Re: *Advance Notice of Proposed Rulemaking on Prediction Markets, RIN 3038-AF65, 91 Fed. Reg. 12,516 (Mar. 16, 2026) — Comment of KalshiEX LLC in Support of Combination Event Contracts*

Dear Mr. Kirkpatrick:

I respectfully submit this comment in response to the Commission's March 16, 2026 Advance Notice of Proposed Rulemaking on Prediction Markets (the "ANPRM"). I address Question 12 and the related questions concerning combination and multi-leg contract structures.

A combination event contract—a single, fully-collateralized, exchange-listed binary instrument that pays only if each of its enumerated underlying events resolves in the specified direction—is the natural extension of the binary event-contract format to the joint-outcome state space. It is not a novel category of risk. It is the binary-outcome analog of multi-asset derivatives that have been listed by registered exchanges and traded over the counter under both Commission and Securities and Exchange Commission supervision for more than three decades: dual digitals, basket options, spread options, multi-asset autocallables, correlation swaps, and more. Each of these is, in economic substance, a payoff conditioned on the joint behavior of multiple underlyings. None has ever been treated by the public as gaming or gambling, as contrary to the public interest, or as systemically vulnerable to manipulation. Instead, the opposite.

Combination event contracts serve the Commodity Exchange Act's two enumerated economic purposes, risk transfer and price discovery, in ways that linear combinations of single-leg contracts demonstrably cannot. They are the only mechanism by which a market can produce, in real time and at low cost, the joint and conditional probability information that has been identified as the most valuable, and most underutilized, output of prediction markets in economics literature. They make available to retail and smaller commercial participants, on a transparent and centrally cleared venue, the same correlation-trade exposures that have historically been the exclusive province of institutional participants in dealer markets.

The foundational economics literature on prediction markets identifies joint and conditional probability elicitation as the most underutilized capability of prediction markets and as the source of their greatest potential public value. Wolfers and Zitzewitz, writing in the Journal of Economic Perspectives in 2004, observed that carefully designed contracts elicit not merely point probabilities but the market's beliefs about distributions and conditional relationships, "the market's beliefs about regression coefficients," in their phrase. The 2008 article by Arrow, Forsythe, Hanson, Ledyard, Milgrom, Schelling, Shiller, V. Smith, Sunstein, Tetlock, Varian, Wolfers, Zitzewitz and others in Science—the leading interdisciplinary statement of the prediction-market consensus—expressly urged regulators to "lower barriers to the creation and design of prediction markets" because their forecasting accuracy "could substantially improve decision-making in the private and public sectors." Robin Hanson's work on combinatorial information markets (2003, 2007), elaborated by Chen, Fortnow, Lambert, Pennock, and Wortman Vaughan (2008), formalized the central insight: combinatorial markets are the unique mechanism by which dispersed beliefs about dependence structure are aggregated into market prices.

A market that quotes the probability of event A and a separate market that quotes the probability of event B identify the marginal probabilities. They don't identify the joint probability of A and B, and they do not identify the conditional probability of A given B. Those quantities can be recovered—directly and in real time—only from a market priced on the joint event itself. A combination contract priced at q on the joint event {A, B}, traded alongside single-leg markets quoting prices p_a and p^b, mechanically identifies the conditional probability $P(A \mid B) = q / p^b$ and the implied correlation between A and B. That number is genuinely new information!

The categories of joint-probability information that a combination market would surface, and that no other commonly available instrument produces in real time, include:

- **Conditional macroeconomic forecasts under specified political regimes**. A combination on "candidate X wins the general election AND year-over-year CPI exceeds Y percent on the next print" reveals the market's conditional inflation forecast under that political outcome—information of immediate use to fixed-income strategists, the Federal Reserve's communications staff, and the financial press.
- **Macro regime probabilities**. A combination on "Federal Reserve cuts at the next FOMC meeting AND unemployment rate exceeds Z percent by year-end" distinguishes the "soft-landing" and "hard-landing" scenarios that single-leg Fed and unemployment markets necessarily blend together.
- **Catastrophe-and-policy-response interactions**. A combination on "Major hurricane landfall in Florida AND the legislature fails to pass insurance reform before storm season" reveals the market-implied probability of a coverage gap—directly relevant to reinsurance pricing and to residual-market planning.
- **Geopolitical risk premia**. A combination on "Country X imposes new export controls AND benchmark commodity exceeds $K" isolates the geopolitical risk premium that is currently embedded in commodity term structures but that no instrument allows to be traded as a separate quantity.

A combination market is a market paid only when several discrete conditions all resolve favorably. Two features define it: the payoff is governed by the joint occurrence of the legs, not by any one of them, and it is binary (either paid out or not). The price of any combination is dominated by the dependence between the legs (correlation), and the discontinuity at each trigger creates concentrated hedging risk that determines how the structure can be manufactured, distributed, and offset.

The principal objection is that these products are just "gambling," because they superficially resemble sports parlays. They do, of course. But they resemble, at least as closely and often considerably more so, an entire catalogue of structures the Commission and the SEC have permitted to trade for decades, such as:

- Dual and multi-way digital options. A dual digital pays a fixed amount only if two specified conditions are satisfied at the relevant observation time—for example, EUR/USD above a stated level and the ten-year rate below another. These are recognizable OTC exotic structures, including in cross-asset forms such as rates-FX or equity-rates combinations. Range accrual notes generalize the digital idea across time: the coupon accrues for each observation day on which one or more reference rates remain within specified bands, so the total coupon is proportional to the number of days on which the condition is met. A multi-rate range accrual—accruing only on days when, for example, a curve spread is positive and a short rate is in range—can be economically decomposed as a strip of daily dual digitals. Dual-currency range accruals apply the same idea in FX, and cross-asset accruals can apply it across underlyings. In each case, the payoff is economically equivalent to a combination of digital conditions, decomposed across time or across underlyings, with the coupon proportional to how often the joint event holds.
- A spread option on, say, the gasoline-crude crack pays continuously based on how far the refining margin clears the strike, but the structure is mathematically equivalent to an infinite continuum of dual digitals on the joint event "gasoline outperforms crude by more than k," summed across every value of k. Every European payoff decomposes into a portfolio of digitals on its measurable events; for a spread option, those digitals are on joint events in two-asset space. The smooth payoff is the listable form of the combination, chosen because the gamma singularity of an actual digital makes it impossible to market-make on a central limit order book.
    - The economic content reinforces this. A refiner buying a crack spread option is not taking a view on outright crude or outright gasoline; he is taking a joint view that gasoline rallies

and crude doesn't catch up enough to crush his margin. A soybean processor buying a crush option is taking a combined view across three legs at once (beans, meal, oil). A merchant generator buying a heat-rate option is taking a joint view that power outperforms gas by more than the plant's heat rate. Calendar spread options on Henry Hub or WTI are bets on joint behavior across the forward curve. WTI-Brent locational options are bets on geographic dislocation. Each end-user is taking a view on a joint event whose economic meaning is the combination outcome; the listed product simply offers the combination with the payoff scaled to magnitude rather than truncated to a coupon.

- Credit and insurance tranche products generalize the combination into a count-and-sum form. A first-to-default basket pays on the digital event "any one of these names defaults": an OR-combo across credits, the inverse of the all-or-nothing structure but built from the same logical primitives applied to multiple discrete events. A last-to-default basket converges to strict AND-logic across all credits. Index tranches in CDX and iTraxx slice the cumulative-loss distribution into attachment-detachment bands, so the senior tranches pay only when many discrete defaults have accumulated, the equity tranche pays from any default at all, and the mezzanine sits in between. Each individual default is a discrete event; the tranche payoff is a smooth function of the count of those events that have occurred. The structure is a combination on a counting variable, with the coupon distributed continuously across the attachment range rather than concentrated at a single threshold.
- Multi-peril catastrophe bonds operate identically in insurance form: each covered event is a discrete trigger, the payoff is a piecewise-linear function of cumulative losses, and the tranche structure determines whether the bond is wiped out by a few large events or many small ones. Aggregate reinsurance with per-event franchises explicitly counts qualifying events and pays once the count-and-sum threshold is cleared. Industry loss warranties layer two discrete digital triggers, an industry-loss index threshold and a sponsor-loss hurdle, both of which must hit, making them dual-trigger combinations in pure form. Mortgage credit-risk transfer notes from the GSEs use cumulative-loss attachment plus delinquency tests as gating digitals on the cash-flow waterfall, combination logic across loan-pool performance.

In every one of the above, the dependence structure is the dominant pricing input; the trigger boundaries are where the hedging difficulty concentrates; the end-user economic logic is "I am taking a view on the joint behavior of multiple things, not on any one of them." The relevant insight for product design is that the combination is not an alien structure imported from gambling: it is structurally natural in finance, and the listed and OTC derivatives universe is largely composed of products that compose, smooth, slice, or hedge it.

I'd ask the Commission to identify any principle on which it could conclude that a binary, fully-collateralized, exchange-listed, centrally-cleared combination event contract—a contract whose payoff cannot exceed $1.00, whose maximum loss is the premium paid, and whose every leg has been individually self-certified—is contrary to the public interest, while continuous-payoff multi-asset structured products with identical correlation-trade economics exist. I don't think that principle exists.

If anything, the comparison runs strongly in favor of the listed combination event contract. Combination event contracts are: (i) exchange-listed with transparent prices, (ii) centrally cleared, (iii) fully collateralized with no leverage, (iv) standardized rather than bespoke, (v) priced continuously rather than at issuance plus illiquid secondary marks, and (vi) accessible at small minimums. Each of those attributes is one the Commission has historically cited as a benefit of exchange trading over OTC trading.

Implied-correlation exposure has historically been the province of institutional desks transacting OTC in correlation swaps, dispersion trades, and worst-of structured notes, products that typically require an

ISDA Master Agreement, an Eligible Contract Participant counterparty, six- or seven-figure minimums, and custom documentation. Listing combination event contracts on a Designated Contract Market is the first realistic mechanism for retail and smaller commercial participants to express, hedge, or take views on correlation.

There is a clear population of identifiable commercial participants whose loss functions are joint-state loss functions, that is, whose economic loss is incurred only in the conjunction of two or more events, and not in either marginal alone. For these participants, a portfolio of single-leg contracts is not an efficient hedge. The portfolio (i) overpays in marginal states, (ii) ties up collateral proportional to the sum of leg premia rather than the (smaller) joint premium, (iii) leaves correlation risk unhedged because correlation is not a linear function of marginals, and (iv) introduces execution risk across separate order books. The following are real and identifiable use cases:

- **Homebuilders and mortgage originators** sustain balance-sheet losses specifically in the joint state of elevated mortgage rates and rising unemployment: demand contraction combined with credit deterioration. Either alone is manageable; the conjunction is the recession scenario. A combination on “Fed funds rate exceeds X by date D AND unemployment rate exceeds Y by date D” is a direct hedge that no single-leg combination replicates without basis risk.
- **Exporters with tariff exposure** face concentrated loss in the joint state of dollar strengthening against the relevant currency and tariff imposition. Hedging the marginals separately overpays in benign states and underhedges the joint state if execution timing diverges across markets.
- **Insurers and reinsurers** in catastrophe-prone states face tail risk in the joint state of major event landfall and failure of regulatory or legislative remediation. A Florida property insurer’s tail concern is precisely “hurricane lands AND insurance reform fails before the season.” A combination contract aligns the payoff to the loss state.
- **Technology firms facing antitrust and competitive contracting risk** sustain bankruptcy-tail loss only in the joint state of adverse antitrust ruling and competitor success in a flagship public-sector contract. Either alone is recoverable.
- **Municipal issuers** face budgetary tail risk in the joint state of monetary tightening and declining state revenue receipts, a macro-and-fiscal conjunction not adequately captured by single-variable hedges.
- **Agricultural producers and cooperatives** face the conjunction of regional drought and export-control regimes that prevent the price benefit normally expected from a domestic supply shock.
- **Issue-advocacy organizations** whose operations are conditional on both an electoral outcome and a specific subsequent legislative outcome have a defined operational and budgetary risk in the joint state.
- **Broadcasters and championship-series sponsors** with upfront commitments against championship inventory face concentrated ad-makegood and impression-shortfall losses only in the joint state of a small-market matchup and an early series end. A marquee Finals that ends in four games typically still clears delivered-audience guarantees; a small-market Finals that goes seven games typically does too; only the conjunction triggers the makegood obligations that turn the underwriting loss-making. A combination on "{small-market team in Finals} AND {series ends in five games or fewer}" aligns the hedge to the loss state.

Some might argue that a hedger can simply buy YES contracts on each leg separately. That fails the user on four grounds:

First, there's a basis-risk problem. Long YES on each of A and B pays $2 in {A, B}, $1 in {A, ¬B} or {¬A, B}, and $0 in {¬A, ¬B}; the intended hedge target, payoff only in {A, B}, has a payoff vector (1, 0, 0, 0). They're not the same instrument and are not the same hedge.

The single-leg replication is also capital-inefficient. Margin and collateral on the linear combination scale with the sum of leg prices, while margin and collateral on the combination contract scale with the joint price. For positively correlated legs, the combination collateral is materially lower; for negatively correlated legs, it is bounded above by the smaller marginal. In either case, it is at most equal to and generally less than the linear-combination collateral.

Beyond capital efficiency, correlation risk is not a linear function of marginals. The variance of an index decomposes into average single-name variance plus a pairwise-covariance term, and the covariance term can't be inferred from marginals. The same holds in the binary-outcome setting. The joint price contains information that is identified neither as a sum nor as a product of the marginals. A trader holding only single-leg positions has no exposure to changes in the correlation between events; a trader holding a combination contract does.

Execution risk compounds the picture. Fills on separate order books decorrelate prices intra-trade, while a combination instrument is filled at a single price, removing leg-execution slippage. This is the same rationale that supports the listing of futures spreads, Treasury yield-curve butterflies, and crack and crush spread futures. The Commission has approved each of those structures in part because they collapse the execution risk of an otherwise multi-leg trade. The same logic applies, with equal or greater force, to combination event contracts.

Implied correlation between events is genuinely new information not derivable from single-leg markets. It's the binary-outcome analog of the implied correlation that the listed equity options market produces and that Cboe disseminates as the Implied Correlation and Dispersion indices. The academic and practitioner literature documenting the price-discovery value of implied correlation in equity markets—Driessen, Maenhout, and Vilkov (2009); Härdle and Silyakova (2009); Jacquier and Slaoui (2010)—establishes the analytical framework for treating implied correlation as a tradeable, separately-priceable risk premium with informational content.

The Special Rule's "involves" inquiry under 7 U.S.C. § 7a-2(c)(5)(C) is directed at the underlying event, not at the contract's structural form. The point was made forcefully by Judge Cobb in her opinion granting summary judgment to KalshiEX in the elections-contract litigation, and was reinforced by the Third Circuit's decision in KalshiEX v. Flaherty, which confirmed that the Commodity Exchange Act preempts state recharacterization of CFTC-regulated derivatives as gambling. The leg-by-leg analysis controls. A combination of underlyings whose individual referent events are not gaming cannot become gaming because they are bundled. The instrument is, simply, a multi-underlying binary derivative.

Others claim that the contracts are lottery-like, and will harm retail participants. This objection treats long-tail payoff distributions as inherently suspect. It is not the law and it is not the Commission's historical practice. Out-of-the-money options and binary options have payoff distributions that are at least as long-tailed as combination event contracts, and have been listed and approved by the Commission and the SEC for decades. A trader who buys a deep out-of-the-money put on the S&P 500 has a payoff distribution materially more skewed than a trader who buys a combination contract on the joint resolution of two roughly fifty-percent events.

Three more specific points are worth making. First, capital efficiency relative to single-leg replication makes combination contracts a more protective vehicle for the same expressive view. A trader who wishes to express a view on the joint event saves capital by purchasing the combination rather than a four-leg replication, and her maximum loss is bounded by her premium in either case, but it is a smaller

premium with the combination. Second, retail speculation in a given contract is not a basis for prohibition under the CEA. As Commissioner Berkovitz observed in his April 2021 statement on the ErisX NFL futures certification, once a contract has economic purpose for any class of users, speculators must be permitted to participate; that is the structure of every derivatives market the Commission regulates. The Commission has never required, and could not consistently require, that every participant in a regulated derivative have a specified hedging purpose. Speculation is critical for derivatives markets – how else would hedgers have liquidity? Third, the appropriate response to retail-protection concerns about any specific contract is calibrated position limits and transparent disclosure, tools already at the Commission's disposal under the Core Principles, not categorical prohibition.

Combination event contracts serve the Commodity Exchange Act's enumerated economic purposes, risk transfer and price discovery, in ways that single-leg contracts cannot. They produce informational public goods of independent value to forecasting, journalism, policy analysis, and academic research. They democratize correlation exposure that has historically been institutional-only; and they raise no incremental manipulation concern under Core Principle 3 that is not already addressed leg-by-leg.

The Commission's mandate under CEA § 3(a) is to facilitate derivatives markets that manage risk and discover prices. Combination event contracts do both, in domains where no other instrument does either.

Respectfully submitted,

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cc: Michael Selig, Chairman