Event Contracts Are Financial Products Even When People Have Fun Trading Them

The Commissions are asking the right questions at the right time. Event markets have developed quickly. Contracts that were once unusual or academic now trade on regulated national exchanges with real liquidity, market makers, clearing, surveillance, and increasingly sophisticated participants. They also cover subjects that do not fit neatly into the examples regulators were thinking about twenty years ago.

That is not a crisis in the statutory framework. It is what financial innovation normally looks like. Markets develop first, lawyers discover that old definitions now have interesting applications, and regulators eventually have to explain how the pieces fit together. The present Request for Comment is an opportunity for the Commissions to do exactly that.

One place to start is with an argument that has some intuitive appeal but, on closer examination, is misleading. The Commissions said in 2012 that certain customary transactions entered into by natural persons primarily for "personal, family, or household purposes" should not be treated as swaps or security-based swaps. It is tempting to read that language broadly. A person who trades an event contract because she enjoys following sports or politics is doing something personal. Perhaps the contract therefore is not a swap.

The problem is that this is not what the 2012 interpretation was about.

The examples make that clear. The Commissions discussed mortgages and mortgage rate locks, agreements to purchase or lease real property, residential fuel arrangements, consumer services, warranties, and similar transactions. These arrangements can contain provisions that look surprisingly derivative-like if removed from their context. A mortgage can contain an interest-rate lock. A heating-oil contract can fix or cap a future price. A service contract can require a contingent payment. An agreement to buy property can contain an option.

But nobody entered those transactions principally to buy the derivative feature. The consumer wanted the house, loan, fuel, property, or service. The derivative-like provision rode along with something else.

The Commissions identified precisely those characteristics when explaining how to recognize similar transactions. The contingent payment generally was not severable from the underlying transaction. The arrangement was not traded on an organized market or over the counter. And, for consumer arrangements, the transaction generally involved an asset owned or being acquired by the consumer or a service provided by or to the consumer. The Commissions described the first two characteristics as particularly important because the arrangements did not involve the sort of freestanding risk shifting characteristic of swaps and security-based swaps. Product Definitions Adopting Release, 77 Fed. Reg. 48,208, 48,246–48 (Aug. 13, 2012).

An event contract looks almost exactly opposite.

There is no house being purchased alongside the contract. There is no gallon of heating oil that eventually arrives. There is no consumer loan whose interest rate happens to be capped. There is no separate good or service to which the contingent economic feature is ancillary. A participant buys a contract paying according to whether some future event occurs because the participant wants the contingent exposure represented by that contract.

The contingent exposure is not incidental to the transaction. It is the transaction.

That distinction is also much more administrable than asking why a particular customer traded. Suppose the same election contract is bought by four people. A hedge fund buys it because its model says the probability is wrong. A business owner buys it because the election affects her business. A retail trader buys it because he thinks he can make money. Another retail trader buys it because he thinks politics is fun and he can make money. Nothing about the contract changes as we move from one account to the next.

Yet a subjective-purpose interpretation would potentially make the first trade a swap, perhaps the second a hedge, perhaps the fourth a consumer transaction, and leave us to decide whether the third trader enjoys himself enough to change the product's statutory identity.

That cannot be how an exchange-traded product is classified. A DCM needs to know what it is listing before the customer arrives. A DCO needs to know what it is clearing. The CFTC needs to know which regulatory requirements apply. Intermediaries and counterparties need to know what transaction they are entering. And on an anonymous central market, the person on one side of the trade generally does not know who is on the other side, much less why that person decided to trade.

The Commissions' existing approach points in the same direction. The 2012 release says Title VII classification should be determined from the instrument before execution based on its terms and characteristics. A rule under which the same standardized instrument changes regulatory character according to what a particular trader had in mind would be a peculiar exception to that approach.

The much more natural reading of the consumer interpretation is therefore also the simpler one. A consumer transaction does not become a swap merely because some provision embedded in it performs a derivative-like function. But when a customer enters a freestanding financial transaction precisely to acquire the contingent economic position, there is no underlying consumer transaction from which to separate the derivative. The derivative is what the customer bought.

Casinos present a useful comparison, but not for the reason one might initially think

There is a harder version of the argument. Ordinary casino wagers existed long before Dodd-Frank. Nobody ordinarily described a wager at a blackjack table or sportsbook as a swap, and treating every casino wager as an off-exchange swap would produce some very strange consequences under the CEA, including the restrictions on swaps with persons who are not eligible contract participants.

There is something to that intuition. An ordinary casino wager should not become a Title VII swap merely because its payout depends on an uncertain event.

But the conclusion does not follow that any financial contract that resembles a wager is therefore a casino wager. That skips the question that matters.

Gambling can describe a behavior. A person can gamble recklessly on a stock, a future, a house, or almost anything else with an uncertain value. State gaming regulators do not therefore acquire jurisdiction over the New York Stock Exchange whenever somebody buys a meme stock with

rent money. Conversely, a person can enter a casino with a fixed entertainment budget, lose exactly what she planned to lose, and behave more responsibly than someone levering a brokerage account five to one.

The behavior tells us something about the person. It does not necessarily tell us what the product or institution is.

State gambling regimes have historically regulated defined gambling activities and businesses such as casinos, lotteries, sportsbooks, and particular games or wagering arrangements. They have not treated every instance of economically risky behavior undertaken in hope of gain as "gambling" subject to gaming regulation. Securities markets remain securities markets even though people can gamble in them. Futures markets remain futures markets even though people can trade futures with no hedge and a terrible idea.

That is an important distinction for responsible-trading policy as well. Risk can be used responsibly or irresponsibly in almost any financial market. The sensible regulatory response to irresponsible use is to address the behavior and the risks it creates through appropriate customer protections, surveillance, market rules, disclosures, position controls, or other measures. It is not ordinarily to declare that the underlying financial product has changed categories because one class of customers sometimes uses it badly.

A casino and a national financial exchange also have materially different structures. A regulated exchange creates standardized positions that market participants can buy and sell against one another. It produces public prices from competing orders, permits positions to be entered and offset, clears transactions, maintains books and records, surveils trading, and operates under federal market rules intended to protect market integrity. A casino or sportsbook operates under a different institutional and regulatory model. The fact that both can involve putting money at risk on an uncertain outcome is real, but so is the fact that buying an equity option and placing a roulette wager both involve risking money and we nevertheless have little difficulty recognizing that they are different products.

The CFTC's own treatment of election contracts illustrates the distinction particularly well. In 2023, the Commission prohibited Kalshi's Congressional Control Contracts after concluding that they involved gaming and activity unlawful under state law and were contrary to the public interest. But it did so through CEA section 5c(c)(5)(C) and Regulation 40.11, the statutory mechanism Congress gave the CFTC to review particular event contracts offered on registered markets. It did not conclude that describing the activity as wagering caused the contracts to disappear from the CEA.

The district court later disagreed with the Commission about "gaming" and unlawful activity and vacated the order. Its reasoning makes the structural point even clearer. The court described event contracts as derivative contracts and held that the relevant inquiry under the Special Rule concerned the activity underlying the contract. The Congressional Control Contracts involved elections and politics, not the act of gambling on an election. KalshiEX LLC v. CFTC, No. 23-3257 (D.D.C. Sept. 12, 2024).

The 2023 order was vacated, so its interpretation of "gaming" is not authority on that question. But the regulatory architecture remains instructive. Even when the Commission itself thought the contracts amounted to gaming, it treated that as a question about whether a CFTC-regulated

event contract could be listed under the CEA. It did not reason that the contract ceased to be a derivative because the activity resembled wagering.

That is the cleaner way to keep the questions separate. Product classification asks what the financial instrument is. Product permissibility asks whether the CEA permits that instrument to be listed. Customer-protection rules ask how people may use it. Those questions can interact, but they are not the same question.

The off-exchange wager problem proves less than it first appears

The eligible-contract-participant point deserves a direct answer because it is clever. If every conventional casino wager were a swap, then ordinary retail wagers entered outside a DCM would appear to collide with the CEA's restrictions on off-exchange swaps with persons who are not ECPs. Congress plainly did not set out to federalize every blackjack table through Title VII.

Fair enough.

But that shows that an ordinary casino wager is not necessarily a swap. It does not tell us that a standardized event contract traded on a financial market is therefore the same transaction.

The missing step is the assumption that anything with the economic form "I pay money now and receive money if X occurs" must have the same legal character. Financial law has never worked at that level of abstraction. A life-insurance policy, an option, a wager, a guarantee, an indemnity, and an event contract can all contain contingent payments. We still have to ask what arrangement the parties actually entered, what rights it creates, how it trades, and which statutory definition describes it.

Venue should not magically change the legal identity of an otherwise identical product. If precisely the same financial contract moves from an exchange to bilateral trading, its terms and economic rights remain the same even though the legal consequences of offering it there may change dramatically. But the converse is equally important. Two transactions do not become identical merely because their payoff diagrams can be drawn with similar lines.

Futures, swaps, and the danger of letting the wrapper answer the question

Event contracts also expose another reason to focus on substance. Depending on their terms, instruments providing economically similar exposure may implicate different CEA categories. Some may satisfy the statutory swap definition. A differently structured product may satisfy the requirements for a future. Others can implicate an option exclusion or, where securities are involved, one of the Title VII securities provisions.

That possibility is not a weakness in the framework. It is a warning against classification by label.

Saying that an event contract could be "styled" as a future gets the sequence backwards. The drafter can call a contract whatever she likes. The question is whether the rights and obligations she wrote actually satisfy the statutory category. If they do, the resulting legal consequences follow.

The fact that form can be pliable makes substance more important, not less. A transaction should not receive one regulatory identity because the rulebook calls the threshold a "strike," another

because the exchange calls it an "event," and a third because someone calls the product a "future." The Commissions should look through those labels to the economic rights actually created.

Public companies present a different question

The consumer issue asks whether event contracts are financial derivatives at all. Issuer-related event contracts raise the next question. Assuming the instrument is a swap, when does an event concerning a public company make that swap a security-based swap?

Here too there is an initially attractive but ultimately unworkable answer. One might look at how important the event is to the company. Vehicle deliveries can be enormously important to an automobile manufacturer. A new product can be enormously important to Apple. FDA approval can be existential for a biotechnology company. Winning playoff games can generate substantial revenue for the publicly traded owner of a sports franchise. A merger can transform a company's balance sheet.

These examples have one thing in common. Shareholders care about them.

But Congress did not say that an issuer-related swap becomes an SBS whenever the event is important to shareholders. Nor did it say whenever the event materially affects the company, significantly influences its results, predicts its revenues, or causes its stock to move. Congress required an event that "directly affects the financial statements, financial condition, or financial obligations of the issuer."

"Directly" needs to mean something.

Consider vehicle deliveries. It may be perfectly true that the number of cars an automaker delivers is an excellent indicator of revenue. It may even be true that deliveries are among the most important operating metrics investors use to estimate quarterly results. Neither proposition establishes directness.

Cars are delivered. Customers pay for them. Accounting rules determine when revenue is recognized and in what amount. Costs, pricing, foreign exchange, product mix, financing arrangements, and other factors determine the ultimate financial result. The very statement that deliveries "translate into" sales describes an economic process through which one fact affects another.

Even assuming deliveries largely predict revenue, prediction is not direct effect.

Taken a step further, the problem with a predictive-value test becomes abundantly clear. Consider a swap that pays according to the number of rainy days in Sandusky, Ohio, in July. Nothing on the face of that contract concerns a security. It references the weather in one American city, and it is the kind of instrument the CFTC has overseen for decades. No one would think to characterize as security-based.

But Six Flags Entertainment Corporation ("Six Flags") operates Cedar Point theme park in Sandusky, and attendance at an outdoor amusement park is driven by whether it rains. Rainy days in Sandusky in July may predict Cedar Fair's July revenue as reliably as any single fact one could name — quite possibly more reliably than a delivery count predicts an automaker's

quarterly revenue. If predictive power established that an event directly affects an issuer's financial condition, that weather swap would be a security-based swap.

Nor would it stop there. Oil prices predict the results of refiners, interest rates predict the results of banks, and freight rates predict the results of shippers. Each of those contracts references something other than a security, and each would be drawn into the security-based swap definition on the strength of a correlation. Congress did not write a statute whose jurisdictional lines are set by regression analysis. It required that the event directly affect the issuer. The weather in Sandusky does not do that. It affects how many people visit a theme park, which affects ticket sales, which affects revenue, which appears in a financial statement.

A product launch is clearer. Suppose Apple launches a new iPhone. The launch may cause people to buy phones. Those sales may increase revenue. Depending on prices and costs, that may increase earnings and cash. Investors may capitalize those expectations immediately, which is why Apple stock can move the moment the launch occurs.

But the immediacy of the stock-market reaction does not shorten the business causal chain. The stock moves today because investors are pricing what they expect customers to do tomorrow. That is what securities markets are supposed to do.

If a product launch "directly affects financial condition" merely because it may have very large financial consequences, "directly" has been replaced with "importantly."

The same is true, almost comically, of sports results involving a publicly traded owner. Winning a playoff game can generate additional ticket sales, concessions, merchandise, sponsorship value, media attention, and perhaps additional games. Those are genuine commercial consequences. Running a successful sports franchise is, among other things, a business in which winning tends to be good for business.

But the basketball game does not become a financial event within the meaning of the SBS definition merely because the team has public shareholders. A Knicks win can be good for MSG Sports without the final buzzer itself altering a debt obligation, asset, liability, financial statement, or existing financial condition. If ordinary operating success were enough, the event prong would reach virtually every important thing a public company does.

Pharmaceutical events make the same point with higher stakes. FDA approval can add billions of dollars to the market value of a biotechnology company in a day. A failed clinical trial can destroy most of it. That makes these events extraordinarily important to securities investors. It does not necessarily make the FDA decision or clinical outcome an event that directly operates on the company's financial statements or obligations.

FDA approval changes regulatory status. The company may then be able to commercialize a product. Commercialization can generate sales. Those sales can generate cash and profits. The securities market may anticipate every step of that process immediately, but an event's effect on expectations about future financial performance is different from the event itself changing a financial obligation or financial condition.

This distinction does not require pretending that all issuer events belong on the CFTC side. Some genuinely do look different.

Default is the obvious example. When an issuer fails to make a required debt payment, the default itself operates on a financial obligation. Bankruptcy likewise changes the issuer's legal and financial position by operation of law. Those are precisely the sorts of examples the Commissions discussed when implementing the SBS issuer-event provision in 2012.

Merger closing can also be different. Depending on the structure, consummation itself may transfer cash, issue or cancel securities, create goodwill, assume liabilities, alter assets, change capital structure, or otherwise operate directly on the company's financial position. That is not the same as saying every event associated with an M&A transaction is therefore an SBS event. Signing, regulatory clearance, a shareholder vote, satisfaction of a procedural condition, and closing can each have different legal effects. The right question is what the particular event specified in the contract itself does.

IPOs deserve the same care. Completion of an IPO can itself involve the issuance of securities, receipt of capital, and alteration of the issuer's capital structure. An earlier milestone such as confidential filing, public filing, roadshow commencement, or the announcement of an intention to go public may stand in a very different relationship to the financial attributes identified by Congress. "IPO event" is not a statutory category any more than "M&A event" is.

Reported financial metrics provide another useful example. A contract can settle on whether a company reports revenue above $10 billion or EPS above $2.00. There is no sensible argument that the information is financially irrelevant. It is literally financial information.

But the event identified by the contract still matters. If the event is the company's report, the report reveals the financial result. It does not create it. Revenue was what it was before the press release. Publishing the number communicates a financial statement. It does not change the underlying asset, liability, obligation, or financial condition being described.

And if the contract is understood instead as settling on the financial result itself, the same conceptual problem remains. A financial result can be the content of a financial statement without being an event that operates on the financial statement. Congress used an event formulation, with bankruptcy and default as natural examples. It did not simply place every number appearing in an issuer's accounts on the SEC side.

That distinction is important because otherwise "financial condition" becomes limitless. Every employee hired, customer acquired, factory opened, permit obtained, product sold, lawsuit won, shipment completed, or game played can eventually affect a company's finances. For a public company, almost every commercially meaningful fact will sooner or later find its way into revenue, costs, assets, liabilities, cash flow, or investors' expectations.

A test that follows that chain far enough will always reach a financial statement.

The word "directly" tells us not to follow it forever.

Financial importance is also an impossible classification rule

There is a practical reason to resist replacing directness with financial significance. Nobody knows how significant many events will be until after they happen.

Suppose an FDA approval has been expected for six months and the stock barely moves when it arrives. Now suppose the same approval is a complete surprise and the stock rises fifty percent. It

would be odd for the contract to be a CFTC product in the first case and an SBS in the second. The event was identical. Only the market's prior expectations differed.

Expected impact does not solve the problem. Then the exchange must forecast the stock-market reaction in order to determine which regulator governs the contract. Materiality does not solve it either because securities-law materiality is intentionally broad and captures precisely the enormous universe of information investors may reasonably care about. Correlation produces the same problem in mathematical clothing. Oil can become highly correlated with Exxon stock without a crude-oil contract becoming an Exxon SBS.

There is a useful symmetry here. The broad consumer theory would make classification depend on what is in the customer's head. The broad issuer-event theory would make classification depend on what is in investors' heads.

Neither is a promising way to regulate a standardized product.

An exchange should be able to classify a contract from the contract itself. What does it pay on? What rights does it create? What economic exposure does the holder receive? If it concerns an issuer event, what does that specified event itself do to the issuer's financial statements, financial condition, or financial obligations? Those questions can be answered when the product is designed and before anyone trades it.

They also produce sensible results. A default contract can fall on the SBS side because default itself operates on a financial obligation. A merger closing may fall there where closing itself changes the issuer's financial position. A total return swap on Apple is plainly organized around Apple stock. An event contract on whether Apple releases a foldable iPhone is organized around whether Apple releases a foldable iPhone, even if shareholders care enormously about the answer.

The regulatory framework should catch up to the market, not chase every trader

The growth of event markets therefore presents a relatively ordinary regulatory task. The markets have become more important, more liquid, and more varied. Products now isolate exposures that previously could be expressed only indirectly through stocks, traditional derivatives, insurance, or not at all. That innovation naturally exposes questions that earlier regulatory guidance did not need to answer in much detail.

The Commissions are right to answer them now.

The answer should preserve the consumer interpretation for what it was designed to do. A mortgage does not become a swap because it contains a rate lock, and a fuel purchase does not become a swap because its price is fixed for future delivery. Those are consumer transactions with derivative-like features attached to something else.

An exchange-traded event contract is different because there is no something else.

Ordinary casino wagers likewise need not become swaps. But the reason should not be that every financial instrument becomes a casino product when somebody trades it for entertainment. Gambling behavior can occur in securities and derivatives markets just as responsible risk-taking can occur in a casino. Regulatory classification follows the product and institution, while customer-protection rules can address how participants use them.

And an event concerning a public company should not become a security-based swap merely because it is important to shareholders. Default and bankruptcy show what the statutory language looks like when the event itself acts on financial condition or obligations. Product launches, vehicle deliveries, sports results, and FDA decisions show the other side. Their economic consequences may be enormous precisely because businesses make or lose money as consequences flow from those events. That does not make the events themselves financial obligations.

Some difficult cases will remain. Merger closing is genuinely different from product launch. IPO completion is genuinely different from a rumor that an IPO is coming. A terminal condition stated directly in terms of a stock price raises harder statutory questions than an FDA decision. Hard cases are a reason to identify the line carefully, not a reason to abandon it.

What the Commissions should avoid are rules that require exchanges to classify products by interviewing customers about why they trade, forecasting how much a stock will move, or determining after the fact how much an event mattered to a company's quarterly earnings. Those approaches make novel markets harder to regulate precisely because they move the classification question away from the product.

The more durable approach is also the more intuitive one. Look at the transaction. If a derivative-like term is merely ancillary to the house, loan, fuel, or service the customer actually came to buy, the consumer interpretation has a job to do. If the customer came to buy the contingent financial exposure itself, treat the transaction as the financial product it is. And if that product concerns a public company, move it onto the securities side only when the additional statutory requirements Congress wrote for that purpose are actually satisfied.

That lets regulation catch up to innovation without pretending the innovation changed the meaning of everything that came before it.

Finally, it is always worth noting that gambling is a behavior, not a description of a product. Certainly there are products that are designed for gambling, the same way that a treadmill, while designed for exercise, is not itself exercise (were that it were!) The assumption that a product is either gambling or not gambling is a disservice both to those who utilize the product in non-gambling ways, and to those who gamble on products that are unwisely excluded from "gambling" such as stocks, bonds, futures, etc. Ultimately, the failure to recognize that gambling is a behavior and the odd but prevailing tendency to classify instruments in a binary classification system of "gambling" or "legitimate" is very unkind, and incorrect.