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From: jsalvati@u.washington.edu
Sent: Thursday, June 26, 2008 2:51 AM
To: secretary
Subject: Public Comment Form

Below is the result of your feedback form. It was submitted by (jsalvati@u.washington.edu) on Thursday, June 26, 2008 at 02:50:41

COMMENT

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commenter_subject: 73 FR 25669

commenter_frdate: 06/25/08

commenter_frpage: 08-004

commenter_comments: To Whom It May Concern,

This is a comment on the Commodities and Futures Trading Commission s Concept Release on the Appropriate Regulatory Treatment of Event Contracts.

Recently, the American Enterprise Institute and others have asked the Commodities and Futures Trading Commission to prohibit for-profit prediction market exchanges, and only allow prediction markets to charge modest fees . I will make the case here that both for-profit exchanges and more than modest may both be important for getting the most benefits from prediction markets.

One of the major benefits of prediction is that people and companies can use prediction markets relatively accurate and well-calibrated predictions to improve their planning. Market predictions reduce the calculation work that people and companies have to do in order to come up with predictions because they can outsource the work to prediction markets.

It would be a mistake to unnecessarily limit the areas which prediction markets are used to predict, because it is difficult to predict what areas may help people and companies improve their planning. For profit exchanges will have incentives to find as many places where such more accurate and better calibrated predictions are useful, especially in industry. Thus it would be a mistake to prohibit either for-profit exchanges or limit the fees that exchanges can charge.

Consider the following scenario:
A number of companies in some industry are interested in the information about the future price of certain products, the future of industry relevant technologies or in future demand for certain products or any number of things of that might be predicted using prediction markets.

In response to this interest, a for-profit company creates a prediction market exchange for contracts about the information that those companies are interested in, and then sells access to the exchange to companies in relevant industries. The exchange company uses the revenue generated from exchange subscriptions to subsidize contracts in order to generate more accurate predictions. Employees from the companies who subscribe to the exchanges would be the market participants.

Such exchanges would be even more attractive to companies than internal prediction market exchanges because contract subsidies and the pooling of market participants in multiple companies into one market would improve the usefulness of prices significantly.

Allowing a for profit company to create such exchanges means that it will have strong incentives to make its exchange contracts the more useful to its subscribers, whereas non-profit companies will have weaker incentives to do so. Now, perhaps someone would step up and create a non-profit exchange to fill this role, but perhaps none would. This is especially likely in markets where there is little camaraderie and collusion. Non-profit exchanges will probably also get created and develop slower than for-profit exchanges. This would very bad in cases where subscriber needs change frequently, because non-profits would have trouble keeping up.

Limiting the fees that exchanges can charge is also a bad idea, because the amount by which the exchange company would need to subsidize a contract in order to achieve the desired accuracy could be large in some cases. When developing models, and collecting an analyzing data is costly, large subsidies would be needed to get people to make accurate predictions.

I do not doubt that non-profit prediction market exchanges are likely to be very valuable, especially in public policy arenas, but it would be a serious mistake limit prediction market exchanges to non-profits.

Sincerely,
John Salvatier
University of Washington Engineering Student

commenter_name: John Salvatier
