

Please note that the comments expressed herein are solely my personal views

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- **Industry Filing IF 12-003**
- **90-day Review of NADEX's Proposed Political Event Derivatives Contracts**

Dear Mr. Stawick.

Thank you for giving us the opportunity to comment on your 90-day Review of NADEX's Proposed Political Event Derivatives Contracts (Industry Filing IF 12-003).

The Commodity Futures Trading Commission (Commission) has, pursuant to Commission Regulation 40.11(c), commenced a 90-day review of the North American Derivatives Exchange's (NADEX's) self-certified submission dated and received by the Commission on December 19, 2011, and its proposed political event derivatives contracts. These contracts are based on the results of the 2012 elections:

- Democratic majority in the US House of Representative binary contracts
- Republican majority in the US House of Representative binary contracts
- Democratic majority in the US Senate binary contracts
- Republican majority in the US Senate binary contracts
- US Presidency binary contracts

I would like to raise the following concerns that I have regarding these proposed political event derivatives contracts:

Congressional intent

Section 745(b) of the Dodd-Frank Act amended Section 5c of the Commodity Exchange Act by adding the following under new (c)(5)(C)(i) concerning event contracts, which states that:

“EVENT CONTRACTS.—In connection with the listing of agreements, contracts, transactions, or swaps in excluded commodities that are based upon the occurrence, extent of an occurrence, or contingency (other than a change in the price, rate, value, or levels of a commodity described in section 1a(2)(i)), by a designated contract market or swap execution facility, the Commission may determine that such agreements, contracts, or transactions are contrary to the public interest if the agreements, contracts, or transactions involve—

- (I) activity that is unlawful under any Federal or State law;
- (II) terrorism;
- (III) assassination;
- (IV) war;
- (V) gaming; or
- (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.”

The proposed political event derivatives contracts clearly “involve” an element of gaming, and are contrary to the public interest.

Lack of economic rationale

Certain event contracts serve a useful economic purpose. For example, weather derivatives covering snowfall or hurricanes offer protection against actual suffered losses. Entities can use such derivatives in risk management to protect against actual suffered losses caused by adverse or unexpected weather conditions. I would argue that the proposed political event derivatives contracts offer no such protection against actual suffered losses. Whilst weather is purely random, the defined political events and their ramifications are based on future human decisions, which can vary, but are certainly not random. I must say that I find the concept of using the proposed contracts to protect against “actual suffered losses” caused by the outcome of the 2012 elections to be quite perverse.

Additional arguments raised by NADEX are not sufficient

According to NADEX, “Political Event Contracts can offer a highly accurate predictive value of election outcomes” and that “these contracts also provide a real-time gauge of voter sentiment, which can be more valuable and more accurate than public opinion polls”.¹ I accept that there is some truth here, and that this is a positive feature of these contracts. Furthermore, NADEX states that “retail traders in existing political election markets should have a DCM alternative” and that “offering Political Election Contracts on a DCM such as NADEX will fulfil Congress’ mandate to promote responsible innovation and fair competition among boards of trade [and] other markets”.² Finally, NADEX argues that “The public will benefit from federal oversight of these markets”.³

¹ See NADEX press release, 19 December 2011 available at: <http://www.nadex.com/content/files/pressrelease-11.pdf>

² See NADEX Submission, 19 December 2011, available at: <http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul121911nadex002.pdf>

³ See NADEX press release, 19 December 2011.

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Whilst these are valid arguments, I am not yet convinced that they are sufficient to outweigh the negative aspects associated with the proposed contracts; that they “involve” an element of gaming; and that there is no economic rationale for the proposed contracts. I am also not convinced that the Commission bears any responsibility to improve “public opinion polls”, or that it is the duty of the Commission to allow any contract just because it is permitted in another jurisdiction.

Yours sincerely

C.R.B.

Chris Barnard