Docket No: CFTC-2026-0331-0001

RIN: 3038-AF65

Subject: Advance Notice of Proposed Rulemaking – Prediction Markets

Date: March 23, 2026

COMMENT ON ADVANCE NOTICE OF PROPOSED RULEMAKING

1. Executive Summary

The Commodity Futures Trading Commission's (CFTC) Advance Notice of Proposed Rulemaking (ANPRM) regarding prediction markets requires a regulatory framework that prioritizes operational resilience and strict adherence to the statutory text of the Commodity Exchange Act (CEA). The rapid proliferation of event contracts listed by Designated Contract Markets (DCMs) exposes structural vulnerabilities in traditional market surveillance and clearing paradigms. This submission provides functional, textually grounded implementation guidance to optimize administrative predictability and ensure the statutory framework functions as written.

While prediction markets offer demonstrable benefits in price discovery, information aggregation, and market efficiency—purposes explicitly fostered under CEA § 3(b)—these benefits are contingent on structural safeguards. Innovation cannot outpace the mathematical realities of risk management. The following recommendations offer actionable mechanisms to preserve these market efficiencies while differentiating permissible economic hedging from prohibited activities under CEA § 5c(c)(5)(C), minimizing agency litigation risk.

2. Procedural & Statutory Alignment

The Commission’s authority to prohibit contracts contrary to the public interest is strictly enumerated. To survive judicial review, the final rule must anchor its definitions directly within the statutory text, avoiding expansive interpretations of terms like "gaming" that lack explicit congressional instruction. In the current jurisprudential environment, where courts exercise independent judgment on statutory ambiguities, relying on subjective qualitative assessments to define prohibited contracts invites immediate vacatur. To satisfy the logical outgrowth test under the Administrative Procedure Act (APA), the Commission must adopt bright-line, empirically verifiable criteria for an event contract's legal and operational viability.

3. Section-by-Section Technical Analysis

A. Margin and DCO Core Principles (Question 2.f and 3.c)

> *"What factors should the Commission consider in determining whether prediction markets should be permitted to offer trading on margin..."*

Issue: Applying traditional historical Value-at-Risk (VaR) models to binary event contracts creates systemic under-collateralization risks. The binary payoff convexity vs VaR breakdown at the extreme tails of probability means that short, volatile resolution windows cannot be safely margined using legacy futures methodologies.

Proposed Redline/Fix: "DCMs and DCOs may permit margined trading for event contracts exclusively for Eligible Contract Participants (ECPs). Retail participant positions must remain fully collateralized unless the DCO demonstrates a Commission-approved risk model specifically calibrated for binary option decay dynamics."

Operational Safeguard: This bifurcation aligns with CEA § 5b(c)(2)(D) by ensuring margin remains strictly risk-based while ring-fencing the clearinghouse from sudden retail liquidation cascades.

B. Public Interest and Gaming (Question 19.b)

> *"How should the Commission distinguish between various types of contests? For example, should a sports competition be treated differently than an award competition..."*

Issue: Relying on the thematic nature of a contest to define "gaming" establishes an arbitrary baseline. The distinction must be grounded in the presence of underlying commercial risk and price discovery utility per CEA § 3(a).

Proposed Redline/Fix: "An event contract is presumed to involve 'gaming' under CEA § 5c(c)(5)(C)(i)(V) if the underlying occurrence lacks a demonstrable, measurable financial, commercial, or economic consequence applicable to market participants outside the transaction itself."

Operational Safeguard: This objective test shifts the evidentiary burden to the DCM to prove an "economic purpose," effectively providing the Commission with a defensible, textually grounded standard that avoids arbitrary and capricious challenges regarding the cultural value of specific events.

C. Information Asymmetry and Manipulation (Question 30)

> *"Some events underlying event contracts are under the control of a single individual or small group of individuals."*

Issue: Contracts susceptible to single-actor resolution bypass standard market surveillance mechanisms, rendering traditional Position Limits (CEA § 5(d)(5)) ineffective against deterministic insider manipulation.

Proposed Redline/Fix: "DCMs must establish hard position limits proportional to the Shannon entropy of the outcome space, defined as $H(X) = -\sum P(x_i) \log_2 P(x_i)$. For highly centralized events where outcome probability is deterministically controlled by a single actor (approaching zero entropy), aggregate open interest must be capped at statistically immaterial thresholds."

Operational Safeguard: By formally linking position accountability to the mathematical entropy of the outcome space, the Commission neutralizes the financial mechanism for insider manipulation, effectively satisfying Core Principle 3 (listing contracts not readily susceptible to manipulation) through a defensible, quantitative standard.

4. Operational Impact Assessment

In practice, DCMs will fail to maintain compliance if the Commission implicitly requires them to dynamically adjudicate state-by-state variations in gaming laws (Question 16). Placing this burden on centralized exchanges will result in fractured liquidity and regulatory gridlock. The Commission should establish a federal functional safe harbor for listing determinations, without displacing underlying state law applicability. If a contract meets the federal economic hedging utility test, the DCM can satisfy its CFTC listing obligations without the Commission becoming an arbiter of 50 disparate state gaming codes. This formulation preserves state sovereignty while ensuring federal markets function predictably.

Furthermore, mandating real-time swap data repository (SDR) reporting (Question 5.a) for micro-duration event contracts using legacy infrastructure will jam existing reporting pipelines. For <24-hour contracts, the message traffic volume scales exponentially against a fixed set of liquidity providers. The Commission should adopt a batched, end-of-day reporting mechanism for binary event contracts with a duration of less than 24 hours to prevent operational network congestion while preserving full market transparency and auditability.

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All views expressed are my own and do not represent any institution or organization.