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Prediction Markets

Prediction markets offer a powerful mechanism for aggregating dispersed information, allowing participants to hedge and speculate based on their beliefs about future events. Because prediction markets incorporate diverse perspectives and involve institutional and retail participants putting their own capital behind their predictions, these markets can produce highly accurate forecasts, often outperforming expert analysis and other traditional sources of news and information. By allowing individuals to buy and sell contracts tied to specific outcomes – known as "event contracts" – prediction markets help reduce uncertainty by providing real-time probabilities that reflect the collective wisdom of participants. In other words, prediction markets can enhance the economic value of information itself, allowing businesses and individuals to make better-informed decisions. Prediction markets can be particularly valuable in fields such as finance, politics, academics, and technology, among others, where decision-makers seek high quality information to navigate future risks and uncertainty.

Prediction markets also function as a risk management tool. Businesses and investors can use these markets to hedge against uncertain events and associated risks, such as election outcomes and other geopolitical occurrences, regulatory changes, weather events, or economic shifts. By taking positions in these markets, they can offset potential losses elsewhere in their portfolios. Speculators, meanwhile, provide important liquidity in these markets by attempting to profit from price changes in futures contracts. This function is comparable to that of speculators and retail participants in agricultural futures markets, such as those for corn or wheat.

Background on Event Contracts

"Event contracts" function as simple binary (or "yes-or-no") predictions on events including, but not limited to, elections, economic indicators, commodity price movements, weather, and sports. Prices can fluctuate based on market sentiment and new information, reflecting the collective probability the market assigns to each outcome. Event contracts are straightforward and adaptable, and therefore, widely usable for forecasting, risk management, and speculation across various industries and products. Event contracts are traded via orderly, transparent, two-sided markets on federally regulated platforms. Types of event contracts include, among other things:

- Political events, such as elections;
- Economic events, such as certain corporate occurrences and macroeconomic data releases;
- Weather events; and
- Sports and entertainment events.

General Benefits of Event Contracts

Event contracts can provide many benefits to market participants, including:

- **Hedging:** Prediction markets allow businesses and individuals to hedge risks associated with various events. For example, a small manufacturing business might use political event contracts to hedge risks related to elections. Event contracts can also be used to hedge risks in financial portfolios. Moreover, because they are smaller in size than futures contracts, event contracts can allow for greater retail accessibility and more accurate hedging (larger futures contract sizes can lead to retail investors taking on larger hedge positions than they truly want – or avoiding the hedge altogether). Retail trading also adds liquidity to these markets, which helps other participants hedge more effectively.

- **Customer Protection:** Prediction markets and event contracts are regulated at the federal level by the Commodity Futures Trading Commission under the Commodity Exchange Act. Federal regulation provides a number of customer safeguards and market integrity measures. For example, the exchanges (known as "Designated Contract Markets" or "DCMs") that provide prediction markets via event contracts, as well as the brokerage firms (called "Futures Commission Merchants" or "FCMs") that provide retail customers access to those markets, are required to safeguard customer funds by segregating them from the firms' own proprietary business activities. These firms also are required to prevent manipulative trading activity to help ensure the integrity of prediction markets, instilling greater confidence in the usefulness and predictive value of the event contracts. Brokers are also subject to strict know-your-customer rules and marketing guardrails.

- **Information Aggregation:** Prediction markets are a powerful predictive tool that can aggregate diverse opinions and dispersed knowledge into accurate forecasts. Prediction markets often exhibit lower statistical errors than professional pundits, forecasters and polls, and can be more reliable than other traditional sources of news and information. As a result, prediction markets can enhance the economic value of all types of information.

- **Reduce Uncertainty:** Prediction markets generally reflect the "best estimate" of the probability of an event occurring. Prediction markets can reduce uncertainty about the likelihood of future events and can be an effective tool in predicting the outcome of those events. This helps individuals, businesses and policymakers to make better-informed decisions and allocate resources more efficiently. For example, prediction market event contracts can generate information that is useful for businesses when planning their future operations, as well as information that is useful for an individual's portfolio and how the outcome of events can impact the pricing of financial instruments.

- **Speculation:** Like traditional securities, options, and futures markets (e.g., corn and wheat), prediction markets can be used by market participants, including retail investors, to profit from price movements. The profit motive incentivizes market participants with specialized knowledge to participate in the marketplace. In doing so, speculative investors provide important information and liquidity to prediction markets.

- **Educational Value:** Prediction markets create a financial incentive for market participants to be better informed about the likelihood of future events occurring. By making information publicly available, prediction markets can democratize access to information.

Types of Prediction Markets and Event Contracts

As noted above, there are several types of prediction markets and event contracts including, but not limited to:

- **Politics.** Political prediction markets and event contracts allow businesses to hedge risks associated with geopolitical and election events. Companies and individuals can hedge or speculate on the partisan composition of government and on the uncertainty of which political party will control Congress, both of which can impact the probability of legislation impacting a company or individual. Moreover, by providing an unbiased and market-based mechanism for viewing and understanding complex issues, political event contracts can cut through partisan narratives and improve the quality of public information.

- **Economics.** Economic prediction markets and event contracts enable market participants to hedge risks related to macroeconomic announcements, such as unemployment rates, payroll data, and the federal funds rate. These contracts allow participants to hedge exposure to specific events without sacrificing the upside of their instruments and can meaningfully improve the hedging process. For example, event contracts can augment the utility of hedging by allowing participants to directly hedge macroeconomic risks before the data is released.

- **Weather.** Prediction markets and event contracts for weather-related events and patterns allow market participants to hedge risks related to future weather events, associated government policies, and related activities carried out by market participants (for example, insurers). They can protect an investor from risks related to the degree to which weather events impact the economy and particular industries. These contracts can also be created around specific weather-related events such as drought, sea level rise, polar ice volumes, and agricultural yields, providing a more refined hedge. Weather event contracts can also provide information that will be valuable to policymakers. For example, an event contract based on the rise of sea levels would provide policymakers with valuable information on the potential future costs of government programs like the National Flood Insurance Program.

- **Sports.** Sports-based event contracts are one subset of the broader event contract category that have recently gained popularity. Unlike sports gambling, in which there is a “House” and oddsmakers, sports event contracts are transferrable financial contracts traded between buyers and sellers in open, transparent, two-sided markets on federally regulated exchanges, known as DCMs. The global sports industry brings in an estimated

$2.65 trillion in revenue.[1] Various commercial entities, including team sponsors, media outlets, and vendors, can use sports event contracts to manage risks related to team performance. For example, team sponsors could hedge their risk of a team having a losing season. Consumer-focused businesses near a sports stadium may want to hedge the possibility of cancellation or lower attendance that would impact their revenue on game days. Similarly, the price discovery provided by these prediction markets can result in more accurate and valuable information which would, for example, enable consumer-focused businesses to better predict their labor and material resource needs.

U.S. Federal Regulation of Prediction Markets

Prediction markets offer "event contracts" that, as currently listed on most DCMs, are "swaps" under the Commodity Exchange Act ("CEA"). As such, these products are listed and self-certified on CFTC-registered DCMs. Retail investors can buy or sell these contracts through an intermediated model using FCMs or can participate directly through a retail DCM.

While the recent growth in these markets is new, the regulatory framework that governs them is not. Event contracts offered on CFTC-registered markets have operated within the longstanding regime established under the CEA for decades. This is the same regulatory framework that underpins trillions of dollars in futures and swaps activity each year.

The CFTC has traditionally treated FCMs as the main line of defense for customer protection. For decades, retail customers participated in futures and swaps markets through an FCM. However, in more recent years, the markets have seen more direct retail participation with DCMs and Derivatives Clearing Organizations ("DCO"), bypassing the traditional intermediated model in which customers interact with FCMs that route orders to DCMs for execution, similar to how retail customers interact with equities markets through a registered broker-dealer.

FCMs are required to be members of the National Futures Association ("NFA"), a self-regulatory organization, and must comply with layered rules regarding segregating and safeguarding customer funds, running risk management and capital/liquidity programs, supervising staff and customer-facing activity including solicitation, maintaining customer identification and AML programs (including the collection of the occupation and trading experience of a customer upon onboarding), and avoiding fraud and unfair dealing. The NFA also enforces advertising and promotional rules that further restrict misleading conduct and high-pressure sales. Taken together, these are effective, well-tested protections – not an unregulated or experimental environment.

When retail investors access these markets without an FCM through a retail direct clearing model, many of those protections may not apply in the same way. For example, a retail-facing DCM or DCO is not required to be a member of the NFA. While event contract trading is currently fully collateralized, potential risks like the misuse of funds, weak disclosures, questionable or abusive marketing practices, or operational failures potentially still remain.

[1] Anani, Z. (2025, October 21). *The size of US sport: A $1+ trillion industry. Global Institute of Sport.* https://gis.sport/news/the-size-of-us-sport-a-1-trillion-industry/

Retail customers in a DCM/DCO path may also lack forum choice in disputes that FCM customers receive.

Robinhood encourages the CFTC to consider and review any investor protection gaps, including KYC/AML requirements, and any other important policy issues for swaps trading market structure when a customer is onboarded directly with a DCM rather than interacting with these markets through intermediaries like FCMs. The regulatory requirements should be the same regardless of whether a retail investor participates in prediction markets through an FCM or directly on a DCM.

Robinhood believes that DCMs and DCOs should be subject to the same customer protection requirements applicable to FCMs to the extent DCMs are permitted to onboard retail customers directly. This could be achieved by:

- Requiring direct retail participants to clear through an affiliated or unaffiliated clearing FCM; or
- Applying FCM-equivalent obligations directly to DCMs and DCOs that elect directly to onboard retail customers.

Such an approach would align regulatory obligations with economic reality and mitigate incentives for regulatory arbitrage, while preserving flexibility for market structure innovation. Ensuring that all retail participants are subject to the same baseline customer protections would reduce risks and facilitate more clear and effective supervisory oversight by the CFTC.

DCMs should also be required to maintain heightened listing standards for contracts that are more prone to manipulation. Specifically, DCMs should distinguish between categories of event contracts based on the degree of control a single individual or small group has over the underlying event, applying enhanced scrutiny where influence is highly concentrated. Certain mention markets, micro “proposition” contracts and contracts with unclear or ambiguous resolutions could present concerns and may not be appropriate for the general public.

Additionally, certain event contracts may fall within the jurisdiction of the Securities and Exchange Commission (“SEC”) or present classification questions under existing regulatory frameworks. In particular, the application of the “security-based swap” definition – especially the requirement that an event “directly affect” the financial condition, financial statement, or financial obligations of an issuer – remains an area of uncertainty in the context of event-based contracts. More broadly, overlapping statutory definitions and product characteristics may result in economically similar contracts being characterized in different ways, including as swaps, security-based swaps, or even securities options, depending on their structure and listing venue. This underscores the need for clear and consistent classification.

The Path Forward

Robinhood believes that prediction markets, including those related to sporting events, economic events, weather events, and political events, are in the public interest, as they provide legitimate hedging, risk-management, growth, and informational benefits for individuals and businesses. Robinhood supports the steps already underway at the CFTC as it works with market participants, the public and other federal regulators to provide robust, prudent, and tailored federal regulation of these exchange-traded markets.