BETTER MARKETS

FACT SHEET

Crypto Companies and Prediction Markets are Advising the CFTC

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Introduction

Voters are broadly skeptical of the crypto industry. Over 70% of voters believe crypto benefits insiders, criminals, and scammers. 63% of adults say cryptocurrencies are not to be trusted.

Prediction markets fare no better. Just 4% of Americans say that prediction markets are good for society. Surveys show over and over that most Americans view prediction markets as gambling.

So why is the Commodity Futures Trading Commission (CFTC) doing everything it can to expose Americans to these risky products? Less than nine months into the tenure of CFTC Chair Mike Selig, it is clear that the CFTC will give the crypto industry and prediction market platforms anything they want. The reason may be simply that it is these industries that have Chair Selig's ear.

Today, the CFTC will have the first meeting of its Innovation Advisory Committee (IAC). Chair Selig formed the IAC himself. Its ostensible purpose is "to gather expertise and recommendations on innovation in financial markets." Although innovation in our financial markets could take many forms, Chair Selig seems focused on promoting crypto and prediction markets. Two of the committee's three panels will focus on crypto and prediction markets, with AI being the other one.

This is not surprising when considering the composition of the IAC.

The IAC is Dominated by Crypto Companies and Prediction Markets

Crypto companies and prediction markets form a majority of the IAC's members. This means they are advising the CFTC as to what it should do. But the CFTC is supposed to police the markets. It is hard to understand how it can do that when it is being advised by the very firms it is supposed to regulate. It is also hard to understand how the composition of the IAC complies with federal law.

Federal law requires that the membership of an agency advisory committee "be fairly balanced in terms of the points of view represented." The IAC's own charter seems to recognize this mandate, as it says that the IAC "will consist of members who reflect a wide array of backgrounds and viewpoints, including those who represent segments of the financial industry, regulatory bodies, financial technology providers, public interest groups, academia, and market infrastructure firms." Yet the composition of the IAC violates both federal law and the terms of its own charter.

The IAC has 35 members. Two are professors. The other 33 represent the financial industry.

- The IAC has 16 members that represent crypto and decentralized finance.
- The IAC has five members that represent prediction markets.
- The IAC has five members that represent exchanges.
- The IAC has two members that represent clearing agencies.
- The IAC has two members that represent financial services firms, two members that represent trade organizations, and one venture capital firm.

It is not clear why the IAC needs 16 members that represent the crypto industry or five members that represent prediction markets. It is also not clear how any of these members qualify as "public interest groups." In no way do these members indicate balance in terms of the points of view represented. Nor do they reflect a wide array of backgrounds and viewpoints. Instead, the IAC's composition ensures that the CFTC will hear only the perspective of the financial industry.

The CFTC Gives Crypto and Prediction Markets What They Want

Given who is advising the CFTC, it should come as no surprise that under Chair Selig the CFTC has taken numerous actions to benefit both crypto companies and prediction market platforms.

The CFTC has given the crypto industry its preferred regulatory status, approved crypto products previously deemed too risky for U.S. investors, and sided with crypto companies it previously sued.

- Under Chair Selig, the CFTC joined the SEC in interpreting the federal securities laws to exclude most crypto assets from the definition of a security and instead treat them as digital commodities. This interpretation boosted the crypto industry's long-sought goal of being regulated by the CFTC and not the SEC. That is because, compared to the SEC, the CFTC has fewer resources, laxer rules, and less of a focus on protecting retail investors.
- The CFTC also approved a perpetual futures contract for bitcoin. Again, this fulfilled an item on the crypto industry's wish list. A perpetual futures contract is a contract with no expiration date that allows traders to speculate on the price movement of a crypto asset by using leverage, which allows a trader to control a bigger position than their initial investment. This means that small swings in the price of the crypto asset can lead to large losses, which makes perpetual futures the most dangerous product in crypto. That is why, until the CFTC's recent action, these unregulated, high-risk instruments were not available in the United States. The CFTC's action allows crypto to portray perpetual futures as "the purest form of trading" even though perpetual futures are inappropriate for retail investors.
- The CFTC has even gone so far as to file a motion in court to relieve a crypto company from a judgment it previously obtained against the firm. Despite the firm previously settling the case and agreeing not to deny the allegations on which it was based, the CFTC now says it shares the firm's view that the case should not have been brought. In doing so, the CFTC sided with the firm, which is represented on the IAC, against its own enforcement staff.

Although it hardly seems possible, the CFTC has been even more submissive to prediction markets.

- Two months ago, the CFTC proposed rules to govern prediction markets that give the prediction market platforms almost everything that they want. The proposed rules would continue to allow prediction markets to offer so-called event contracts on sporting events under the guise that they involve trading a financial derivative when what they actually involve is gambling. Indeed, the proposed rules allow event contracts to be used to gamble on almost anything. The proposed rules would even allow event contracts on political elections despite the threat that these event contracts pose to our democracy. The rules the CFTC proposed cemented its role as the prediction markets' chief cheerleader.

- The CFTC has also sided with prediction market platforms in their attempt to circumvent state gambling laws. Several states have sued prediction markets, alleging that their event contracts on sporting events violate state laws prohibiting unregulated sports betting. Instead of recognizing that event contracts on sporting events involving gambling, the CFTC has chosen to intervene in these cases to try to convince the courts that a wager on whether a team is going to win a game somehow constitutes trading a financial derivative.

- Even more remarkably, the CFTC has gone so far as to tell prediction markets to ignore lawful court orders in their litigation with the states. After a Michigan state court barred a prediction market platform from operating in Michigan to prevent the state's most vulnerable citizens from being exploited by a sports betting operation masquerading as an investment opportunity, the court ordered the firm to close out certain bets that had been made and void, cancel, or refund them. Yet the CFTC ordered the firm to execute the bets, in defiance of the Michigan state court. Similarly, after a federal court refused to prevent New York from suing the same firm for circumventing state gambling laws, the CFTC authorized the firm to continue operating in the state even if a court enjoins it from doing so. The prediction market platform involved in these cases is represented on the IAC.

The IAC is Advising a Single Individual in Chair Selig

The ability of the IAC's members to get what they want from the CFTC might not be so pronounced if the CFTC was operating as Congress envisioned. Normally, the CFTC has five commissioners, with three from the majority party and two from the minority party. This prevents the agency from taking action based on the whims of one person, and the minority commissioners are able to engage a broader range of stakeholders into the process for formulating agency action, highlighting concerns and issues that might otherwise be overlooked. Currently, however, Chair Selig is the only commissioner on the CFTC. This means that he can and does act unilaterally, although the CFTC attempts to hide that fact when it acts to benefit its preferred industries.

Indeed, the way in which the CFTC announces these unilateral actions is farcical.

- In announcing its intention to treat crypto assets as digital commodities and not securities, the CFTC said: "On this matter, Chairman Selig voted in the affirmative. No Commissioner voted in the negative." No Commissioner voted in the negative because the CFTC had no other Commissioner. The only vote was Chair Selig's. Although the CFTC's statement makes it appear as if the CFTC acted unanimously, in actuality there was only one vote cast.

- The CFTC said the same thing when issuing its policy statement in conjunction with its approval of perpetual futures contracts on bitcoin. The CFTC said: "On this matter, Chairman Selig voted in the affirmative. No Commissioner voted in the negative." Again, no Commissioner voted in the negative because no other Commissioner was on the CFTC.
- The CFTC says the same thing when taking action to benefit prediction markets. In proposing the rules to govern event contracts that gave the prediction markets almost everything they wanted, the CFTC said: "On this matter, Chairman Selig voted in the affirmative. No Commissioner voted in the negative." It wasn't possible for any other Commissioner to vote in the negative and oppose the CFTC's action, because the only individual on the CFTC whom the prediction markets needed to persuade was Chair Selig.

Chair Selig's speeches are no more forthright about his unilateral authority over the CFTC's actions. He has given numerous speeches promoting both crypto and prediction markets. In these speeches, Chair Selig gives the impression that his view is not necessarily the view of the CFTC.

- In one of his first speeches, Chair Selig discussed his desire to ensure that the United States is the crypto capital of the world. He began the speech by noting that "the views I share today are my own as Chairman and do not necessarily reflect those of the Commission." Yet Chair Selig was, and still is, the only member of the Commission. Who else's views could reflect the views of the Commission if not his? In the case of a CFTC Chair who has no other Commissioners, his views *do* necessarily reflect those of the Commission.
- Chair Selig said the same thing in a speech touting the virtues of prediction markets. He began the speech by saying that "the views I share today are my own as Chairman and do not necessarily reflect those of the Commission." Again, as the only member of the Commission, his views do necessarily reflect the views of the Commission. This means that to get the CFTC to adopt their recommendations, the members of the IAC, whom Chair Selig appointed, need only persuade Chair Selig himself. This makes the fact that the CFTC is essentially being advised by crypto companies and prediction markets, without balanced points of view or a wide array of backgrounds or perspectives, especially pernicious.

Conclusion

The CFTC under Chair Selig, much like the SEC under Chair Paul Atkins, appears to believe that invoking "innovation" justifies any action to benefit crypto or prediction markets. Although these actions may benefit the members of the IAC, which is filled with crypto companies and prediction market platforms, investors are getting left behind. The CFTC is approving crypto products that endanger retail investors. And prediction markets are a platform on which almost everyone loses. Instead of having a meeting to further promote crypto and prediction markets, the CFTC should listen to the American people and police the industries it supposedly regulates.

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