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## *Divided CFTC Releases “Gaming” Event Contract Rule Proposal*

MAY 16, 2024

On May 10, 2024, the Commodity Futures Trading Commission (CFTC or Commission) proposed amendments to CFTC Regulation 40.11 (the Proposed Rule) that further define “gaming” contracts considered “contrary to the public interest” under section 5c(c)(5)(C) of the Commodity Exchange Act (CEA).<sup>1</sup>

This is the latest development in the Commission’s long-standing effort to address event contracts that are based on political and economic indicators, and other event contracts considered “gaming.” We have previously written about the Fifth Circuit litigation involving PredictIt and the CFTC’s order related to political event contracts of KalshiEX LLC (access our prior alert [here](#)).

While litigations related to PredictIt and KalshiEX LLC make their way through the courts,<sup>2</sup> the Commission’s vote to approve the proposal demonstrates its ongoing interest in codifying its views around what event contracts may be impermissible gaming under the CEA. The Proposed Rule, if adopted, will limit the types of event contracts that can be listed for trading on CFTC-registered trading platforms. Depending on its implementation timeline, the Proposed Rule would also negatively impact the permissibility of certain currently outstanding event contracts with open interests—forcing them to be wound down and open interests to be liquidated. Finally, and importantly, the Proposed Rule would allow the Commission to establish a categorical ban on certain types of contracts in one fell swoop that would otherwise be evaluated by the Commission on a contract-by-contract basis.

This alert provides a preliminary analysis of the CFTC’s Proposed Rule issued late last week, and a redline of how the Proposed Rule would amend CFTC Regulation 40.11 is posted [here](#). Comments

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<sup>1</sup> <https://www.cftc.gov/PressRoom/PressReleases/8907-24>.

<sup>2</sup> The PredictIt litigation was moved to the DC federal court earlier this year. *See In re: Kevin Clarke*, case number 24-50079, in the US Court of Appeals for the Fifth Circuit and *Clark et al. v. CFTC*, case number 1:24-cv-00167, in the US District Court for the District of Columbia; *see also KalshiEX LLC v. Commodity Futures Trading Commission*, case number 1:23-cv-03257, in the US District Court for the District of Columbia.

on the Proposed Rule are due on or before July 9, 2024. The WilmerHale Futures & Derivatives Group continues to review the text of the proposal and related materials closely, and we are happy to answer any questions you may have.

## *Overview of the Proposal*

Section 5c(c)(5)(C) of the CEA provides that the CFTC may determine that contracts based on the occurrence of an event are contrary to the public interest if the contracts 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. A contract that “involves, relates to, or references” one of these enumerated activities and is determined by the CFTC to be contrary to the public interest may not be listed or made available for clearing or trading.

The Proposed Rule would further define the enumerated activity of “gaming” to include the staking or risking by any person of something of value on (i) the outcome of a political contest, including an election or elections; (ii) the outcome of an awards contest; (iii) the outcome of a game in which one or more athletes compete; or (iv) an occurrence or non-occurrence in connection with such a contest or game, regardless of whether it directly affects the outcome.

The CFTC interprets CEA section 5c(c)(5)(C) here to authorize categorical public interest determinations if the Commission determines that contracts involving an enumerated activity or prescribed similar activity are, as a category, contrary to the public interest, as opposed to a determination on a contract-by-contract basis. Therefore, the CFTC also proposes to amend Regulation 40.11(a)(1) to include a determination that event contracts involving each of the enumerated activities are, as a category, contrary to the public interest and therefore may not be listed for trading or accepted for clearing on or through a registered entity.

## *Proposed Amendments to CFTC Regulation 40.11*

The Commission states that it interprets CEA section 5c(c)(5)(C) to contemplate a two-step inquiry. First, the Commission must assess whether a contract in a specified excluded commodity “involve[s]” an activity enumerated in CEA section 5c(c)(5)(C)(i)(I) – (V) (each, an “Enumerated Activity”) or other similar activity as determined by the Commission by rule or regulation (“prescribed similar activity”). Then, if the Commission determines that the contract involves such activity, the Commission must assess whether the contract is contrary to the public interest.

The Commission aims to enhance clarity of the two-step inquiry for event contracts by proposing amendments to Regulation 40.11 that would (1) provide descriptions of excluded commodities and contracts that involve an enumerated activity, (2) define gaming as an enumerated activity, and (3) detail the public interest considerations.

## 1. Description of Excluded Commodity

The CFTC proposes to amend Regulation 40.11(a)(1)-(2) and 40.11(c) to refer to “agreements, contracts, transactions, or swaps in excluded commodities based on 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(19)(i) of the Act).” The amendment aims to more precisely track the text of CEA section 5c(c)(5)(C) and to clarify the CFTC’s interpretation that the reference to “section 1a(2)(i)”<sup>3</sup> in section 5c(c)(5)(C) was intended by Congress to refer to the excluded commodities described in section 1a(19)(i) and thereby carve out from the scope of section 5c(c)(5)(C) event contracts based on a change in the price, rate, value or levels of the measures, indices and instruments described in 1a(19)(i).<sup>4</sup> The CFTC acknowledges that historically, it has not recognized these types of event contracts as falling within the scope of CEA section 5c(c)(5)(C).

The CFTC requests comment on its interpretation that the reference to “section 1a(2)(i)” was intended to refer to excluded commodities described in CEA section 1a(19)(i) and on the examples of event contracts that the CFTC believes would fall outside the scope of CEA section 5c(c)(5)(C) and Regulation 40.11. The Commission specifically asks commenters whether there are additional types of event contracts that should be identified in the nonexclusive list of contracts and what indices or measures are “other macroeconomic index[es] or measure[s]” for purposes of CEA section 1a(19)(i).

The CFTC proposes to amend Regulation 40.11 by removing the terms “relate to” and “reference” wherever they appear and to simply refer to event contracts that “involve” an enumerated activity. The Commission notes in the Proposed Rule that this change would be consistent with the Nadex<sup>5</sup> and Kalshi<sup>6</sup> orders, both of which focused on whether the event contract “involved” an enumerated activity. The CFTC states that a contract may “involve” an enumerated activity, or prescribed similar activity, in circumstances where such activity is not, itself, the underlier of the contract.

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<sup>3</sup> The CFTC notes in the proposal that there is no “section 1a(2)(i)” in the CEA.

<sup>4</sup> The Proposed Rule provides examples of these types of contracts, including (i) economic indicators, including the CPI and other price indices, the US trade deficit with another country, measures related to gross domestic product, jobless claims or the unemployment rate, and US new home sales; (ii) financial indicators, including the federal funds rate, total US credit card debt, fixed-rate mortgage averages (e.g., the 30-year fixed-rate mortgage interest rate), and end-of-day, -week or -month values for broad-based stock indexes; and (iii) foreign exchange rates or currencies.

<sup>5</sup> On January 3, 2012, the CFTC commenced a 90-day review under Regulation 40.11(c) of binary option contracts that paid out based on the results of various US federal elections in 2012. On April 2, 2012, the CFTC issued an order prohibiting the contracts from being made available for clearing or trading. See <https://www.cftc.gov/PressRoom/PressReleases/6224-12>.

<sup>6</sup> On June 23, 2023, the CFTC commenced a 90-day review under Regulation 40.11(c) of event contracts that were based on which political party will be in control of each chamber of Congress. On September 22, 2023, the CFTC issued an order prohibiting the contracts from being made available for clearing or trading on or through Kalshi. See <https://www.cftc.gov/PressRoom/PressReleases/8780-23>.

## 2. Enumerated Activities

The CFTC proposes to define the term “gaming” within Regulation 40.11 to establish a common understanding and uniform application of the term, thereby reducing the instances where contract-specific reviews are commenced to evaluate whether a contract involved gaming.

Gaming would be defined as “the staking or risking by any person of something of value upon: (i) the outcome of a contest of others; (ii) the outcome of a game involving skill or chance; (iii) the performance of one or more competitors in one or more contests or games; or (iv) any other occurrence or non-occurrence in connection with one or more contests or games.” The proposed definition would only apply in the context of the CFTC’s administration of CEA section 5c(c)(5)(C) and Regulation 40.11.

The proposed definition of gaming focuses on the staking or risking of something of value on a contest of others or a game, including the outcome of such contest or game, the performance of competitors in such contest or game, or other occurrences or non-occurrences in connection with such contest or game. The CFTC considered the definitions of the terms “gambling,” “betting” and “wagering” by state and federal statutes. The CFTC explains that the proposed definition of “gaming” is narrower than several state definitions of “gambling,” “betting” and “wagering,” which include a person staking or risking something of value on the outcome of any contingent event not in the person’s influence or control, not just the game or a contest of others. However, the CFTC proposes to define gaming to include the staking or risking of something of value on a contingent event in connection with a game or contest, which the Commission believes would be as much of a wager or bet on the game or contest as staking or risking something of value on the outcome of the game or contest would be.

Under the proposed definition, gaming would include the staking or risking by any person of something of value on (i) the outcome of a political contest, including an election or elections; (ii) the outcome of an awards contest; (iii) the outcome of a game in which one or more athletes compete; or (iv) an occurrence or non-occurrence in connection with such a contest or game, regardless of whether it directly affects the outcome. The CFTC emphasizes that this is a non-exhaustive list of examples of activities that constitute gaming.<sup>7</sup>

### – Political contest

- The CFTC would consider a political contest to include but not to be limited to a federal, state or municipal election or primary contest, for any political office, as well as any political contest in a foreign jurisdiction, including any political subdivision thereof, or in a supranational organization. If the contract is premised on the outcome

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<sup>7</sup> Though the CFTC states it does not believe that it is necessary to define “terrorism,” “assassination” or “war” at this time, the CFTC requests comment as to whether commenters agree with its view that a registered entity is unlikely to seek to list for trading or accept for clearing a contract that involves a state law prohibiting certain activity that, while not repealed, is generally considered archaic and is not enforced.

of one or more political contests or would otherwise amount to the staking or risking of something of value on the outcome of one or more political contests, that contract would “involve” gaming. By including political contests as an example of gaming, the CFTC aims to highlight that the proposed definition is not limited to sporting events.

- Awards contest
  - The CFTC would consider the staking or risking of something of value on the outcome of entertainment award contests such as the Emmys, the Oscars or the Grammys; athletics award contests such as the Heisman Trophy; or achievement award contests such as the Nobel Prize or the Pulitzer Prize.
- Outcome of a game in which one or more athletes compete
  - This would encompass, among other things, the staking or risking of something of value on the outcome of a professional or amateur (including scholastic) sports game.
- Occurrence or non-occurrence in connection with such a contest or game
  - Whether or not an occurrence or non-occurrence directly affects the outcome of a contest or game is of no importance to determining gaming under the Proposed Rule. The CFTC explains that such an occurrence or nonoccurrence would encompass (i) whether a particular candidate enters or withdraws from a political contest, or polls above or below a certain threshold; (ii) whether a particular individual is nominated for an award or attends an award ceremony; and (iii) in the context of an athletic game, the score or individual player or team statistics at given intervals during the game, whether a particular player will participate in a game, and whether a particular individual will attend a game.

The CFTC requests comment on, among other things, whether there are examples of gaming that might fall outside of the proposed definition, what other types of votes or elections the CFTC should specifically identify, whether the availability at gaming venues of bets or wagers on a particular event should be a relevant factor in the CFTC’s gaming determination, and whether staking something of value on the outcome of a political contest is similar to gaming.

### **3. Public Interest Considerations**

The CFTC proposes to amend Regulation 40.11(a)(1) to include a determination that event contracts involving each of the enumerated activities are, as a category, contrary to the public interest and therefore may not be listed for trading or accepted for clearing on or through a registered entity.

Historically, the CFTC has conducted a contract-specific approach to analyzing whether an enumerated activity or prescribed similar activity is contrary to the public interest. However, the CFTC interprets CEA section 5c(c)(5)(C) to authorize categorical public interest determinations if the Commission determines that contracts involving an enumerated activity or prescribed similar

activity are, as a category, contrary to the public interest, as opposed to a determination on a contract-by-contract basis.

The CFTC explains that this approach would allow consistent treatment of categories of contracts determined to be contrary to the public interest.

Though “public interest” is not defined in section 5c(c)(5)(C) of the CEA, the CFTC has historically evaluated whether a contract is contrary to the public interest with reference to the contract’s commercial hedging or price-basing utility, along with considering other public interest factors.<sup>8</sup>

The Commission states that no one factor will be determinative of its public interest evaluation, and it will continue to consider all relevant factors when evaluating whether a contract or category of contracts is contrary to the public interest. The Commission states that, in addition to hedging utility, price-basing utility, and threats to national security or other threats to the public good, the following factors may be relevant when conducting its public interest evaluation of a contract or category of contracts: (i) the extent to which the contract or category of contracts would draw the Commission into areas outside its primary regulatory remit; (ii) whether characteristics of the contract or category of contracts may increase the risk of manipulative activity relating to the trading or pricing of the contract; and (iii) whether the contract or category of contracts could result in market participants profiting from harm to any person or group of persons.<sup>9</sup>

#### **4. Authority to Identify Additional Similar Activities to the Enumerated Activities**

The CFTC reiterates that it retains the authority under CEA section 5c(c)(5)(C)(VI) to determine, in the future, that other activities are similar to the enumerated activities and that event contracts involving similar activities are contrary to the public interest and thus may not be listed for trading or accepted for clearing on or through a registered entity.

#### **5. Implementation Timeline**

The Commission proposes that the final rule amendments, if adopted, would be effective 30 days after publication in the *Federal Register*, and proposes an additional 30-day implementation period after the effective date (for a total of 60 days from the publication of the final rule amendments in

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<sup>8</sup> For example, terrorism, war, assassination, and activity that is unlawful under any federal or state law are indicative of additional public interest concerns for Congress, beyond a contract’s hedging and price-basing utility, in establishing the heightened authority set forth in that provision. The CFTC adopted national security and the broader public good as relevant factors for consideration from the views expressed by Senator Dianne Feinstein and Senator Blanche Lincoln in a short colloquy regarding the proposed Dodd-Frank Act provision that ultimately was enacted as CEA section 5c(c)(5)(C). See 156 Cong. Rec. S5906-07 (daily ed. July 15, 2010) (statements of Sen. Diane Feinstein and Sen. Blanche Lincoln, <https://www.congress.gov/111/crec/2010/07/15/CREC-2010-07-15-senate.pdf>.)

<sup>9</sup> The CFTC notes that the factors that inform a public interest determination, and the weight given to each such factor, are likely to vary depending on the particular characteristics of the contract or category of contracts that is being evaluated.

the *Federal Register*) solely for event contracts that are listed for trading as of the date of publication of the final rule amendments and that are impacted by the amendments. The Commission requests comment on the proposed implementation timeline, including whether the proposed 60-day implementation period provides sufficient time for the expiration of, or orderly cessation of trading in, listed event contracts that are impacted by the Proposed Rule.

## **6. Views of the Commissioners on the Proposed Rule**

In voting in favor of the proposal, Chairman Rostin Behnam noted that over the past 20 years, the CFTC has remained consistent in determining that election or political contracts should not be allowed on the US futures and options markets. He stated that political event contracts “ultimately commoditize and degrade the integrity of the uniquely American experience of participating in the democratic electoral process” and “put the CFTC in the role of an election cop.”

In her opening statement, Commissioner Kristin Johnson reiterated Chairman Behnam’s concerns about the expanding event contracts market and voiced support for the Proposed Rule. Johnson stated that the proposed amendments to Regulation 40.11 send a “clear message on the gamification of the US political process and other contracts that are not in the public interest.” Johnson emphasized the importance of the notice and comment period for the Proposed Rule, particularly the factors that the Commission will look to when reviewing a contract and making a public interest determination.

Commissioner Christy Goldsmith Romero expressed strong support in her opening statement, noting that she would support a proposed rulemaking that went further than the scope of the Proposed Rule. She stated that she “would support a rule that goes even further and proposes to ban election event contracts as contrary to the public interest similar to other activity enumerated by Congress in the Dodd-Frank Act.” Goldsmith Romero stated her view that derivatives products that interfere with national interest do not have a place in US markets and that the Commission should not allow products to enter the market if there is an unacceptable risk if left unchecked.

In her dissenting statement, Commissioner Summer Mersinger stated that the Proposed Rule, among other things, exceeds the legal authority that Congress granted the CFTC in the CEA, relies heavily on a brief legislative history and “cherry picks” from that history, and relies on an “economic purpose test” for evaluating the public interest that was based on a provision of the CEA that was repealed by Congress nearly a quarter-century ago. She also stated that the proposed definition of gaming is overly broad and captures every “occurrence or non-occurrence in connection with a game” and specifies that elections and awards are not “gaming.” Mersinger also questioned the CFTC’s legal authority to determine in advance that entire categories of event contracts are contrary to the public interest.

Commissioner Caroline Pham stated in her dissent that “an appropriate Event Contracts Proposal would have struck a balance between Federal oversight and State autonomy by focusing on the

CFTC’s core mandate of promoting market stability and protecting market participants from fraud and abusive practices.” Pham stated that Congress intended that the CFTC regulate event contracts within the bounds of the section 5(c) prohibitions and that the Proposed Rule only creates a gray area for exchanges rather than a workable framework. Pham also highlighted specific areas for public comment, including the lack of discussion of the comment letters the CFTC recently received on the definition of gaming, as well as Regulation 40.11 and event contracts more broadly, and the Commission’s “misplaced election integrity concerns.

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