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COMMENT

David A. Stawick
Secretary
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 *Fed. Reg.* 25669 (May 7, 2008)

Dear Mr. Stawick:

The Coalition for Internal Markets appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission") Concept Release on the Appropriate Regulatory Treatment of Event Contracts, 73 *Fed. Reg.* 25669 (May 7, 2008) ("Concept Release"). The Concept Release notes that the Commission is soliciting comment "on the appropriate regulatory treatment of financial agreements offered by markets commonly referred to as event, prediction, or information markets." The Commission defines event markets for the purpose of the Concept Release as contracts that "are neither dependent on, nor do they necessarily relate to, market prices or broad-based measures of economic or commercial activity." [1]

The Coalition for Internal Markets ("CIM") is a coalition of public companies that sponsor event markets that are open for participation only by their employees or similar individuals. The Coalition presently is composed of Google, Inc. and Yahoo! Inc. Although the details differ with respect to how our internal event markets operate, we share a common belief in the use of internal markets as an accurate means of information aggregation, including pricing information, in the economic utility of such markets and in the benefits that they provide the public even when used as an internal forecasting and prediction tool. In light of our experience with the benefits of these markets, as discussed in greater detail below, we also support the availability of similar "public" markets. We believe that our experiences as operators of internal markets will provide the Commission with additional facts and insights with respect to the use of internal event markets by companies in the operation of their businesses.

How our markets operate

[1] Concept Release, 73 *Fed. Reg.* at 25669.

Google

Google has operated a prediction market since April, 2005. Its operation is patterned after that of the Iowa Electronic Markets, except that currently no money is used by its market participants. In Google's terminology, each question that is the subject of trading activity is termed to be a "market." Questions are not binary in nature, but the 2 to 5 possible responses are mutually exclusive.

Payment for correctly predicting an event is one unit of a fantasy currency. There is no pay-out for incorrect predictions. Traders wishing to participate in the market are given a supply of currency at the beginning of each calendar quarter. Trading is conducted via a continuous double auction in each market. Participation is limited to current employees and some contractors and vendors. There is no automated market maker, but several employees did create robotic traders that sometimes played this role.

The market itself originates all contracts in the form of a long and short bundled position. Traders can purchase from the market a bundled long and short position for a single unit of currency and then decompose the bundle and sell any of the contracts in their purchased bundle. Traders are not, however, permitted to create short positions. Traders may also purchase a position from another trader that has purchased a bundled position from the market. Traders can also reassemble the contract bundles and sell them back to the market. Currency units at the end of each quarter can be redeemed for raffle tickets for a variety of modest prizes.

Since its inception, the Google market has traded 25 to 30 separate "markets' each calendar quarter. The markets were designed so that each expired by the end of the quarter in which it was listed. New markets were then listed with the beginning of a new quarter.

The markets listed on Google's internal prediction market relate to forecasts of product demand; to internal performance, such as whether a new product will leave beta on time; on company news unrelated to direct performance, such as whether the company will open a new office in a specified location; and to the external business environment that might affect planning decisions, such as the mix of hardware and software used to access Google. In addition, Google hosted a few markets unrelated or marginally related to Google's business which were included for training purposes.

Google has used its internal marketplace not only to make forecasts, but also to monitor and evaluate how information and attitudes are distributed within its organization. For example, Google has also used its internal market data to assess the strength of relationships between various working teams. Google has also used its prediction market data to measure how optimism about its business objectives varies over time and in different parts of its organization.

Yahoo!

Yahoo! Inc. has been designing, building, and analyzing prediction markets since 2002. Since that time, Yahoo! has experimented with internal markets to identify promising new products and to guide strategic decision-making within the company. Yahoo!'s internal markets are open only to company employees or similar persons. Yahoo!'s internal markets operate using an automated market maker. Some use Hanson's logarithmic market scoring rule market maker and others use Yahoo!'s own dynamic parimutuel market maker.

In addition to its internal markets, Yahoo! has fielded three prediction market experiments open to the public: the Yahoo!-O'Reilly Tech Buzz Game, the Bix American Idol market, and the Yoopick sports prediction market. Each of these publicly offered prediction markets is operated as a game, using virtual currency. Those wishing to participate are provided with virtual dollars to fund their trading account. The opening round of the Tech Buzz Game awarded modest prizes to the top traders. In subsequent rounds of the Tech Buzz Game and the other Yahoo! public markets, no prizes are awarded; rather the incentive is the reward of doing well compared to other traders.

For example, the Yahoo!-O'Reilly Tech Buzz Game enables players to buy contracts in technologies that they consider to be popular and to sell those that they believe to lack merit. Contracts are listed in various, rival technologies. Players have access to the current "buzz" around each technology, as measured by the number of Yahoo! Search users seeking information on it. The fantasy market's object is to anticipate future search buzz and to buy and sell contracts accordingly. Thus, a player who believes one type of technology is undervalued might buy contracts in that technology, while a player who thinks that the technology is overpriced might sell its contracts, or buy a competing technology. The Tech Buzz game employs the dynamic parimutuel market design invented at Yahoo!, thus serving as a testbed for understanding and evaluating this new technology. *See* http://research.yahoo.com/node/207.

The goals of Yahoo!'s public experiments are two-fold: to produce useful data about consumer trends and to evaluate alternative market designs for their efficacy. Having better data about consumer trends and search volumes helps Yahoo! improve the quality of its search engine, which is important to improving the public's ability to access information readily, and the relevance of its advertisements, from which Yahoo! derives billions of dollars in revenue annually. It also helps its product developers and others better anticipate future areas of consumer demand.

Yahoo! also uses prediction markets by incorporating them into its content pages. For example, Yahoo! News highlights prediction market odds on its popular Election Dashboard product, which is viewed by tens of millions of people. *See* http://news.yahoo.com/election/2008/dashboard.

As part of its research into internal prediction markets, scientists within Yahoo! Research have published a dozen academic papers including data analyses of existing markets and designs for next-generation markets, filed half a dozen patent applications, and organized four workshops on the topic.

Future Evolution

CIM believes that the performance of the experimental prediction markets described above would be enhanced if traders were able to commit funds to their trading positions, even if the potential stakes are limited. CIM further believes that this step is necessary for these markets to reach their potential with the associated benefits to the public. This evolution can and should be fostered by the Commission under its Congressional mandate to foster innovation in the futures markets.

Statutory and Regulatory Background Encourages Innovation

Congress has encouraged the Commission to administer the Commodity Exchange Act, 7 U.S.C. 1 *et seq.* ("Act") in a flexible manner, furthering market innovation to the greatest degree possible. Indeed, in enacting legislation to comprehensively regulate commodity futures trading in 1974, Congress was aware that non-traditional futures contracts, such as possible futures contracts on mortgages and ocean-freight rates, were being developed.[2] It is clear that the broad definition of "commodity" under the Act, which is in contrast to the prior practice of Congress of enumerating those "commodities" which were subject to the Act, underscored Congress' intent that the Act be sufficiently broad to apply to new and innovative futures contracts as they are developed.[3]

Equally important, in 1992 Congress added Section 4(c)(1) to the Act, granting the Commission broad authority to exempt any agreement, contract or transaction from any of the provisions of the Act.[4] Congress added this broad exemptive authority "in

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[2] *See e.g.* H.R. Rep. No. 975, 93rd Cong. 2d Sess. 76 (1974).

[3] In the absence of such a broad application of the meaning of "commodity" it might be possible to return to the situation prior to the 1974 amendment wherein futures trading in some contracts was unregulated by the Commodity Exchange Authority, the Commission's predecessor agency, because the contract's underlying was not within the definition of "commodity." Prior to the Commodity Futures Trading Commission Act of 1974, the "commodities" covered by the Act were specifically enumerated. Thus, in order for the Commodity Exchange Act to apply to a new contract, Congress was required to amend the Act and enumerate the new "commodity." This meant that some futures contracts were regulated under the Act and others were not. By adopting such a broad and flexible definition of "commodity" Congress clearly intended that all futures contracts that could trade on an exchange would be regulated under the Act as such.

[4] *See* Section 203 of the Futures Trading Practices Act of 1992 (the "1992 Act")

order to promote responsible economic or financial innovation and fair competition."[5] As the Commission notes, "under Section 4(c), the Commission has the discretion to grant an exemption to certain classes of transactions without having to make a determination that such transactions are subject to the Act in the first instance." Concept Release, 73 *Fed. Reg.* at 25672. The Commission further notes that it may use its exemptive authority "to establish a set of regulatory provisions applicable to a defined class of products." *Id.* at 25673.

Congress, through its enactment of the Commodity Futures Modernization Act of 2000 ("CFMA"), again reaffirmed its intent that the Commission administer the Act flexibly and to further market innovation. A primary purpose of the CFMA was "to promote innovation for futures and derivates."[6] The CFMA does so by replacing prescriptive, one-size fits all regulation with a system of principles-based regulation. The overarching principle of the CFMA is that the level and degree of regulation will vary depending upon the type of market participant and the nature of the commodities traded. Based upon this principle, the CFMA establishes a system of tiered regulation wherein the degree and nature of regulation varies depending upon the nature of the market regulated. Thus, some market tiers are subject to fewer or different regulation depending upon the nature of the market participants and the commodities traded.

The Commission throughout its history has responded affirmatively to the Congressional mandate to foster innovation in futures trading and in futures markets. The Commission re-introduced exchange-traded options, initially through a very successful pilot program.[7] It fundamentally altered the concept of what constitutes a futures contract by approving the introduction of financial futures, including approving the first contracts on broad-based indexes of securities. Even more significant, the Commission approved the first cash-settled futures contract, making it possible to construct and trade futures contracts on any intangible interest which is otherwise incapable of being delivered. Through this action, it has become possible to construct and trade futures contracts on various formulae or mathematical constructs, including indexes or other underlying interests that may not be related to price levels, such as contracts on weather and climate conditions, crop yields, bankruptcy filings, credit default events and events such as the possible merger of two companies. At the time of the introduction of these innovative contracts, doubts were raised with respect to whether such contracts could be considered to be contracts for future delivery of a commodity

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[5] Section 4(c)(1) of the Act provides that the Commission may exempt any contract, agreement or transaction from any of the provisions of the Act if the exemption is consistent with the public interest. The Conference Report to the 1992 Act stated that the public interest should include the national public interests of the Act, the prevention of fraud and preserving the financial integrity of the markets, *in addition to promotion of responsible economic or financial innovation* and fair competition. House Conference Report No. 102-978, p.78.

[6] Section 2(6) of the Commodity Futures Modernization Act of 2000, Pub. Law No.106-554, 114 Stat. 2763.

[7] *See* 46 *Fed. Reg.* 54500 (Nov. 3, 1981).

within the meaning of the Act. Nevertheless, the Commission in each instance chose to facilitate innovation and these innovations are now widely accepted.

Event Markets Fall Within the Act

As the Commission noted in the Concept Release, "the regulatory purview of the Act extends to and includes transactions that are either structured as options or futures when such transactions involve interests that constitute commodities under the Act." Concept Release at 2561. As the Commission further notes, "A significant number of event contracts are structured as all-or-nothing binary transactions commonly described as binary options." Concept Release at 25670. The Commission also points out that event contracts can also price consensus estimates of moving values, the same as any commodity futures contract. The internal prediction markets operated by the Coalition members currently list binary options on the occurrence or non-occurrence of a discrete event or of a number of mutually exclusive alternatives.[8] Accordingly, the primary issue with respect to whether and how these markets should be regulated by the Commission is whether the underlying subject of the contracts are "commodities" within the meaning of the Commodity Exchange Act, 7 U.S.C. §1 *et seq* ("Act").

Congress has defined "commodity" under the Act in very broad terms. Prior to creation of the Commission, the Act covered only those underlying interests that were enumerated in the Act. The Commodity Futures Trading Commission Act of 1974, Pub. L. No. 93-463, extended the definition of "commodity" to include "all services, rights and interests in which contracts for future delivery are presently or in the future dealt in." Section 1a(4) of the Act. Congress, in 1974 was aware that non-traditional futures contracts were being developed such as possible futures contracts on mortgages and ocean-freight rates, and intended to include within the regulatory scheme governing futures trading "all commodities, goods, articles, services, rights, and interests which are or may be the subject of futures contracts."[9]

The definition of "excluded commodity" under section 1a(13) of the Act provides additional clarity to the meaning of "commodity" under the Act. A commodity that is defined as an "excluded" commodity must, in the first instance, be within the broader definition of "commodity." Section 1a(13)((iii) and (iv) define an "excluded commodity" as including:

> (iii) any economic or commercial index based on prices, rates, values, or levels that are not within the control of any party to the relevant contract, agreement, or transaction; or

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[8] Although the more typical contract currently used is a binary contract on a discrete event or several mutually exclusive alternatives, CIM's members may in the future also list contracts on moving values.
[9] H.R. Rep. No. 975, 93rd Cong. 2d. Sess. 76 (1974).

> (iv) an occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or level of a commodity not described in clause (i)) that is—(I) beyond the control of the parties to the relevant contract, agreement, or transaction; and (II) associated with a financial, commercial, or economic consequence.

Importantly, the section 1a(13)(iii) definition recognizes that the index which is a "commodity" need not be based on price levels, but may also be based on any economic or commercial index on a "rate, value or level" not within the control of the parties to the contract. Similarly, section 1a(13)(iv) leaves open the possibility that the occurrence, extent of occurrence or contingency need not be based on price, but may be on any rate, value or level that is not within the control of the parties to the contract, so long as it is "associated with a financial, commercial or economic consequence." Accordingly, the very broad definition of "excluded commodity" makes clear that a contract for future delivery of a commodity need not be based on fluctuations in the price level but may be based on any occurrence or contingency relating to any value not within the control of the parties to the contract that is associated with a financial, commercial or economic consequence. Options or futures contracts on weather, climatic conditions, bankruptcies or crop yields all can be described in this manner. So too, can the types of commercially-related events, circumstances or contingencies listed for trading on our internal markets.[10] Thus, it is clear that the Act does apply to certain, if not all, event markets and that clarification by the Commission of its views with respect to the operation of these markets under the Act is an appropriate and necessary step in fostering their development.

CIM's Proposal

CIM believes that the Commission should exercise its section 4(c) exemptive authority and propose rules specifically adapted to, and permitting, the operation of small-stakes event markets. CIM believes that small-stakes event markets of the kind first developed by the Iowa Electronic Markets[11] have the potential to provide significant public benefits and recommends that the Commission propose regulations under which such markets may operate, both as internal markets or as public markets. However, CIM strongly believes that the potential benefits of these markets should not be restricted to markets operated by academic or other non-profit entities. The members of CIM are public, for-profit companies that are committed to research and development and to introducing new technologies that improve the communication of knowledge. Accordingly, it is in the public interest and is consistent with the continued leadership of

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[10] Our markets also include contracts that are intended merely to maintain trader interest in the market. As we explain in greater detail below, we believe that such contracts should be eligible to be listed on an internal event market pursuant to Commission rules adopted under the Commission's section 4(c) exemptive authority.

[11] Concept Release , 73 *Fed. Reg.* at page 2570.

the United States in the information sciences for the Commission to permit for-profit companies to participate in the development and evolution of these innovative markets.

In this regard, CIM believes that it is very much in the public interest for the Commission to apply the principles of its New Regulatory Framework proposal (and of the CFMA) in formulating a regulatory approach to the operation of small-stakes event or "prediction" markets. These principles are that the regulatory requirements that apply to a particular market tier will be appropriate to address four regulatory goals: 1) ensure the integrity of the market; 2) deter manipulation, 3) protect the market's financial integrity and 4) protect customers.[12] CIM believes that small-stakes markets—whether internal or public—share characteristics that would broadly guide the Commission's regulatory approach to such small-stakes markets. However, there are differences between internal and public small-stakes markets which would result in differences in how they might meet the regulatory goals and the procedures that the Commission should use in authorizing the markets to operate.

CIM believes that the benefits of event markets can be realized through trading by interested persons with limitations on the amount any trader may risk in the market and limitations on a trader's overall losses. Unlike the traditional futures market, which provides commercial entities with a mechanism for hedging and thereby requires larger, commercial-sized exposures by traders, the information aggregation functions of event markets can occur when traders risk only modest sums. But permitting traders to risk even modest sums, we believe, yields a marked improvement in market performance over the current practice of experimental internal markets of offering fixed prizes as an incentive to traders or of certain public event markets of offering no external trader incentive. Accordingly, CIM believes that there would be significant public benefits if the Commission, through the exercise of its section 4(c) authority, establishes a framework for the operation of small-stakes event markets, making appropriate distinctions between internal and public markets. This new regulatory tier for small-stakes event markets would be a complement to the current statutory tiers of designated contract market, derivatives transaction execution facility and exempt board of trade.

A small-stakes market tier would be characterized by limitations on the amount that a trader could risk at any one time, or lose over a defined period of time, as a consequence of trading in the market. CIM recommends that an appropriate limitation on the amount at risk at any one time or the amount that can be lost over the course of a year be U.S.$2,000, indexed for inflation. The market would be non-intermediated and would be required to be electronic. As explained in greater detail below, in reliance upon the 4(c) exemption, the market would be able to list for trading futures or option contracts on any contingency, extent of a contingency or other event or occurrence except for classes of events, such as the outcomes of sporting events, that are prohibited by Commission

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[12] "A New Regulatory Framework," Report of the Staff Task Force, http://www.cftc.gov/files/opa/oparegulatoryframework.pdf (February 2000) at v.

rule.[13] These basic standards establishing the criteria for qualifying to operate a market in this tier would be incorporated in Commission rules.[14]

It is important to distinguish that small-stakes markets may be either internal markets or public markets. Although both may be used by companies in making business-related decisions, the two types of small-stakes markets serve very different functions. An internal event market is used by the company as a means of assisting in internal decision making. Internal markets limit market participation to persons with an affiliation to the company or institution operating the market. Companies use internal markets to provide employees with an anonymous means of providing feedback to management, of aggregating information through an anonymous, apolitical, democratic process for expressing opinion and as an alternative to existing information aggregation mechanisms within the company. Small-stakes markets may also be open to members of the public for trading, like the Iowa Electronic Market (which operates under a Commission no-action letter). Public small-stakes markets may serve a number of purposes, including permitting a company to gather information on issues relevant to its business from a large cross-section of the public, as a mechanism for a company to communicate with its potential customer base and as a means for a company to better discover and understand potential business and social trends which may affect its business.

Market Operation Subject to Core Principles

The operation of a small-stakes market, regardless of whether it is an internal or public market, would be subject to Core Principles. These would include, for example, the broad requirements that:

- The market establish trading rules, which may be in the form of protocols or a disclosure document, which specify how trading, and trade matching, shall take place on the market,

- The market establish a robust trade matching engine to match bids and offers , or in the case of a single market-maker model –to make bids or offers into the market,[15] which may be developed and/or operated by technology service

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[13] In concept, this follows the Commission's reasoning and form in its proposal for a derivatives transaction facility. See, "A New Regulatory Framework," at 10. *See also* "A New Regulatory Framework for Multilateral Transaction Execution Facilities, Intermediaries and Clearing Organizations," 65 *Fed. Reg.* 77962, 77969 (December 13, 2000).

[14] *See e.g.*, Part 37 rules, *Id.* at 77982

[15] It is important to note that certain internal event markets have developed using, and currently operate under, a single market-maker model. In this model, an automated market maker is the universal counterparty to every trader. Generally, the bids and offers that the automated market-maker puts into the market are derived from an analysis of the interaction of buying (selling) sentiment of the market participants and the existing open interest. The automated market maker at any particular time, may have a

providers and which captures information that can be used in determining whether violations of the trading rules or protocols has occurred;

- The market establish rules, which may be in the form of trading protocols or a disclosure document, to deter trading and market abuses, and that the market have the power and capacity to address violations thereof;

- The market establish appropriate criteria that participants must meet;

- The market establish rules, which may be in the form of trading protocols or a disclosure document, detailing the financial framework which shall apply and which ensures the financial integrity of transactions entered into on its facilities;

- As appropriate to the size of the market, the number of participants whether it is a public market and other factors, the market have a program to monitor trading on the market for fair and orderly trading and have and exercise authority to maintain a fair and orderly market;

- The market provide information to the Commission as requested about the market, its operations and transactions thereon as well as other relevant information;

- Internal and public small-stakes markets shall make available to market participants information with respect to current prices, bids and offers in the market; public small-stakes markets shall make publicly available information with respect to actively traded products information on volume, open interest and daily opening and closing prices; and

- The market shall keep books and records (including trading records) available in a form and manner acceptable to the Commission for a period of five years.

CIM contemplates that the manner in which internal and public small-stakes markets would meet the above Core Principles might differ significantly. This is consistent, however, with the Commission's recognition that there are a variety of acceptable practices which may meet the requirements of a Core Principle. For example, an internal market run by a company would have as its chief purpose the generation of information (by means of discovering prices in the market) for use by the company in the conduct of its business. Accordingly, an internal market would not be expected to make generally available to the public information with respect to market prices relating to a particular event contract. Indeed, it is conceivable that a company may treat the trading results of an internal market as confidential, proprietary information and require market participants, as a condition for participation, to keep their trading information

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net long or short position. This model benefits the market by providing a ready source of liquidity and may be a more intuitive means of trading for novice traders than a traditional, double-sided auction market.

confidential. In contrast, a public small-stakes market would be required to make generally available certain information, as is any other Commission-regulated public market. As provided in the Core Principle, this would include at a minimum the open and closing prices for the contracts traded thereon. Additional information generated through trading on the market, consistent with current industry practice, would be the property of the exchange operator and could be used by the market operator or sold to others.

Under the Core Principles, the individual markets would establish the specific criteria that market participants would be required to meet. With regard to internal markets, the markets could be available to employees, direct vendors/vendees, contractors and others, as defined by the market, that are directly involved in the firm's business activities. The firms could establish additional requirements or criteria as they deem appropriate for access to , or the conduct of, their markets. For example, firms may wish to permit only certain of their employees from participating in the market, such as engineers; or they may wish to restrict participation by supervisors or persons with superior knowledge of the firm as a consequence of their position, or they may wish to include a limited number of invited experts to participate . The applicable criteria would be included in the rules or protocols of the market.

In contrast, by definition, public markets would be broadly open to potential market participants. A public market would be required to establish appropriate participation criteria for potential market participants. Because of the small stakes requirements and the non-intermediated nature of the market, however, those criteria would likely be modest, and might be limited to proof of identity, being legally able to enter contracts, bona fide access to a credit card with a sufficient line of credit to ensure the financial integrity of the transaction, having access to proper and sufficient internet connectivity and other similar requirements.

Included among the requirements that would apply to market participants in both internal and public small stakes markets would be adherence to the $20000 limit on losses or on funds at risk. Each small stakes market would be required to take reasonable steps to ensure compliance with the limit, including taking reasonable steps to detect and deter a trader from evading the limit by establishing multiple accounts at the same market. These might include checking for duplicate credit card numbers, conducting credit checks where appropriate and surveilling the markets for coordinated trading patterns.

CIM believes that acceptable practices for these small stakes markets with respect to the nature of the trading mechanism should be broad. Some currently operating experimental internal markets operate through a mechanism whereby the market operator acts as the universal market maker and counterparty. This universal market maker takes into account market depth and trader sentiment in determining the bid and offer price for all contracts offered to the market. Market experience has been that this mechanism offers novice traders a more intuitive and accessible means of trading than a double-sided

auction trading mechanism. In light of the fact that some experimental internal and public event markets currently make use of a single market-maker mechanism, CIM believes that it is an appropriate exercise of the Commission's section 4(c) authority to include such a trading model within the rules for this type of small-stakes market.

Finally, the market would be required to have a robust electronic system for trade matching or for offering bids and offers to the market if using a universal market maker model. The electronic system and various other components of market operation could be provided by service vendors to the market operator. With respect to internal markets, the market could be operated by a vendor under contract to the sponsoring company or as a joint venture among two or more participating companies.

Products

As discussed above, internal and public event markets have relied upon offering a mix of contracts, including some based on popular-culture, to maintain trader interest. Thus, the offer of certain high-interest contracts provides the liquidity to the market that sustains trading in contracts that may provide greater public benefits with respect to the type of information provided.[16] CIM believes that this will remain true in the context of small-stakes internal and public markets. Unlike traditional futures markets, where liquidity providers, such as locals or other similar traders can earn significant returns from their trading activity, it is unlikely that small-stakes markets will offer liquidity providers such opportunities. Thus, although trading real funds may make market participants more serious with respect to their trading activities, market participants may still be motivated by access to the opportunity to trade a mix of contracts, including some that are popular-culture based contracts.

Accordingly, CIM believes that as an exercise of its section 4(c) exemptive authority, the Commission should permit a broad array of contracts to be listed. This can be accomplished by using a structure similar to that of the Derivatives Transaction Facility which the Commission proposed as part of its New Regulatory Framework. Under that structure, the Commission approved the operation of the market and permitted the market to list contracts that under Commission policy or rule may not have been subject to regulation as futures contracts under the Act.[17] The Commission could

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[16] Google, in the operation of its current internal market, uses such popular culture contracts as 'training' markets to acquaint novice traders with how the market operates. Google has also found statistically that the inclusion of popular-culture or 'fun' markets increases liquidity overall on the trading platform, including the liquidity of the contracts geared at eliciting information that is directly applicable to operation of the business.

[17] This broad structure has been carried over by the CFMA into the structure of the Act governing Derivatives Transactions Execution Facilities. Under section 2(g), a DTEF is permitted to list for trading any contract, agreement or transaction on an exempt or excluded commodity other than securities. Prior to enactment of the CFMA, the Commission adopted a similar structure under its section 4(c) authority which would apply to the market tier that it denominated as a Derivatives Transaction Facility. Such a structure

include in this regulatory approach enumerated classes or categories of contracts that by rule would not be permitted to be traded on the section 4(c) exempt market. Through this approach, for example, the Commission could make clear that contracts on the outcome of specific sporting events and other enumerated types of contracts would not be permitted to trade on the small-stakes market.

Market Authorization or Registration Process

CIM contemplates that the Commission would establish separate procedures for the authorization or registration of internal and public small-stakes markets in light of the differing regulatory interests raised by these two types of markets. CIM suggests that the appropriate authorization process for internal event markets is by notice to the Commission, similar to that applicable to Exempt Boards of Trade. Section 5d of the Act provides that Exempt Boards of Trade may operate upon receipt by the Commission of a notice, provided in the form and manner established by the Commission, of the market's intent to operate as an exempt board of trade. CIM believes that the notification procedure which should apply to internal event markets would be quite similar to the notice registration procedures for Exempt Boards of Trade established by the Commission in Part 36 of its Rules, 17 C.F.R. Part 36.

Specifically, CIM recommends that internal event markets be authorized to operate subject to the conditions noted above; that is, 1) the market limits participation to employees and other affiliated persons; 2) the amount traders may put at risk or lose is limited; 3) the market agree to adhere to applicable Core Principles, including recordkeeping requirements; and the products listed for trading not include any product that the Commission has prohibited. A notification provision would require the market operator to identify itself to the Commission and to certify that it complies with the safe-harbor requirements for operation as an internal event market.

CIM believes that based upon the private nature of the market a notification process for market authorization is appropriate for internal event markets. Although as discussed above, there are public interest benefits in the ability of such markets to operate, the Commission's interest in formally vetting an application for registration and in conducting on-going market oversight is limited because of the essentially private nature of these markets' operation. For example, because companies offering internal markets can be expected to ensure that their employees are adequately protected when participating in an internal market, there would be few, if any, concerns about customer protection. For a company to do otherwise would risk jeopardizing the larger relationship between the employer and its employees. Moreover, because information derived from internal markets is generally treated as proprietary, traditional regulatory concerns with respect to the reporting of non-bona fide market prices to the public—either through manipulative or other abusive practices-- are alleviated. Finally, the conditions for

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would be an appropriate means of permitting small stakes markets to list a wide variety of contracts in order to maintain participant interest and thereby support market liquidity.

meeting the exemptive relief, which constitute a safe-harbor, are sufficiently clear and understandable so that a market could self-certify to its adherence to the conditions of the safe-harbor.

CIM believes that with respect to public, small-stakes event markets an expedited procedure for registration by the Commission is appropriate. CIM contemplates that as part of this expedited registration and review procedure, the market would be required to demonstrate its ability to operate in compliance with the relevant Core Principles. CIM believes that Part 37 of the Commission's rules provides a good starting point for the procedures to be used in the registration process for small-stakes markets. As under Part 37 of the Commission's rules establishing the procedures to register DTEFs, the Commission should establish an expedited procedure whereby it approves or denies an application for registration as a public small stakes market. In this regard, CIM recommends that the Commission provide for automatic registration of a public small stakes market ninety days after a notice of registration and demonstration of compliance with Core Principles is filed. The Commission would be able to extend the period for an additional ninety-days for complex or novel notifications. After that period, the Commission would be required to disapprove a notice of registration or let the registration become effective. Individual contracts traded on the market could be listed for trading following self-certification by the market no less than one day prior to listing.

CIM believes that Commission vetting of applications by public event makets is appropriate in light of the ability of the public to access the market and the requirement that the public market make generally available certain pricing and other information. Review of such applications will ensure that appropriate safeguards are in place before they begin trading. However, it is crucial that in establishing its procedures, the Commission provide the level of review of an application that is appropriately geared toward the small-stakes nature of the market. Review of an application would be more than a simple notice filing that would be required for an internal event market and that is currently required for an Exempt Boards of Trade[18], but in light of the limitation on the amount that participants can trade, review should be less than that of a DTEF.[19] In this regard, the nature of the review process must be modulated and in harmony with the small-stakes nature of the market.

CIM also contemplates that the Commission specifically recognize in its procedures that markets may rely on third party software and hosting entities to initially set-up, or to operate, a public event market.[20] CIM believes that the Commission's market registration procedures for public, small-stakes event markets should provide for the approval of standardized vendor-supplied trading and regulatory compliance

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[18] *See* 17 C.F.R. §36.2(b).

[19] See 17 C.F.R. §37.5(b)

[20] Such companies may also set up and operate internal markets for companies. However, in light of the notice registration provision that would apply to internal markets, there would be no special procedure needed with respect to hosted markets.

packages that can be offered to market operators as an off-the-shelf market solution or that the vendor can use such standardized and pre-approved systems to operate the market on behalf of a company. CIM believes that such a prior approval should be taken into consideration in a review under the normal 90 day review process to each new client of such a vendor. Instead of requiring each such client company to complete a full market registration application, CIM recommends that the Commission approve the vendor's trading and compliance systems and that it permit an abbreviated registration of each public, small-stakes event market using the vendor's systems.

As discussed in greater detail in our responses to the Commission's specific questions, small stakes event markets are capable of providing unique public benefits. This is especially true for internal, small-stakes event markets. By providing these markets with greater legal certainty, the Commission would further the public interest by assuring that their benefits would continue to be available. The Commission has authority under section 4(c) of the Act and under other provisions to provide legal certainty to these markets. Congress has encouraged the Commission to support innovation in futures trading and in futures markets.

The Commission in its New Regulatory Framework, which was largely codified by Congress in the CFMA, recognized the merit of tailoring regulatory requirements depending upon the nature of the market and of the market participant. It would be a natural extension of the current regulatory scheme for the Commission to recognize the need for and appropriateness of a regulatory tier geared toward small-stakes event markets. The regulatory tier would provide for a streamlined registration procedure and would establish operating Core Principles that are consistent with the safeguards incorporated in the characteristics and access limitations of the market.

CIM urges the Commission to propose and adopt rules establishing such a regulatory framework so that event markets, both internal and public, can reach their potential and thereby provide significant public benefits.

With these recommendations in mind, we are pleased to respond to the Commission's specific questions.

Public Interest

1. What public interests are served by event contracts that are designed and will principally be traded for information aggregation purposes and not for commercial risk management or pricing purposes?

2. How are these interests consistent with the public interest goals embodied in the Act?

3. What calculations, analyses, variables, and factors could be used to objectively determine the social value of information to the general public that may be discovered through trading in event contracts? Should this be a factor in determining whether the

Commission plays a role in regulating these markets?

Event markets have great potential to serve the public interest goals embodied in the Act. However, it should be noted that until the Commission provides greater legal certainty with respect to the operation of these markets, their public benefits will remain largely untapped and theoretical. In this regard, it should be noted by the Commission that futures contracts traded for many years before Holbrook Working in his seminal works on futures trading articulated how futures contracts were used for hedging and price basing.

This situation is not unique to event markets and has been true to some degree with respect to each of the major innovations made in futures trading. Trading experience and the behavior of particular instruments in various market settings is an important means of determining the relevant analyses and factors to make objective determinations about trading vehicles. For example, as noted above, one of the great advances in futures markets has been the reintroduction of options on futures contracts. Prior to the Commission's pilot program to reintroduce exchange-traded options, the degree to which they would be traded was unknown. Moreover, a full understanding of financial futures, including issues such as the role of the cheapest to deliver, was gained only after the contracts were listed and traded. Similarly, prior to their introduction, it could be theorized whether and how climate and weather contracts would be used, but their actual use by commercial interests could be studied only after introduction and trading.

Despite the fact that the full extent of the public benefits of event markets will be discovered only after they are traded more widely, there is already a very significant body of academic scholarship attesting to the public benefits that may be derived from the trading of event markets.[21] Based on experience of various experimental markets it is apparent that event markets serve the same public interests as traditional futures trading.

Futures trading benefits the public in two ways. Centralized trading provides useful information by aggregating the opinions of individual participants through a centralized market trading mechanism. Traditionally, this has been a consensus with respect to a future price level of a commodity, but it has also included consensus opinions on non-price information such as future crop yields, future interest rate levels, the level of regional insured property losses, bankruptcy filings or weather conditions. This permits market participants to make better informed decisions with respect to their allocation of resources, benefiting not only the market participant, but society at large. The public is similarly served by the operation of internal markets by benefiting from the more efficient allocation of resources that is possible when a company uses an internal market to assist it in its internal decision making.

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[21] *See e.g.* Robert W. Hahn and Paul C. Tetlock , "*Information Markets, A New Way of Making Decision,*" http://aei-brookings.org/admin/authorpdfs/redirect-safely.php?fname=../pdffiles/phpoY.pdf

Secondly, traditional futures markets have benefited the public by offering individual market users the ability to hedge an exposure that they have. Although small stakes event markets will have limited ability to serve this function, public event markets certainly may. For example, manufacturing firms may have exposure to non-price related events, such as the timing of a scientific breakthrough. An event market would offer such a company one means to lay-off part of this risk. Of course, to the extent that the market is limited to small-stakes trading, direct risk-shifting through the market necessarily would be limited. Nevertheless, the consensus opinion that is indicated through the market price would provide the company with important information that it could use in determining its risk and how to address that risk.

Accordingly, both internal and public event markets have the potential to serve the public interest in very much the same way as traditional futures markets. As the Commission notes in the Concept Release, Congress recognized that commercial interests are able to look at properly functioning futures markets to "facilitate the making of marketing, financing, and distribution decisions." Concept Release, 73 *Fed., Reg.* 25672, note 14. Internal markets serve precisely this function for the companies that operate such markets. Public event markets serve this function, as well.

C. Jurisdictional Determinations

4. What characteristics or traits are common to or should be used to identify event contracts and event markets?

Event contracts that take the form of futures contracts or options are amenable to the Commission's jurisdiction. Thus, the basic identification that need be made is whether the structure of the traded instrument is a contract of sale for future delivery or an option. Under CIM's proposal, if the contract falls within the definition of either of these instruments, then the Commission's regulatory framework would apply to those markets that register with the Commission under the applicable regulatory framework. This approach, using the Commission's exemptive authority under section 4(c), relies on a market's adherence to the terms of the Commission's rules in order for it to operate within the parameters of the exemptive relief.[22]

5. How do these characteristics and traits differ from those of commodity futures and options contracts that customarily have been regulated by the Commission? How are they similar?

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[22] As explained above, this approach is similar to the Commission's proposal to establish administratively the regulatory framework that would have applied to Derivatives Transaction Facilities. *See also* section 5a(g) of the Act.

CIM has proposed including within the framework that would apply to this market tier certain provisions that may address possible differences between traditional futures contracts and contracts on events that have been traded in more experimental settings. For example, in light of the fact that most internal markets and experimental event markets have provided for either low notional amount contracts or limitations on the amount that may be traded, CIM has included such a limitation in the regulatory framework that it is proposing. CIM has also proposed that this regulatory tier provide for non-intermediated trading and that trading be only electronic.[23] These requirements do not necessarily address distinctions between event contracts and other types of futures contracts, but rather address particular characteristics of certain markets that may seek to trade event markets.

These regulatory distinctions, however, would not prohibit event contracts from trading in other appropriate regulatory tiers, subject to greater regulatory requirements. For example, nothing in CIM's proposal would prohibit a designated contract market from listing a binary option for trading, for example, under the full regulatory scheme that applies to such markets.

6. Are there criteria based on the provisions of the Act that could be used to make jurisdictional determinations with respect to event contracts and markets?

7. Given the purposes and history of the Act, would it be appropriate for the Commission to apply a test premised on commercial risk management or pricing functions to demarcate the Commission's jurisdiction over particular contracts? If so, what factors could be used to make such a determination?

As discussed above, CIM believes that the structure of the CFMA, including in particular the structure of permitted instruments that may be traded on a DTEF provides the best template for addressing the issue of what contracts can be listed for trading on the type of small-stakes market that we are proposing. Following the overall structure of the CFMA, the regulatory framework which would apply to trading in internal and public event markets would be largely determined by the nature of the participants permitted to trade on the market and the other access limitations that we have suggested. Using this structure, the most critical issue for the Commission is whether the regulatory framework applicable to the market tier is appropriately calibrated to the nature of the market and the traders thereon.

8. Given the purposes and history of the Act, would it be appropriate for the Commission to apply any test premised on the economic purpose of certain types of transactions to

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[23] By recommending that small-stakes event markets be non-intermediated, CIM does not mean to suggest that these markets could not operate as they presently do, using a centralized market maker which is the universal counterparty to all market participants. Rather, the requirement that markets be non-intermediated means that all market participants act in the capacity as principal and that no agency trading be permitted.

demarcate the Commission's jurisdiction over particular contracts? If so, what factors could be used to make such a determination?

As the Commission notes in the Concept Release, when exercising its section 4(c) exemptive authority the Commission need not make a jurisdictional determination.[24] Moreover, section 4(c) provides that the Commission may exercise its exemptive authority under that provision when "the exemption would be in the public interest."

As the Commission notes, former section 5(g) included a public interest test for designation of individual contracts. That section 5(g) public interest test incorporated within its scope an "economic purpose test."[25] The economic purpose test was used by the Commission in determining whether to designate individual contracts. The economic purpose test required that the proposed "contract reasonably can be expected to be or has been, used for hedging and/or price basing on more than an occasional basis."[26] It should be noted that the public interest test of former section 5(g) of the Act was repealed by Congress in 2000. Congress instead chose to permit contract markets to self-certify that proposed contracts would be in compliance with the Core Principles of the Act. In light of Congress' repeal of former section 5(g) and its included economic purpose test, the Commission should avoid imposing new requirements which would appear to resurrect that provision.

Nevertheless, section 4(c) itself contains a public interest provision separate from that of the former section 5(g) of the Act. The Commission could apply section 4(c)'s public interest standard by making clear in its adoption of an exemption under section 4(c) that certain classes of contract do not come within the exemptive relief provided. For example, the Commission could make a determination that inclusion of event contracts on the outcome of individual sporting events and other specifically defined classes of contracts would not be within the public interest. This would be an appropriate expression and exercise of its responsibility under the section 4(c) public interest authority separate from and different than the repealed economic purpose test.

As CIM discussed above, certain event contracts relating to popular culture when listed on small-stakes markets serve the public interest by acting as liquidity catalysts. In this way, they are akin to the role played by professional traders in traditional markets. The Commission should take this into account in enumerating categories of contracts that may not be listed for trading in this market tier. Taking into account the role that such popular-culture related contracts can play in maintaining interest by casual, small-stakes traders, the Commission should restrict only those contracts the listing of which on these markets the Commission determines to be specifically contrary to the public interest. The Commission in making that determination should consider whether the class of contracts

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[24] Concept Release, 73 Fed. Reg. at 25672.
[25] *Id.*
[26] 17 C.R.R., Part 40, Appendix A(a)(4).

so restricted has traditionally been differentiated from futures contracts, whether the contracts are subject to alternative Federal or State regulatory schemes, whether their listing might touch upon National security issues or whether their listing would otherwise be clearly repugnant to the public interest. Although this is a different analysis of the public interest from the repealed economic purpose test, it is an appropriate measure of the meaning of the "public interest" standard included in the section 4(c) exemptive authority.

9. What calculations, analyses, variables and factors would be appropriate in determining whether the impact of an occurrence or contingency will result in a financial, commercial or economic consequence that is identified in Section 1a(13) of the Act?

10. What calculations, analyses, variables, and factors would be appropriate in determining whether an economic or commercial index that is based on prices, rates, values, or levels should or should not qualify as an excluded commodity under Section 1a(13) of the Act?

11. What identifiable factors, statutorily based or otherwise, limit the events and measures that may underlie event contracts when such contracts are treated as Commission-regulated transactions?

As discussed above in its proposal, CIM believes that the Commission should exercise its section 4(c) authority as broadly as section 4(c) permits by exercising its exemptive authority (subject to the conditions of the applicable regulations) without definitively characterizing the instruments. Rather, the Commission should determine what types of event contracts would be repugnant to the public interest to be traded on an appropriately regulated internal or public small-stakes market.

Clearly, gaming has been subject to alternative regulatory frameworks and contracts on the outcome of individual sporting events should not be included within the exemptive relief. The Commission has also raised the questions of whether listing contracts relating to terrorism or assassinations are repugnant to the public interest.

12. What objective and readily identifiable factors, statutorily based or otherwise, could be used to distinguish event contracts that could appropriately be traded under Commission oversight from transactions that may be viewed as the functional equivalent of gambling?

Gaming is prohibited under a number of Federal and state statutes, and the definitions contained in those statutes would be a good beginning point in differentiating bona fide event contracts from gaming contracts. Clearly, gambling has been commonly thought of in connection with betting on the outcome of individual sporting events and games of chance. Thus the Commission might construct a definition by way of

examples, and expand the list or provide other guidance in response to case-by-case queries.

13. The Commission notes that Section 12(e) of the Act generally provides that the CEA supersedes and preempts other laws, including state and local gaming and bucket shop laws, with respect to transactions executed on or subject to the rules of a Commission-regulated market, or with respect to transactions exempted from the Act pursuant to the Commission's exemptive authority under Section 4(c) of the Act. What are the implications of possibly preempting state gaming laws with respect to event contracts and markets that are treated as Commission-regulated or exempted transactions?

14. Should certain underlying events or measures--such as those based on assassinations or terrorist activities--be prohibited altogether due to the social perception and impact of such events? What statutory or other legal basis would support this treatment?

CIM's members will not list such contracts for trading on their markets and consequently take no view on whether such contracts should be permitted under the Commission's regulatory framework. However, it is possible that the Commission may wish to consider whether it should differentiate between internal and public markets in its consideration of this issue.

15. Are there event contracts, such as political event contracts, that should be prohibited from trading under the Act, or that deserve separate treatment or consideration, due to the nature and importance of their outcomes? What statutory or other legal basis would support this treatment?

Event contracts on political events currently are traded pursuant to a Commission no-action position. The long history of trading in these contracts supports making such trading available to other market operators under a transparent regulatory framework.

D. Legal Implementation

16. Is it appropriate for the Commission to direct certain or all event contracts onto markets that are regulated differently from and perhaps less stringently than DCMs? For example, it may be warranted or necessary to treat event markets that aggregate information solely for academic or research purposes, event markets set-up for internal corporate purposes, or event markets that offer exceedingly low notional value contracts to traders differently than markets that possess the attributes of traditional DCMs.

CIM believes strongly that it is in the public interest for the Commission to establish an additional regulatory tier for small-stakes internal and public markets. Establishing such a regulatory tier would enable those internal and experimental public markets to introduce small-stakes trading to their venues. This will foster market innovation, particularly with respect to the trading of internal event markets.

In this regard, it should be stressed that a variety of companies currently operate internal markets and a number of experimental, non-monetary based public event markets are already trading. Our proposal is motivated by our belief in the great promise that we see in these current experiments and in their ability to further the public interest goals of the Act. We believe that these markets would be able to better fulfill their potential promise if market participants could put at risk limited amounts of their own capital to trade. This is a significantly different market model from that of DCMs, DTEFS or EBOTs. Accordingly, we believe that event contracts should not be forced to trade on any one type of market, but rather that the Commission should establish the regulatory framework whereby small-stakes internal or public markets can operate.

If the Commission were to add a new market tier, event contracts could be traded on small stakes internal or public markets, on DCMs, on DTEFs or on EBOTs, depending upon the nature of the market participants. We believe that this result is consistent with the Act's structure and with the regulatory goals of the Act. It also recognizes that event type contracts have already been listed on DCMs and, under a no-action letter, on a market that imposes limits on the amount of capital that traders can risk. The experience of these very different markets in trading event contracts has not revealed any particular regulatory or public policy issue that would suggest that there is any reason not to provide the legal framework which would foster the growth of these markets.

17. Is it appropriate for the Commission to use the Section 4(c) exemptive authority of the Act for implementing a regulatory scheme for event contracts and markets? In this regard, the Commission notes that it has the discretion to grant an exemption under Section 4(c) to certain classes of transactions without having to make a determination as to whether such transactions are subject to the Act in the first instance.

18. Is the issuance of staff no-action relief, such as the relief issued to the IEM, an appropriate or preferable means for establishing regulatory certainty for event contracts and markets? Is a policy statement appropriate or preferable?

Internal and public event markets have been offered on an experimental basis for some time. The Iowa Electronic Market ("IEM"), as the Commission notes, began operation under a Commission no-action letter first issued in 1992.[27] A significant number of companies operate internal event markets and there have been a number of experimental public event markets operating. In light of the considerable practical operating experience of these markets, and the significant academic scholarship and public discourse of these issues, CIM believes that there is a sufficient factual and

[27] That letter was subsequently superseded by a more expansive letter issued in 1993. *See* Concept Release, 73 *Fed. Reg.* at note 5.

theoretical basis surrounding the use, organization and operation of event markets for the Commission to undertake a rule making.

CIM believes that proposing a regulatory framework and the adoption of rules will best provide the legal certainty needed if these markets are to continue to evolve and to meet their full public interest potential. In this regard, establishing a regulatory framework would be most useful with respect to the operation of public small stakes markets. CIM is of the view that rules adopted under the Commission's 4(c) authority would be a useful basis for addressing many of the issues that the Commission has raised in this request for public comment.

19. What are the benefits and drawbacks of permitting certain event markets to operate pursuant to Commission established conditions that are similar to the conditions under which the IEM operates?

As we have noted, we believe that it would clearly be in the public interest for the Commission to establish a regulatory tier for small-stakes, non-intermediated, electronic markets. These are among the conditions of the IEM no-action letter. CIM believes that these conditions differentiate our market model from the other models that are currently subject to the regulatory framework of the Act. As we have also noted, we believe that the public benefits of event markets will be enhanced if the experimental markets as currently operated are provided a legal framework under which that they can evolve into Commission-regulated, small-stakes markets.

However, we also believe that the additional conditions of the IEM letter, that the market be operated for an academic purpose and by a non-profit entity should not be incorporated in any statement of general applicability. As the operation of internal and experimental public event markets by our companies demonstrates, furtherance of public understanding and scholarship relating to these markets is not dependent upon their operation within an academic setting or by non-profit entities. We believe that any such restriction would harm the development and research that is already taking with respect to event markets and would be contrary to the public interest.

E. Market Participants

20. Would it be appropriate to allow market participants, and in particular, retail customers, to trade on Commission-regulated event markets with the knowledge that the Commission may not be able to effectively monitor the measures or events that underlie certain event contracts?

One benefit of establishing a regulatory framework is that the Commission, through the issuance of acceptable practices under applicable Core Principles, could provide guidance to markets on establishing contracts with precisely stated, objective and transparent pay-out criteria, including appropriate mechanisms for verification of the

occurrence of a pay-out event. Markets registered under this provision would be obliged, as are designated contract markets, to operate the market consistent with the applicable requirements. The Commission's main role, as it currently is, would be limited to general oversight of the markets. Moreover, the Commission under a regulatory framework could reserve and incorporate the Act's private right of action provision, ensuring that aggrieved private parties would have an avenue to obtain recourse.

21. What unique protections and prophylactic measures are appropriate or necessary for the protection of retail users of event contracts and markets?

CIM's proposal suggests a number of protections that would protect retail market participants. First, to the extent the market is an internal market, market participants must have an affinity relationship with the market organizer. Secondly, the markets would limit the account of capital that participants could put at risk or lose. Finally, as provided under the Core Principles, the market rules could be provided to participants in the form of a Disclosure Document. These are significant safeguards which would distinguish this market tier from other market tiers regulated under the Act.

22. What are the implications of permitting the intermediation of event contracts, including intermediation on behalf of retail market participants, both with respect to trade execution and clearing?

CIM's proposal for a new market tier includes the condition that the market be non-intermediated. Intermediation would introduce a significantly different market model from the model that CIM has proposed. First, limitations on the amount of capital that a market participant can place at risk or lose in a small-stakes market would require intermediaries to invest in systems to carry a large number of small accounts, which as a practical, business matter would probably be unattractive. Moreover, the use of intermediaries would increase the regulatory and self-regulatory oversight necessary to operate the market, defeating the purpose of the market tier, which is to reduce the regulatory requirements commensurate with the safeguards built into the framework, such as the limitations on loss. Finally, the use of intermediaries is contrary to the way that internal markets operate. By their structure, internal markets restrict participants to those having a direct, preexisting relationship with the company through employment or similar affiliation.

23. Are there any types of trader or intermediary conduct, peculiar to event contracts and markets, that should be prohibited or monitored closely by regulators?

We are not aware of any such behavior.

24. What other factors could impact the Commission's ability, given its limited resources, to properly oversee or monitor trading in event contracts?

We believe that it is very possible for the Commission through the construction of a sound and appropriately calibrated regulatory framework to oversee these markets using its available resources.

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The Commission has raised important and timely issues in its Concept Release. Our companies have operated internal event markets and/or experimental public event markets for a number of years. We believe that markets listing futures and binary option contracts on various non-traditional underlyings have significant potential public benefits. Moreover, we are active participants in the very significant theoretical research and development taking place with respect to the operation of experimental event markets. Based on our experience, event markets have the potential to further the public interest by facilitating commercial interests in "the making of marketing, financing and distribution decisions" or by "disseminating pricing information" that indicates consensus opinions on future events that are obtained through fair trading facilities or mechanisms.

Also based on our experience, we believe that the benefits of these experimental markets will increase if they are permitted to evolve into Commission-regulated small-stakes futures markets. We believe that these benefits are most likely to be derived if the market model which is used is geared toward the special characteristics of the markets as they are currently developing. This model includes a number of the characteristics shared by an event market that is currently operating pursuant to a Commission no-action letter, and include, limitation on the amount that market participants can have at risk in the market (or lose within a defined period of time); non-intermediation of the market, and operation through an electronic trading platform.

These market characteristics distinguish this market model from any of the other regulatory market tiers under the Act and Commission rules. Accordingly, CIM believes that it is in the public interest for the Commission to adopt rules establishing a regulatory framework geared toward the special characteristics of these markets. In doing so, the Commission will be furthering the regulatory and public interest goals of the Act.

Moreover, this approach follows a template established by the Commission under its New Regulatory Framework and codified by Congress in the CFMA. This successful template establishes differing degrees and kinds of regulation dependent upon factors including the nature of traders permitted access to the trading platform. Unlike the EBOT or DTEF, which are based on limiting access to eligible parties that meet high net worth requirements, the new regulatory tier would be restricted to small-stakes trading. In the case of internal markets, market participants would additionally be required to be employees of or have a similar relation to, the market's sponsoring company.

CIM further believes that the Commission should use its section 4(c) authority to describe broadly those contracts which may be listed on the exempt market under rules

established by the Commission. Finally, CIM does not believe that its proposals should force all event markets to operate under the same regulatory tier. Consistent with the current statutory and regulatory structure, market operators could continue to choose to offer such contracts in different tiers under the regulations relevant to that market tier.

CIM believes that experimental event markets which its members have operated have demonstrated significant public benefits. The Commission has in the past administered the Act to further the Congressional directive that regulation of the futures market not impede market innovation. CIM believes that the Commission has the opportunity to foster beneficial innovations as Congress intended and commends the Commission for its foresight in seeking public comment on these issues. We look forward to cooperating with the Commission in its consideration of an appropriate regulatory framework for these exciting markets.

We would be happy to discuss our comments or any of the issues raised in the Concept Release at greater length with the staff. Please feel free to contact Paul M. Architzel of Alston & Bird, LLP, outside counsel to the Coalition of Internal Markets at (202) 756-3492, Bo Cowgill of Google, Inc. at (650) 380-2213, or David Pennock of Yahoo! Inc. at (212) 571-8140.

Respectfully submitted,

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