

A close-up photograph of an hourglass with blue sand, set against a solid blue background. The hourglass is positioned vertically, with the top bulb containing a small amount of sand. The sand is falling through the narrow neck into the bottom bulb. The lighting is soft, highlighting the texture of the sand and the glass.

This webinar will begin shortly.

FIA



Event Contracts

—
18 May 2023



Reminders

- The webinar will be recorded and posted to the FIA website within 24 hours of the live webinar.
- Please use the “question” function on your webinar control panel to ask a question to the moderator or speakers.



Presenters

Host:

Natalie Tynan, Associate General Counsel, Head of Technology,
Documentation Strategy, FIA

Panelists:

Caroline Dawson, Partner, Clifford Chance London

Darren Littlejohn, Partner, Clifford Chance NY

Jesse Overall, Associate, Clifford Chance NY

Presentation prepared by **C L I F F O R D**
C H A N C E



Listing Procedure for New Derivatives Contracts

Designated Contract Markets (“DCMs”) may list new derivatives contracts by either:

- **Self-Certification** (17 CFR § 40.2) – at least one business day prior to listing, a DCM can self-certify that the contract being listed complies with the Commodity Exchange Act (“CEA”) and CFTC regulations. No formal CFTC approval is required but the CFTC may then object to the self-certification.
- **Voluntary Submission** (17 CFR § 40.3) – A DCM may request affirmative CFTC approval that the contract is compliant with the CEA and CFTC regulations. The CFTC must make a decision within 45 days of submission and may extend that time for an additional 45 days or longer with the applicant’s consent.



Event Contracts

- Broadly, an **event contract** is a derivative contract whose payoff is based on a specified event, occurrence, or value such as the value of a macroeconomic indicator, corporate earnings, or the dollar value of damages caused by a hurricane.
- The CFTC, based on the authority granted by Congress in CEA section 5c(c)(5)(C), created Rule 40.11 (17 CFR § 40.11). There are 3 main components:

(1) "**TAWGA**": prohibits the listing of any event contract that involves, related to, or references:

- **T**errorism,
- **A**ssassination,
- **W**ar,
- **G**aming, or
- **A**ctivity that is unlawful under any State or Federal Law.

(2) "**Similar**"/**Public Interest**: disallows any event contract that is "**similar**" to the list above and that the CFTC determines to be **contrary to the public interest**.

- To date, the CFTC has not designated any activity to be similar the list above.

(3) **CFTC Review**: if the CFTC believes that an event contract may involve any TAWGA activity, or "similar" activity, then the CFTC may suspend the listing or trading of the contract for a review period of 90 days, or longer with the applicant's consent.

Section 5c(c)(5)(C); Rule 40.11; excluded commodity definition

CEA Section 5c(c)(5)(C) [7 USC 7a-2(c)(5)(C)]

(i) 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) of this title), 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; (VI) other similar activity determined by the Commission, by rule or regulation, to be contrary to the public interest.

(ii) Prohibition – No agreement, contract, or transaction determined by the Commission to be contrary to the public interest under clause (i) may be listed or made available for clearing or trading on or through a registered entity.

CFTC Rule 40.11

a) Prohibition. A registered entity shall not list for trading or accept for clearing on or through the registered entity any of the following: (1) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, that involves, relates to, or references terrorism, assassination, war, gaming, or an activity that is unlawful under any State or Federal law; or (2) An agreement, contract, transaction, or swap based upon an excluded commodity, as defined in Section 1a(19)(iv) of the Act, which involves, relates to, or references an activity that is similar to an activity enumerated in § 40.11(a)(1) of this part, and that the Commission determines, by rule or regulation, to be contrary to the public interest...

(c) ...The Commission may determine, based upon a review of the terms or conditions of a submission under § 40.2 or § 40.3, that an agreement, contract, transaction, or swap based on an excluded commodity ... which may involve, relate to, or reference an activity enumerated in § 40.11(a)(1) or § 40.11(a)(2), be subject to a 90-day review... (1) The Commission shall request that a registered entity suspend ... listing or trading ... during the Commission's 90-day review period... (2) ... The Commission shall issue an order approving or disapproving [such] agreement, contract, transaction, or swap ... not later than 90 days subsequent to the date that the Commission commences review, or ... at the conclusion of such extended period agreed to or requested by the registered entity.

CEA Section 1a(19)(iv)

“Excluded commodity” means—

- (i) an interest rate, exchange rate, currency, security, security index, credit risk or measure, debt or equity instrument, index or measure of inflation, or other macroeconomic index or measure;
- (ii) any other rate, differential, index, or measure of economic or commercial risk, return, or value that is... based solely on one or more commodities that have no cash market;
- (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
- (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.

History of Economic Purpose and Public Interest Tests

CFTC Act establishes CFTC

The economic purpose test is made a requirement for exchanges to list new futures contracts. Economic purpose test is incorporated within – and subject to – a broader public interest test. Legislative history of 1982 CFTC reauthorization bill rejects replacing “public interest” standard with a “hedging/risk management” standard to allow CFTC to take into account broader issues, such as the possible effect of a new futures contract on the underlying cash market.

Public interest test restored; CFTC issues Rule 40.11

Dodd-Frank Act adds Section 5c(c)(5)(C), which includes express public interest test for event contracts. However, unclear whether the economic purpose test was necessarily restored as well.

Pre-1974: Before the CFTC

Federal Derivatives Legislation

See Futures Trading Act (1921), Grain Futures Act (1922), Commodity Exchange Act (1936). Legislative history and statutory text suggests enactment intended in part to limit price manipulations and fluctuations resulting from excessive speculation, which were perceived as detrimental to producers and consumers and a burden on interstate commerce. See, e.g., Grain Futures Act, ch. 369.

1974: The Commodity Futures Trading Commission Act

2000: The Commodity Futures Modernization Act

Economic purpose and public interest tests are removed

Public interest and economic purpose tests for DCMs listing new futures contracts no longer in effect, replaced with eighteen core principles with which DCM’s must demonstrate compliance. Although no longer any express public interest or economic purpose tests, several of the principles speak to issues arguably relevant to the public interest, e.g., preventing manipulation or abusive practices.

2008: the Dodd Frank Wall Street Reform and Consumer Protection Act

2012: CFTC issues NADEX Order

Return of the economic purpose test

CFTC asserts its view that the legislative history supports the position that the economic purpose test – and not just the public interest test – was restored with Dodd-Frank



History of Economic Purpose and Public Interest Tests

Introduction of Economic Purpose Test – CFTC ACT, 1974

- Introduced in the House draft of Section 207 of the CFTC Act as a requirement that boards of trade had to demonstrate before a contract could be listed.
 - Must show that contracts traded have an economic justification by either being used for price basing/discovery, or hedging – in each case, clear focus on price:
 - “the prices involved in transactions for future delivery in the commodity are ... **generally quoted and disseminated as a basis for determining prices** to producers, merchants, or consumers of such commodity”
 - “such transactions are, or reasonably can be expected to be, utilized by producers, merchants, or consumers engaged in handling such **commodity as a means of hedging themselves against possible loss through fluctuations in price**”
 - To meet the criteria, more than occasional use of the contract for hedging or price basing must be established.
- While the Senate draft of the CFTC Act, which only required that new futures contracts be not contrary to the public interest, was adopted by the Conference Committee, the economic purpose test survived:
 - The public interest requirement was intended "to place a broader obligation on boards of trade" while at the same time incorporating the economic purpose test proposed by the House version, but subject to the broader public interest determination.
 - Therefore, the public interest test incorporates the economic purpose test.
 - In 1982, in the CFTC Act reauthorization bill, a proposal to add language specifically referring to the price discovery or hedging functions was rejected because "Congress did not want to limit the CFTC's obligation to consider broader issues", such as such as the possible effect of a new futures contract on the underlying cash market.



History of Economic Purpose and Public Interest Tests

Evolution of CFTC Guideline No. 1 until 2000

- From its promulgation in 1975 until the passage of the CFMA in 2000, CFTC Guideline No. 1 for boards of trade was amended several times showing waning reliance on the economic purpose test:
 - 1975: Guideline No. 1 adheres to Section 207 of the CFTC Act by requiring an affirmative showing by contract markets of either price discovery and hedging functions or both. Explicit reference to the economic purpose test.
 - 1982: Removed the requirement that boards of trade expressly affirm that trading in the futures contract was not contrary to the public interest, though did not remove the need to make the showing of economic purpose.
 - 1999: Required information to demonstrate that trading in the proposed contracts would meet the public interest test – defined as, that the “proposed contract will not be _____ susceptible to price manipulation or distortion.”
 - Physically-delivered contracts required showing that there was adequate supply.
 - Case-settled contracts required cash settlement price must be justified.
- This shift away from applying the economic purpose test as part of the public interest test, and instead shifting the public interest test to an examination of manipulability, foreshadowed its removal in 2000.



History of Economic Purpose and Public Interest Tests

CFMA

CFMA (2000)

- The Commodity Futures Modernization Act of 2000 (the “CFMA”) removed the public interest and economic purpose tests by deleting Section 207 of the CFTC Act (and the changes it made to Section 5 of the CEA). After the CFMA, there was no express economic purpose requirement for futures contracts.
- Section 207 of the CFTC Act (and the changes it had made to Section 5 of the CEA) was replaced in Section 12 of the CFMA by eighteen core principles with which DCMs had to comply; however, none of the core principles have any express economic purpose requirement.
- Although no longer any express public interest or economic purpose tests, several of the principles speak to issues arguably relevant to the public interest, e.g., preventing manipulation or abusive practices.



History of Economic Purpose and Public Interest Tests

Event Contracts Concept Release

2008 Event Contracts Concept Release

- The CFTC's 2008 Event Contracts Concept Release on the Appropriate Regulatory Treatment of Event Contracts noted that event contracts generally take the form of financial agreements linked to eventualities or measures (e.g., results of presidential elections, the accomplishment of certain scientific advances, world population levels, the adoption of particular pieces of legislation, the outcome of corporate product sales, the declaration of war and the length of celebrity marriages) that neither derive from, nor correlate with, market prices or broad economic or commercial measures. 2008 event contracts concept release
- 2008 Concept Release noted that:
 - "hedging and price basing have been identified as two critical functions of the commodity derivatives markets", and further noted that the public interest and economic purpose tests in former CEA Section 5(g) – which were repealed by the CFMA – nevertheless remained relevant in assessing whether event contracts were consistent with "the national public interests that render federal regulation necessary" in respect of well-functioning derivatives markets.
 - By enacting the CFMA, Congress sought "to promote innovation for futures and derivatives..." and went on to note that "innovative event markets have the capacity to facilitate the discovery of information, and thereby provide potential benefits to the public."
- The Concept Release sought comment on (i) whether event contracts were within the CFTC's jurisdiction, (ii) if so, whether exemptions or exclusions should be applied to them (including allowing them to trade outside of registered futures exchanges), and (iii) how the Commission should address the potential gaming aspects of some event contracts and the possible pre-emption of state gaming laws.
- 2008 Concept Release discussed Iowa Electronic Markets ("IEM") 1993 no-action letter:
 - IEM is an academic event market that operates in reliance on CFTC no-action relief.
 - Contracts based on political elections, economic indicators, and exchange rates, per terms of 1993 letter:
 - IEM must limit access to any one submarket to between 1,000 and 2,000 traders.
 - Real money is permitted, but \$500 cap for any single participant.
 - Relief premised on IEM representations on its academic nature, non-profit purpose, and the market's specific manner of operation.



History of Economic Purpose and Public Interest Tests

Dodd Frank

Dodd-Frank Act (2010)

- The Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank"), added a new provision to the Act, Section 5c(c)(5)(C), specifically addressing event contracts.
- Section 5c(c)(5)(C) permits the CFTC to determine that new event contracts DCMs seek to list are contrary to the public interest if they involve "TAWGA" or "similar" activities.
- CFTC Regulation 40.11 turns Section 5c(c)(5)(C)'s authority to ban futures on excluded commodities involving TAWGA on a case-by-case basis into a per se prohibition.



History of Economic Purpose and Public Interest Tests

Return of Economic Purpose Test and Enactment of CFTC Rule 40.11

- It is facially ambiguous whether the current public interest requirement in CEA 5c(c)(5)(C) mirrors what was removed by the CFMA.
- However, in 2012, the Commission stated in the Nadex order (discussed later on in this presentation) that they believed the Dodd-Frank Act restored the economic purpose test to the “public interest” test under CEA 5c(c)(5)(C) (Nadex order: “WHEREAS, the legislative history of CEA Section 5c(c)(5)(C) indicates Congress’s intent to restore, for the purposes of that provision, the economic purpose test that was used by the Commission to determine whether a contract was contrary to the public interest pursuant to CEA Section 5(g) prior to its deletion by the Commodity Futures Modernization Act”).
 - The legislative history in the July 15, 2010, Senate floor colloquy on Dodd Frank includes the following:
 - Sen. Feinstein: “As you know, the Commodity Exchange Act required CFTC to prevent trading in futures contracts that were “contrary to the public interest” from 1974 to 2000. But the Commodity Futures Modernization Act of 2000 stripped the CFTC of this authority, at the urging of industry . . . I am glad the Senator is restoring this authority to the CFTC.”
 - Sen. Feinstein: “I hope [it] was the Senator’s intent, as the author of this provision, to define “public interest” broadly so that the CFTC may consider the extent to which a proposed derivative contract would be used predominantly by speculators or participants not having a commercial or hedging interest. Will CFTC have the power to determine that a contract is a gaming contract if the predominant use of the contract is speculative as opposed to a hedging or economic use?”
 - Sen. Lincoln: “That is our intent. The Commission needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling through supposed “event contracts.” It would be quite easy to construct an “event contract” around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament. These types of contracts would not serve any real commercial purpose. Rather, they would be used solely for gambling”



Political Betting

- Unlike sports betting, which is now legal in many states, political betting is illegal across all 50 states.
 - US persons are often able to access offshore betting sites to place such bets.
- In general, the CFTC has prohibited political futures trading except in certain limited cases where it is being used for research/educational purposes and there is no profitability involved for the operator.
 - Iowa Electronic Markets run by the University of Iowa currently operates under a no-action letter from the CFTC.
 - In 2014 the CFTC issued a no-action letter to allow Victoria University in New Zealand to operate the PredictIt prediction market, which had event contracts related to political events offered to U.S. persons, with broadly similar conditions to the IEM letter (e.g., non-profit, operated for academic purposes by the university, operated by the university faculty, be limited to 5,000 traders per contract and an \$850 limit per trader, conduct KYC on customers, limit advertising, etc).
 - However, in 2022 the CFTC revoked the PredictIt no action letter, alleging violation of the conditions.
 - In January 2023, PredictIt appealed the CFTC's 2022 no-action letter revocation to the 5th Circuit, which granted a preliminary injunction enjoining the CFTC's 2022 revocation of the 2014 no-action letter pending the outcome of the appeal.
 - On March 2, 2023, CFTC staff issued another letter revoking the previous (2022) revocation, which re-iterated that the 2014 no-action letter was no longer in effect but gave PredictIt a chance to respond.
 - PredictIt is currently operating and providing trading services to US persons pending the outcome of its appeal: <https://www.predictit.org/platform-announcements>



Intrade (2012)

- Intrade was an online trading platform that allowed users to gamble on contracts on the probability of various events occurring
- One of these contracts was about whether Mitt Romney or Barack Obama would win the 2012 Presidential Election
- 1 person placed between \$4 and \$7 million on Romney through Intrade
- Research showed that within the last two weeks of the election, there was an increase on bets on Romney, a lot of them being made by a single person. Prior to this, there had been a low turnout for Romney in the polls, so the thought was that the person was trying to encourage Republican voters to vote by making it seem that Romney would win.
- The CFTC filed a civil suit against Intrade in November 2012 to which Intrade responded by disallowing U.S. customers to place bets on their sites. This led to them suspending their operations in 2013, due to low site traffic.



Nadex (2012)

- In 2012, the North American Derivatives Exchange (“Nadex”), a DCM, listed self-certified political event contracts based on the results of 2012 federal elections including party control on the U.S. House of Representatives, Senate, and White House.
- The CFTC issued an order prohibiting them from listing, based on the following reasoning:
 - (1) The contracts involved “gaming” which is prohibited under Rule 40.11 (TAWGA).
 - The CFTC asked whether the contract, as a whole, involved one of the activities in TAWGA
 - The CFTC reasoned that because some state statutes connect “gaming” and “gambling” to betting on elections, they could equate the two.
 - (2) The contracts do not pass the economic purpose test
 - Because the economic consequences of an election are so unpredictable, the Nadex event contracts “can’t reasonably be expected to be used for hedging purposes.”
 - (3) In the Commission's discretion, they determined the contracts to be contrary to the public interest.
 - CFTC afraid it would negatively affect the integrity of elections.
 - It could incentivize the vote for certain candidates, when that vote is against the political views of the voter.



Kalshi Contracts – Matter Still Pending!

- KalshiEx, LLC is a CFTC-licensed DCM
- On July 19, 2022 Kalshi submitted a proposed political event contracts for the CFTC to review. The payout would be based on a simple question: Will the Democrats or Republicans be in control of House or the Senate at a particular time? The basis of the proposal was:
 - The contract did not involve a TAWGA activity
 - The contract passes the “economic purpose” test
 - The contract would not threaten the integrity of any U.S. election
 - Similar contracts were currently available to U.S. persons
- The Commission has solicited public comments on this matter and has still not issued a ruling on whether the Kalshi contracts are compliant with CFTC regulations.
- Commissioner Pham dissented from the decision to even review these contracts at all, stating:
 - She does not see political control of either house to be one of the activities prohibited by TAWGA, and therefore no further review was required.
 - The CFTC did not establish that these contracts were “similar” to any TAWGA activity, and it only when that analysis is done can the Commission establish the contracts to be against public interest.
 - Does not think that the 2012 Nadex order was binding precedent on the Commission's ruling in Kalshi.



Are Sports Futures Contracts Illegal “Gaming”?

What Is Gaming?

- Unlike most other event contracts, sports futures contracts appear to fall under Rule 40.11’s per se prohibition of contracts involving “gaming.”
- CFTC: “the term ‘gaming’ requires further clarification...the term is not susceptible to easy definition” (Provisions Common to Registered Entities, Jul. 27, 2011).
- “Gaming” is not defined in the CEA or in CFTC regulations.
- July 15, 2010, Senate floor colloquy on Dodd Frank: “The Commission needs the power to, and should, prevent derivatives contracts that are contrary to the public interest because they exist predominantly to enable gambling through supposed ‘event contracts.’ It would be quite easy to construct an ‘event contract’ around sporting events such as the Super Bowl, the Kentucky Derby, and Masters Golf Tournament. These types of contracts would not serve any real commercial purpose. Rather, they would be used solely for gambling.”
- Under Rule 40.11, at present, a contract involving “gaming” would be per se illegal.
 - Would it still be illegal regardless of whether it had an economic purpose (i.e., hedging or price discovery functions)?



Background

Murphy v. NCAA (SCOTUS, 2018)

- Prior to 2018, sports betting was effectively outlawed nationwide, excluding a few states such as Nevada, via the Professional and Amateur Sports Protection Act of 1992 (“**PAPSA**”).
- PAPSA was struck down because it unconstitutionally commandeered power from the states. The ruling gave states the individual authority to legalize sports betting.
 - The Wire Act was not invalidated. Interstate wagering continues to be prohibited under the Wire Act, even by businesses licensed in a particular state.
- The Court in acknowledged that Congress could regulate sports gambling directly, but Congress could not effectively prohibit states from authorizing it.
 - While a federal framework has been proposed by Senator Schumer in 2018, there has been no further action on this law. As of early 2023, thirty-three states and the District of Columbia have legalized sports betting.



ErisX NFL Futures Contracts

Facts

- In December 2020, they self-certified three futures contracts related to National Football League ("NFL") games ("NFL Contracts").
- The certification stated:
 - "[t]he proposed Contracts will be structured as a futures contract for each sports event outcome."
 - the NFL Contracts "will be listed for individual sporting events, and will include contracts based on the moneyline, the point spread and the total points for each game."
- The contracts are structured essentially as binary options with a winning position receiving a settlement price of \$100 and the losing position receiving a settlement price of \$0.
- ErisX's description of the NFL Contracts employs the same terminology and indicates that the contracts would function in the same manner as the (i) "moneyline" contracts on the outcome; (ii) "points spread" on the scoring differential; and (iii) "over/under" contracts on the total points scored, offered by sports bookmakers to the general public.
- Determining that the NFL contracts "may involve, relate to, or reference . . . gaming," the CFTC invoked its authority under Rule 40.11(c) to conduct a 90-day review.
- Hours before the Commission was to issue an Order denying listing, ErisX withdrew its submission – thus, the Order was never released.
- Shortly thereafter, Commissioners Brian Quintenz and Dan Berkovitz issued separate statements in which they discussed the contents of the Order and their positions on the issues therein.



ErisX NFL Futures Contracts

ErisX's Argument

- ErisX argued that the NFL contracts did not implicate Rule 40.11 because they did not involve "gaming" – the argument is that the existence of the economic purpose takes it out of "gaming" under the Rule.
 - The dramatic growth in sportsbooks since *Murphy v. NCAA* has created a need for a hedging instrument for sportsbook operators because many of them hold unbalanced books arising from in-state customers favoring their home team.
 - Stadium owners and vendors also have hedging needs because their revenue largely depends on attendance, which suffers when a team's performance lags.
 - As such, these futures would be used to hedge real commercial risk, as opposed to being used solely for speculative purposes and as a conduit for the public to gamble on the outcome of NFL games (i.e., satisfying the economic purpose test).
- Limited trading to licensed sportsbooks, vendors and stadium owners that are hedging commercial risk along with designated market makers (no retail customers) so only legitimate commercial exposures were to be made rather than gambling on sports outcomes.



ErisX NFL Futures Contracts

Comm. Brian Quintenz's Statement

- Comm Quintenz would have dissented from the Order.
- The Order would have denied listing on two grounds:
 - for being involved in "gaming",
 - for being contrary to the public interest,

both prohibited under Section 40.11.

- Since the NFL Contracts did not serve a hedging function, and would have promoted sports gambling, it failed to meet the public interest requirement.
- Quintenz: Section 5c(c)(5)(C) is an undue delegation of legislative power because "contrary to the public interest" is too vague a standard and gives the Commission too much discretion to deny listing.
- The Court has not found an undue delegation A.L.A. Schechter Poultry Corp. v. United States and Panama Refining Co. v. Ryan (1935).
- Quintenz: Rule 40.11 is void because it imposes a blanket prohibition on contracts involving TAWGA, while Section 5c(c)(5)(C), by its own words actually allows all the enumerated event contracts (i.e., terrorism, war, etc.) but empowers the Commission to determine that contracts are contrary to the public interest on the basis of TAWGA (and, consequently, prohibited by the law).
 - In issuing Rule 40.11 prohibiting TAWGA listings, the CFTC did not provide its reasons for doing so.
 - Because of the discrepancy, Rule 40.11 is "unreasoned" and, thus, void.
- Quintenz: The Commission erroneously placed the burden on ErisX to prove that the NFL Contracts had a hedging utility and in the public interest, when it should have been the Commission's burden to prove the absence of public interest.



ErisX NFL Futures Contracts

Comm. Dan Berkovitz's Statement

- Comm. Berkovitz would have supported the Order.
- Berkovitz: Section 5c(c)(5)(C) involves a two-part test for listing. First, the Commission must find that a contract involves gaming. Second, it must determine that the contract involving gaming is contrary to the public interest.
 - Implicitly saying that Rule 40.11's per se prohibition does not follow from the grant of power under Section 5c(c)(5)(C).
- Berkovitz: As they had previously stated before in NADEX, the economic purpose requirement has been revived by Dodd Frank.
 - The test includes a requirement that the contract must be used for hedging and/or price discovery on more than an occasional basis.
 - If the NFL contracts would perform the hedging function that ErisX claimed, they would satisfy the public interest standard, but ErisX did not prove that the NFL [c]ontracts would provide "an effective and more-than-occasionally used hedging mechanism."
- Berkovitz: The NFL Contracts constitute gaming: "A contract that is structured identically to gaming contracts, labelled with the same terms as gaming contracts, and designed with a purpose to hedge gaming contracts 'involves' gaming."
 - However, Comm. Berkovitz supported amending Rule 40.11: "it would not be 'contrary to the public interest' for the Commission to permit the listing of sports event contracts if an exchange can demonstrate that the contracts will be used to hedge commercial risks arising from lawful commercial activity related to sports betting."
- Indicates that there might be arguments for approving the listing of sports futures contracts if they were sufficiently calibrated to hedge commercial risk of sports betting.



UK Approach

Gambling or Financial Services

Event contracts may be categorised as gaming contracts (regulated by the Gambling Commission) or as financial services (regulated by the Financial Conduct Authority). A memorandum of understanding is in place between the Commission and the FCA to ensure cooperation in

Gambling?

- The Gambling Act 2005 defines gambling as gaming, betting and participating in a lottery. It is an offence to provide facilities for gambling unless authorised to do so.
- Gaming involves playing a game of chance for a prize, including casino games and equal chance games (but not including a sport).
- Betting involves making or accepting a bet on the outcome of a race, competition or other event or process, the likelihood of anything occurring or not occurring, or whether anything is or is not true. **It does not include a bet that involves a regulated activity under the Financial Services and Markets Act 2000.**
- Participating in a lottery involves persons being required to pay to participate, after which one or more prizes are allocated to participants, allocated by chance.
- Persons authorised to provide facilities for gambling may also be required to comply with additional obligations, including under the Consumer Rights Act and under anti-money laundering regulation.

Financial services?

- Regulated activities under the Financial Services and Markets Act 2000 include entering into contracts for difference (CfDs).
- Case law has confirmed that following the Gambling Act 2005 contracts regulated under the Financial Services and Markets Act are beyond the ambit of gambling law, but the scope of what constitutes a regulated CfD is not clearly defined.
- However, there have been a number of cases in which a person who has entered into a derivative that proved to be disadvantageous have claimed (generally unsuccessfully) that these were unauthorised gaming contracts rather than regulated derivatives, and that they were unenforceable as a result.
- E.g., in *Morgan Grenfell v Welwyn* the judge held that a contract for differences could not be a gaming contract if the “purpose and interest of [the parties] was something other than wagering” (i.e., if at least one party had a genuine commercial purpose).
- The FCA also has the power to ban regulated entities from entering into certain types of contracts, and has exercised this in relation to the sale of binary options to retail clients.



BetIndex - Are Sports Futures Contracts Gambling or Financial Services?

- In June 2021, the UK Department of Digital, Culture, Media & Sport commissioned a review into the regulation of BetIndex Limited which collapsed in March 2021.
- BetIndex had operated an online gambling platform called Football Index, which was regulated by the Gambling Commission, but not by the FCA.
- Between May 2019 and March 2021, the two regulators discussed the status of BetIndex and whether or not it should be FCA regulated, but didn't reach a conclusion.
- The Covid-19 pandemic resulted in significantly reduced activity on the platform, with BetIndex ultimately facing severe financial difficulties and going into administration in March 2021. The value of open bets on the platform was around GBP 124m, leading to calls for a public inquiry into by BetIndex was granted a licence (and not subject to regulation by the FCA, which might have resulted in additional protections being available to investors).
- The review resulted in recommendations for better cooperation between the Gambling Commission and the FCA, and a review of financial promotions, as well as criticism of the Gambling Commission and FCA for not coming to a conclusion on the status of the platform, but didn't provide further guidance on whether BetIndex should have been regulated or not.



Thank you for joining us today!

Upcoming Webinar:



Energy Transition: Trends in Derivatives Transactions
10:00 – 11:00 AM ET



Additional questions?

FIA

The logo consists of the letters 'F', 'I', and 'A' in a bold, sans-serif font. The 'F' is a solid dark grey. The 'I' is a solid dark grey. The 'A' is formed by two overlapping shapes: a light green triangle pointing downwards and a light blue triangle pointing upwards. The background features large, overlapping geometric shapes in light green, light blue, and light grey.