is to decrease the net sensitivity

¹³⁴ Commodity Futures Trading Commission. 2020. “Managing Climate Risk in the U.S. Financial System”. <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>

of the asset, which can be done via financial derivatives that hedge the asset’s sensitivity. For example, a carbon offset future. That decrease in sensitivity will also reduce the overall risk.

Climate Risk/Political Control Risk Similarities

Even though the particular impacts of climate change are not known, and certainly the impacts to any market participant are not known, climate change nonetheless poses risk to market participants, and that risk can and should be hedged. This understanding of risk, and risk management, is equally important and applicable to political control. Like climate change, the precise impact of political control to a market participant is not known. Like climate change, political control nonetheless impacts risk. An asset or financial interest that is sensitive to policy or political change, such as climate change, has exposure to political control, as political control impacts the likelihood of a negative incident occurring. A derivative contract can be used to reduce the net sensitivity, and just like in the case of climate change risk, the reduced sensitivity will effectively reduce risk. The same risk management and climate risk hedging described in the Report applies to political control hedging using derivative contracts.

Characteristic	Climate Change Risk	Political Control Risk
Is a risk because it could lead to negative financial impact	✓	✓
Specific impacts unknown	✓	✓
Risk is the product of (i) potential impact of an event or events (sensitivity), and (ii) likelihood of the event occurring (exposure)	✓	✓
Derivatives can be used to reduce net <i>sensitivity</i> , which reduces overall risk	✓	✓

APPENDIX M (CONFIDENTIAL) – ADDITIONAL MATERIALS

Letters by Kalshi’s counsel are provided in a separate document attached to this certification. Also attached is a copy of Commissioner Pham’s dissent on a vote favoring review of Kalshi’s original contract pursuant to the special rule.