

secretary

From: NoReply@cftc.gov
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A comment has been submitted on IF 12-003

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Submitter comment: Please consider the points below in your evaluation of Nadex's proposed Political Event Derivatives (industry filing IF 12-003). Not Gaming Binary options in general are priced based on the market's perceived probability of an event occurring at any time, and structured such that traders can employ a number of strategies based on market observation and on education about the product. Here are a few reasons why political event contracts in particular should be considered legitimate, tradable markets: An individual's prediction about something as significant as the U.S. Presidential election is based on that individual's observations, education, research, and discussion about the event. This is no different from an individual's opinion about any exchange-traded market. Considering an individual's opinion about an upcoming election to be the equivalent of a game, or comparing it to a coin flip for example, reduces the meaning of political debates, public opinion polls, endorsements, editorials, and citizen debate about elections to a pointless exercise. We know of course, that these are all time-honored components of our political process, and that they have real value that can help to determine the eventual outcome of an election. As with most futures contracts that have economic value, there is a hedge element to political event contracts. A large number of industries pay close attention to presidential elections because they help to determine the environment in which firms in those industries operate. If a firm is basing strategic decisions on anticipated election outcomes, binary options on those elections can present a medium-term hedge solution for those companies. The CFTC issued a no-action on the Iowa Electronic Markets in 1992, which was started in 1988, and offers a prediction market for the U.S. presidential election. The no-action letter paved the way for the IEM to continue offering political event contracts, including the presidential election outcome. The main reason this is the case is that the Iowa Electronic Markets were structured for research purposes. But it does enable anyone to place a real-money trade on the election. So this market is essentially the same as what Nadex has proposed -- enabling customers to place a real-money trade on their expected outcome for the election. One of the most compelling characteristics of the Iowa Electronic Markets is its strong predictive ability in past elections -- Presidential or otherwise. There are a large number of variables that go into the outcome of a political election, and each of these variables is digested by the marketplace in arriving at their estimation of the likely outcome. The accuracy of the Iowa Electronic Markets reinforces the argument that there is a predictive element to a centralized marketplace. State and Federal Laws The existence of these contracts for 20 years on the Iowa Electronic Markets -- and the publicity that they receive every time there is a Presidential election -- would indicate a precedent that these products do not violate federal laws or state laws as they currently exist. If there are instances where state laws prohibit the trading of these products, then that should necessarily preclude the approval of their listing for residents of other states. Market Manipulation The existence of the Iowa Electronic Markets, as well as InTrade -- a Dublin-based exchange that lists binary options on the Presidential election -- reduces the likelihood of price manipulation as it presents other trading vehicles that could be used to align markets. For example, if pricing in one market was out of line

with the other, it would present a potential arbitrage opportunity for market participants, which would bring prices into alignment. In addition, there are a number of public opinion polls that are released throughout an election year. Anytime that polling runs contrary to the market price of the contract on a public exchange would lead to an opportunity for the public to trade based on the opinion polls. The existence of a binary option contract on Nadex would have no more likelihood of influencing voters' behavior than any opinion poll, or any of the products that are currently traded. Furthermore, a wider distribution of customers would ensure that any attempts at manipulating the price (i.e. large amounts of money driving prices higher) would be met with new trading from customers who see the discrepancy between public opinion polls and the Nadex Presidential election market, or between the other election markets, and the Nadex Presidential election market. The very existence of a widely traded contract on the Nadex exchange could actually REDUCE the likelihood of manipulating the market to sway public opinion, as the trading of the product would become more widespread and more difficult to manipulate than is currently the case. Viability as a Hedge Contract After every Presidential election, as well as significant Congressional elections, there are typically reports about which market segments benefit, and which do not. Fund managers who manage specific sectors that benefit when a specific party gains the Presidential nomination can use binary options as a hedging mechanism. As a hypothetical example, if a fund manager of an alternative energy portfolio anticipates a Democratic Administration for the coming four year, and he views that favorably for specific stocks, he may purchase those stocks prior to the election. To hedge against the possibility of a different outcome, he may decide to use binary options to reduce the potential portfolio risk if he is wrong in his expectations. In this case, the portfolio manager has the ability to anticipate the market appreciation because of the hedge mechanism he has in place because he can use binary options on the election to reduce the risk of his opinion being incorrect. As another potential hedge example, consider a company that is delaying major decisions during an election year. Binary options on the election outcome could give them an additional tool to hedge against an unexpected outcome in the election, or could enable them to implement strategic decisions ahead of the election. Acting sooner rather than later could potentially give them a competitive advantage -- made possible because they would be able to reduce the financial risk that they would take in implementing a decision prior to knowing the outcome of the election. Other Points 1. Political event contracts are not contrary to the public interest any more than election opinion polls are. 2. Political event contracts are non-partisan -- Presidential election outcomes affect industries and individuals alike -- regardless of political affiliation. 3. Contracts on the U.S. Presidential election are currently traded on an Ireland-based exchange. That market is widely quoted in U.S. financial press, because of the predictive ability that the market has. Submitter IP Address: