



**U.S. COMMODITY FUTURES TRADING COMMISSION**  
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**CFTC Staff Advisory**  
**Division of Market Oversight**

**To: Designated Contract Markets**

**Subject: Prediction Markets Advisory**

“Prediction markets,” on which “event contract” derivatives are traded, are rapidly increasing in popularity with the American public both as a financial asset class and as a proven source of reliable information for news media, sports leagues, financial institutions, and everyday Americans. Staff of the Division of Market Oversight (“**DMO**”) of the Commodity Futures Trading Commission (“**CFTC**” or “**Commission**”) believes it is important to encourage innovation and growth in these markets, within the federal oversight framework for Commission-registered derivatives exchanges set forth in the Commodity Exchange Act (“**CEA**”)<sup>1</sup> and Commission regulations.<sup>2</sup>

Commission staff is issuing this advisory to share with designated contract markets (“**DCMs**”) certain views based on staff’s experience overseeing the listing and trading of event contracts. While certain aspects of the advisory focus on sports-related event contracts, the core principle compliance and product listing requirements highlighted in the advisory apply equally to other categories of event contracts – and to derivative products more generally. DCMs have self-regulatory obligations for the contract markets they operate.<sup>3</sup> As front-line regulators, DCMs should be proactive, ensuring proper surveillance and oversight of trading in all of the products that they list, accounting for the particular characteristics and attributes of each product.

This advisory is intended to provide market participants, legal counsel, and interested members of the public DMO staff’s current views on the listing and trading of event contracts. This advisory

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<sup>1</sup> 7 U.S.C. 1 et seq.

<sup>2</sup> Commission regulations can be found at 17 CFR Chapter 1.

<sup>3</sup> See part II.A., below.

should be reviewed by all registered DCMs and all entities that have applied for designation as a contract market with the Commission.

## **I. BACKGROUND**

While the term “event contract” is not a defined term in the CEA or the Commission’s regulations, event contracts are a type of derivative contract, often a swap with a binary payoff structure, whose settlement is based on the outcome of an underlying occurrence or event. As amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “**Dodd-Frank Act**”), the statutory definition of “swap” in section 1a(47) of the CEA is deliberately broad. As such, it can encompass event contracts within multiple sub-definitions.

Section 1a(47)(A)(i) of the CEA defines the term “swap,” in relevant part, to include “any agreement, contract, or transaction . . . that is a[n] . . . option of any kind that is for the purchase or sale, or based on the value, of 1 or more . . . quantitative measures, or other financial or economic interests or property of any kind,” and section 1a(47)(A)(ii) of the CEA defines “swap” to include “any agreement, contract, or transaction . . . that provides for any purchase, sale, payment, or delivery . . . 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.” Thus, as an example, an event contract that is settled based on the outcome of a sporting event is an agreement providing for a payment dependent on a future occurrence.<sup>4</sup>

## **II. REGULATORY REQUIREMENTS FOR EVENT CONTRACT MARKETS OFFERED BY DCMs**

As a general matter, DCMs are reminded that section 5c(c)(5)(C) of the CEA provides that the Commission may determine that an event contract is contrary to the public interest if the contract involves, among other things, assassination, war, or terrorism.<sup>5</sup> No such contract determined by the Commission to be contrary to the public interest may be listed or made available for clearing or trading on or through a registered entity.<sup>6</sup>

### **A. CEA section 5(d) and Part 38**

DCMs must comply with 23 statutory Core Principles that are set forth in the CEA,<sup>7</sup> as well as applicable CFTC rules and regulations.<sup>8</sup> The statutory Core Principles for DCMs reflect the important role that these exchanges play in promoting the integrity of derivatives markets by,

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<sup>4</sup> DMO staff also notes that depending on how the product is structured, an event contract may constitute a futures contract or a swap under the CEA. An event contract may be structured as a futures contract on an “excluded commodity,” as defined by 7 U.S.C. 1a(19)(iv), where, for example, the futures contract settles based on an occurrence, extent of an occurrence, or contingency that is beyond the contracting parties’ control and associated with a financial, commercial, or economic consequence.

<sup>5</sup> 7 U.S.C. 7a-2(c)(5)(C).

<sup>6</sup> *Id.*

<sup>7</sup> *See, generally*, CEA Section 5(d), 7 U.S.C. 7(d).

<sup>8</sup> *See, generally*, 17 CFR Part 38.

among other things, establishing and enforcing rules for trading on the DCM and monitoring trading activity. Under DCM Core Principle 3, each DCM has a specific statutory obligation to list for trading only derivative contracts that are not readily susceptible to manipulation.<sup>9</sup> Core Principle 4 requires a DCM to have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process, through market surveillance, compliance, and enforcement practices and procedures.<sup>10</sup> And Core Principle 12 requires a DCM to establish and enforce rules to protect markets and market participants from abusive practices, and to promote fair and equitable trading on the DCM.<sup>11</sup>

To meet these obligations, a DCM must, among other things, conduct real-time monitoring of all trading activity on its trading platform(s) to identify disorderly trading and any market or system anomalies.<sup>12</sup> If the DCM identifies any such anomalies, Commission regulations set forth procedures for the DCM to engage in appropriate inquiries,<sup>13</sup> which may include obtaining trader-level data, and may lead under certain circumstances to disciplinary action by the DCM.

Commission staff further reminds DCMs and market participants that Commission Regulation 180.1 makes it unlawful for any person to employ any device, scheme, or artifice to defraud or attempt to defraud any person or manipulate the price of any contract listed on a DCM.<sup>14</sup> Without limitation, these practices include misappropriation of confidential information in breach of a pre-existing duty of trust and confidence to the source of the information (commonly known as “insider trading”), pursuant to CEA section 6(c)(1) and Commission Regulations 180.1(a)(1) and (3).<sup>15</sup> The Commission retains authority to investigate and bring civil enforcement actions related to any such activity.

## **B. DCM Core Principle 3 and the Appendix C Guidance**

Of particular note, DCM Core Principle 3 requires a DCM to only list for trading contracts that are not readily susceptible to manipulation. In connection with this requirement, the Commission has adopted guidance that is set forth in Appendix C to Part 38 (the “**Appendix C Guidance**”).<sup>16</sup> The Appendix C Guidance outlines certain relevant considerations for a DCM when designing a contract, and providing supporting documentation and data in connection with the submission of the contract to the Commission.

With respect to cash-settled contracts (which include event contracts), DCMs are encouraged to recognize and account for the possibility that cash-settled contracts may create an incentive to

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<sup>9</sup> CEA section 5(d)(3), 7 U.S.C. 7(d)(3).

<sup>10</sup> CEA section 5(d)(4), 7 U.S.C. 7(d)(4).

<sup>11</sup> CEA section 5(d)(12), 7 U.S.C. 7(d)(12).

<sup>12</sup> See 17 CFR 38.157.

<sup>13</sup> See, e.g., 17 CFR 38.153, 38.158, 38.250, 38.254.

<sup>14</sup> See 17 CFR 180.1 and 180.2.

<sup>15</sup> See CFTC Division of Enforcement Press Release, <https://www.cftc.gov/PressRoom/PressReleases/9158-26>.

<sup>16</sup> See 17 CFR Part 38, Appendix C.

manipulate or artificially influence the data from which the cash-settlement price is derived or to exert undue influence on the cash-settlement price's computation in order to profit on a position.<sup>17</sup> Accordingly, DCMs are encouraged to consider whether certain categories of event contracts create a heightened potential for manipulation or price distortion. For example, in the context of sports-related event contracts, such contracts could involve those that resolve or settle based on injuries to individual sports participants, unsportsmanlike conduct, or physical altercations between sports participants, as well as contracts that resolve or settle based on the action of a single individual or a small group of individuals, such as officiating actions occurring during a sporting event. DMO staff encourages DCMs to engage with staff in the early phases of designing such contracts to determine if any heightened manipulation or price distortion risks exist, and, if so, whether they may be mitigated with appropriate controls.

With respect to non-price based contracts, some things to consider are the nature and sources of the data comprising the cash-settlement calculation, the computational procedures, and the mechanisms in place to ensure the accuracy and reliability of the index value.<sup>18</sup> The DCM's evaluation should also consider the extent to which a third party has, or will adopt, safeguards against unauthorized or premature release of the index value itself or any key data used in deriving the index value.<sup>19</sup> DCMs should continue to consider the principles of the Appendix C Guidance around transparency, accuracy, reliability, and impartiality when evaluating novel contracts.

### **C. Product Submission Requirements**

To offer a new product for trading, including an event contract, a DCM can provide the Commission with a written certification—a “self-certification”—that the contract complies with the CEA, including the CFTC's regulations thereunder.<sup>20</sup> Alternatively, the DCM may elect voluntarily to seek prior Commission approval of the contract.<sup>21</sup> In each case, the DCM must submit prescribed information to the Commission, including but not limited to, the contract's terms and conditions.<sup>22</sup>

The prescribed information that must be submitted to the Commission also includes an “explanation and analysis that is complete” with respect to the contract's “compliance with applicable provisions of the [CEA], including core principles and the Commission's regulations thereunder.”<sup>23</sup> For example, the DCM's obligation to list only contracts that are not readily

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<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> CEA section 5c(c)(1), 7 U.S.C. 7a-2(c)(1). *See also* 17 CFR 40.2. The Commission must receive the DCM's self-certified submission at least one business day before the contract's listing. 17 CFR 40.2(a)(2).

<sup>21</sup> CEA sections 5c(c)(4)–(5), 7 U.S.C. 7a-2(c)(4)–(5). *See also* 17 CFR 40.3.

<sup>22</sup> 17 CFR 40.2–40.3.

<sup>23</sup> 17 CFR 40.2(a)(3)(v) (for self-certification) and 40.3(a)(4) (for Commission approval). The “explanation and analysis” requirement for self-certified contracts provides for such explanation and analysis to be “concise.” 17 CFR 40.2(a)(3)(v). The “explanation and analysis” requirement for contracts submitted for prior Commission approval does not include the “concise” qualifier. 17 CFR 40.3(a)(4).

susceptible to manipulation. The explanation and analysis must “either be accompanied by the documentation relied upon to establish the basis for compliance with applicable law, or incorporate information contained in such documentation, with appropriate citations to data sources[.]”<sup>24</sup> Further, if requested by Commission staff, a DCM must provide any “additional evidence, information or data that demonstrates that the contract meets, initially or on a continuing basis, the requirements” of the CEA or the Commission’s regulations or policies thereunder.<sup>25</sup>

### III. DCM LISTING FOR TRADING OF CERTAIN EVENT CONTRACTS

Sports-related event contracts and event contracts more generally have often been shown to be consistent with DCM Core Principle 3 where the settlement outcome depends on the aggregate performance of multiple participants over an extended period of play. The breadth of the outcome, in the typical case, reduces the ability of any single actor to manipulate the settlement value without material cost or substantial risk of detection. These categories of event contracts have been self-certified by DCMs pursuant to Commission Regulation 40.2.

DMO staff reminds DCMs that a self-certified product submission must include an explanation and analysis of the contract’s compliance with applicable provisions of the CEA and Commission regulations. DMO staff observes that overly broad or general contract specifications may affect a DCM’s ability to analyze the compliance of the contract’s various permutations with the CEA and Commission regulations, including the contract’s susceptibility to manipulation. Where multiple permutations of a contract may be listed, with different underlying events, there may be different manipulation risks that would need to be analyzed. Overly broad or generalized contract specifications may also impact a DCM’s ability to provide a complete explanation and analysis of compliance in the DCM’s product submission to the Commission. DMO staff would expect a product submission to include, among other things, a description of the settlement methodology that accounts for differing potential permutations of the contract, including identification of the specific data source(s) on which settlement will be based, and an assessment of the reliability, objectivity, and manipulation resistance of such sources.<sup>26</sup> DMO staff recommends proactive engagement with DMO staff when designing contracts with multiple possible permutations.

DMO staff recognizes that sports-related event contracts may implicate the involvement of professional sports leagues and their integrity units, as well as the governing bodies of non-professional sports organizations. DMO staff further understands that the Commission is actively discussing issues of settlement integrity with some relevant sports leagues and their governing bodies and foresees that appropriate information sharing by these entities with the CFTC may lead to enhanced CFTC oversight capabilities. DMO staff therefore recommends that DCMs consider (1) engaging in pre-self-certification communications with such relevant sports governing bodies or authorities when developing terms and conditions, compliance and market oversight programs for sports-related events contracts, (2) including, as part of the self-certified product submission, an explanation of whether the contract is consistent with the relevant league’s or governing body’s

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<sup>24</sup> 17 CFR 40.2(a)(3)(v) (for self-certification) and 40.3(a)(4) (for Commission approval).

<sup>25</sup> 17 CFR 40.2(b) (for self-certification) and 40.3(a)(10) (for Commission approval).

<sup>26</sup> A statement that a contract will settle based upon a consensus of yet-to-be-determined sources may not be sufficient to satisfy the requirements of DCM Core Principle 3.

integrity standards, as applicable, (3) establishing information-sharing and data arrangements with the relevant sports integrity monitoring organization, and (4) relying on official data provided by the relevant league or governing body, as applicable, as the settlement source. DCMs are also encouraged to look to, among other items, any league integrity standards or guidance around markets, contracts, and restricted or insider participants lists, in order to protect against manipulation and insider trading, and to protect the integrity of the relevant league or governing body, as applicable, and the sporting events which it administers. DMO staff also recommends that DCMs cooperate with any league-run investigations into potential manipulation or insider trading investigations. In the view of DMO staff, engagement with the sports leagues and other sports governing bodies may further a DCM's ability to comply with their obligations under DCM Core Principle 3 with respect to sports-related event contracts by enhancing access to information about the nature and dynamics of underlying events (e.g., information about categories of individuals who should be restricted from trading in certain sports-related event contracts as an informed participant).

DMO staff reminds all DCMs that the Commission retains authority to stay the listing of a self-certified contract pending Commission proceedings for filing a false certification or pending a petition to alter or amend the contract terms and conditions pursuant to section 8a(7) of the CEA. This would include any proceedings for filing a false certification that a contract complies with the "not readily susceptible to manipulation" requirements of DCM Core Principle 3. DMO staff believes that proactive engagement with DMO staff and any relevant sports league or governing body may reduce the likelihood of Commission action.

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This advisory is not intended to, does not, and may not be relied upon to create any rights, substantive or procedural, enforceable by law by any party in any matter. This advisory does not provide any no-action position with respect to a recommendation by any division that the Commission initiate an enforcement action for failure to comply with the CEA or Commission regulations. Further, this advisory is not intended to, does not, and may not be relied upon to create any new binding rules or regulations, or to amend existing rules or regulations. This advisory represents only the views of DMO and does not necessarily represent the views of the Commission or of any other division or office of the Commission.

Questions concerning this advisory may be directed to [DMOletters@cftc.gov](mailto:DMOletters@cftc.gov).

Sincerely,

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