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# Regulating Prediction Markets: Federal Oversight, State Authority, and the Road Ahead

## SPEAKERS

Stephen C. Piepgrass | Keith J. Barnett

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In this crossover episode of *Payments Pros and Regulatory Oversight*, [Stephen Piepgrass](#) and [Keith Barnett](#) provide an update on the fast-developing prediction markets landscape. They discuss how federal and state regulators are responding to the growth of event contracts and the legal questions surrounding this emerging market. The conversation highlights the CFTC's continued focus on oversight, market integrity, and the need for platforms to maintain strong controls to detect and prevent manipulation or other improper trading activity.

Stephen and Keith also address the evolving relationship between federal and state regulatory authority, including questions about how prediction markets should be classified and supervised. With litigation in multiple jurisdictions and potential rulemaking on the table, platforms, market participants, investors, and businesses with a stake in this space should keep an eye on how the regulatory framework develops.

## Transcript

### ***Regulatory Oversight Podcast***

### **Regulating Prediction Markets: Federal Oversight, State Authority, and the Road Ahead — Crossover Episode With *Payments Pros* – *The Payments Law Podcast***

**Hosts: Keith Barnett and Stephen Piepgrass**

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### **Stephen Piepgrass (00:04):**

Welcome to a special crossover edition of *Regulatory Oversight* and *Payments Pros*. I'm Stephen Piepgrass, one of the hosts of *Regulatory Oversight* and the leader of our firm's Regulatory Investigation, Strategy and Enforcement, or RISE, practice group. Today, I'm joined again by Keith Barnett, one of the hosts of our *Payments Pros* podcast and a member of our RISE group to talk about recent developments with the CFTC and state regulators and what they mean for prediction markets. Before we begin, I encourage all our listeners to visit and subscribe to our blog at [RegulatoryOversight.com](https://www.regulatoryoversight.com) to stay current on the latest in regulatory news. Today, Keith and I will discuss recent activity involving prediction markets, including actions by the CFTC, related state and federal enforcement activity, and how other developments are shaping this new form of economic activity in the marketplace. Keith advises payment processors, money transmitters, payment apps, and similar companies on compliance with federal and state money services business laws. With more than 20 years of experience in litigation, compliance, regulatory matters, and internal and government investigations, he represents clients before

government regulators, including the CFPB, FTC, SEC, and the CFTC, industry regulators like FINRA, and private litigants in federal and state courts, as well as arbitrators and administrative proceedings, all involving the financial services industry. Keith, thanks for joining me again.

**Keith Barnett (01:33):**

Thanks, Stephen. It's nice to be here.

**Stephen Piepgrass (01:36):**

Great. Well, a lot has happened in the prediction market space since the last time we talked. And as our listeners will recall, we've done a couple of podcasts addressing prediction markets. We talked about national security implications of potential insider trading with Lou Reyes. And then I talked with Keith about the CFTC and its role in enforcement. And today we thought it made a lot of sense to bring folks up to speed on what's been going on with the CFTC and the states since we last talked. And a lot has been happening in that space. We had guidance issued by the CFTC. We had comments on a notice of proposed rulemaking issued by the CFTC, and then we have various developments in the litigation space as well. So Keith, kick us off by talking a little bit about the guidance that the CFTC issued on March 12th and its implications for those operating in this space.

**Keith Barnett (02:34):**

You're right, Stephen, a lot has occurred since the last time we spoke. And March 12 seemed to be a big day for the CFTC. On March 12, the CFTC issued an advisory that was designed to be shared with designated contract markets, certain views based upon the CFTC's experience in overseeing the listing and the trading of event contracts. And in particular, they brought up several core principles that designated contract markets should abide by. In particular, they referred to core principle number three, core principle number four, and core principle number 12. They went into great detail on them. But at a very high level, the CFTC reminded the DCMs first, with respect to core principle number three, that each DCM has a specific statutory obligation to list for trading only derivative contracts that are not readily susceptible to manipulation. And Stephen, I think that part of it is interesting, that is in direct response to allegations not only from state regulators, but just from critics generally saying that people are manipulating the market. Remember the last time we spoke, we spoke about the lack of insider trading cases and how the commodities markets really are not susceptible to that. But it seems to me like this reminder is just to make sure that those who are involved in listing and trading these contracts do not delve into an area where things can be manipulated.

**Stephen Piepgrass (04:20):**

Yeah. And we also, since we last spoke, had an example of potential insider trading involving the Maduro ouster in Venezuela. And obviously those were trades that seemed to have been done on Polymarket. Obviously its primary trading platform is headquartered offshore and is not subject to all of the rules that the CFTC has put in place that other platforms like Kalshi do comply with. And that does make it difficult for investigators and prosecutors to go after cases like this. But in this situation, they have in fact done so, and it was a combined effort of the CFTC and the DOJ, particularly the U.S. Attorney for the Southern District of New York, that brought charges against a member of the armed services for alleged insider trading in that case. Very interesting situation where despite

Polymarket's allowing trading using anonymous accounts, they were still able to identify someone who they allege was the trader in that situation and are prosecuting. That's one I know that many who are observing these markets will be following closely. And it will be interesting to see whether other criminal prosecutions are brought in other cases where observers have speculated whether insider trading may be going on.

**Keith Barnett (05:42):**

Right. And that's part and parcel of what the CFTC said in its guidance, right? So if you have a regulated market, theoretically those who are participating in the market should be able to detect and do certain things when they see any type of manipulation. And in fact, the CFTC went on to talk about core principle number four, which does require a DCM to have the capacity and the responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process through surveillance and compliance practices and procedures. And to meet these obligations, the DCMs must, among other things, conduct real-time monitoring of the trading activities. That is what the CFTC is really looking for in the market participants. Hey, we're gonna do our end on enforcement, but you also have to do your end with respect to internal controls in making sure that everything is above board.

**Stephen Piepgrass (06:46):**

Yeah, and that case involving Polymarket is an interesting one because there were some things that the alleged trader did that were red flags that seemed to have set off and helped this investigation substantially, including opening these accounts shortly before the Venezuela invasion, trading only on subjects surrounding that issue, and then closing the accounts and taking steps to what looks like cover their tracks. All of those things were red flags for investigators, things cited in the complaint that was filed by the CFTC and in the charges brought by SDNY. And those are the sorts of things that CFTC seems to be talking about. But of course, in situations where the platform's regulated by the CFTC, in those situations, the platforms also have to have additional safeguards in place, similar to know-your-customer laws that you're very familiar with in the payment processing space. So I think that gives the CFTC a lot more tools than what those who are trying to police insider trading in offshore platforms have in their arsenal. This might be a good time for us to flip the page and talk about the ongoing litigation right now. A lot going on in that space, and it seems like almost every day we see another state either filing suit or being sued. Maybe we can talk a little bit about the status of those cases, where the CFTC has actually filed their own lawsuits, and then I can talk a little bit, Keith, about the various courts of appeal proceedings that are also going on. So why don't you bring our listeners up to speed on where the CFTC has taken an active role as a litigant.

**Keith Barnett (08:32):**

This is really interesting, Stephen, to be candid with you and to be candid with our audience. We are seeing a turf war between the federal government and the state governments. Usually in my area where I deal with core payments, there's usually not a turf war between the states and the federal government, right? I see a lot of enforcement actions where the FTC, the Federal Trade Commission, joins with states in going after alleged bad actors. Here, we have a situation where we have, at this point, 16 or 17 states at the time of this recording that have been involved in legal issues regarding prediction markets. And these states are either involved in enacting legislation to make sure that their laws are very clear showing that they can regulate prediction markets as

gambling, or they've actually filed lawsuits, both civil and criminal. What the CFTC has done, though, is the CFTC has actually sued the state AGs in six of these states: Arizona, Minnesota, Wisconsin, Illinois, New York, and Connecticut. And so while the states are saying that they are regulating gambling within their borders, the CFTC is arguing that its right to regulate swaps and derivatives places all event contracts, no matter the content, under its purview. So we're having a turf war and different legal interpretations as to what these event contracts are and what they are doing.

**Stephen Piepgrass (10:07):**

Yeah, and there are two states I'd like to highlight just for a second to our audience. One is Arizona, which took a very interesting and aggressive step of actually bringing criminal charges against platform providers, something that had not been done before, and the CFTC very quickly went to court and got an injunction against them. Interesting and aggressive development there. And then the other is Minnesota, which passed a statute that effectively banned participation in many, many of the trades in the prediction markets that are explicitly allowed by the CFTC. Again, if this is a turf war, this is a major battle in that war, and CFTC has gone to court there asking to enjoin enforcement of that statute as well on preemption grounds. So that's something we'll be following very closely. I know the governor has talked about potentially amending that legislation because there are pieces of it that are extraordinarily problematic, even from a Minnesota perspective, including banning trades on weather, which is a problem for farmers who are trying to trade to hedge their market risk.

**Keith Barnett (11:16):**

Right.

**Stephen Piepgrass (11:16):**

That's the very purpose of the CFTC.

**Keith Barnett (11:19):**

That's right.

**Stephen Piepgrass (11:19):**

There's a reason why CFTC went so rapidly to court on this one. Very problematic statute from their perspective and from the perspective, frankly, of farmers in Minnesota.

**Keith Barnett (11:29):**

And that's the problem, though, when you have these statutes that are overly broad. While the states, on the one hand, are saying, "Hey, we're only trying to enforce our gambling laws," but when you have an overly broad state law, that sort of cuts against their argument and, quite frankly, makes it very easy for the CFTC to go in, sue, get injunctive relief, or get an outright victory against the statute.

**Stephen Piepgrass (11:56):**

And this is one of these situations where... And I'm obviously not a Minnesota legislator, so I don't know what they were thinking, but this may be a situation of bad facts making bad law. Because there was a very recent story in the news about a trader in, I believe it was France, that seemed to have manipulated a weather station so that it showed a spike in temperature and had traded on that. Obviously, that's a violation of the rules of these platforms to do something like that, but that's probably where that weather prohibition came about, again, without thinking about the other consequences of it. The other thing I'd love to talk a little bit about is the status of these appellate cases and why it looks like we may very well end up at the Supreme Court with these cases. We've got active matters in the Third Circuit, which ruled in favor of these markets in *Kalshi v. Flaherty*, and that court found that these are legitimate swaps under the CEA, properly regulated by the CFTC, not by the states. Then you've got the Sixth Circuit, which is considering this right now, it's in the briefing stage, *KalshiEX v. Schuler*, and that's one where the CFTC has filed an amicus brief with Ohio being on the other side. Then you have the Ninth Circuit, which recently had oral arguments. Some very interesting arguments and a lot of observers are saying these seem to be questions from the judges that were skeptical of the prediction market platform's positions. One in particular stood out to me as someone who practices in the gaming space. The circuit judge there, Judge Nelson, focused on the self-certification around trades, saying that they do not involve gaming activity. Well, those of us who practice in the gaming space know what gaming means. It means gambling, right? I mean, it's casino gaming. We all know what gaming is. But the judge seemed to think that also encompassed sports, games, right? Well, maybe as a layman, but as someone who practices here, I think we're all pretty sure as to what gaming means in these self-certification contexts. And so I have to confess, may have rolled my eyes a little bit as I was reading some of the questions that came in. But we'll see how that all plays out. That's the Ninth Circuit. And then there's a Fourth Circuit case also underway, which had oral arguments just a week or so ago as of the time of this recording. So what we're seeing in all of this is a likely circuit split shaping up with ultimately probably the United States Supreme Court needing to resolve these basic questions. And we'll see what happens with that.

**Keith Barnett (14:35):**

Yeah, we'll definitely see what happens, and I agree with you on the upcoming circuit split, but then query what the state of predictive markets is gonna look like by the time everything gets to the Supreme Court, because it is possible that the CFTC will have enacted new rules before anything goes before the Supreme Court, and that can throw a wrench into whatever the Supreme Court's decision may be. On March 12th, the CFTC did release an announcement of proposed rulemaking, right, and asking pointed questions about regulations for prediction markets and so the types of event contracts that may be prohibited and things of that nature. And the CFTC made it clear that they intend to use the information received and comments received to inform potential future regulatory action such as rulemaking. That might throw a wrench into everything before the courts right now.

**Stephen Piepgrass (15:31):**

That's a great point, Keith, and we've been watching the comments pour in in that rulemaking process. And obviously, from a CFTC perspective, and actually from the Supreme Court's perspective, the more the CFTC has built out its rules around this, the more activity there is, frankly, in these markets, the harder it is for any court to say we're gonna ban all of this activity altogether or give states the right to do so. And I think that may be what we're seeing play out here as the platforms are rolling out their own rules that are reflective of the direction that

we think the CFTC will take with its rules. And as this market just really explodes and becomes such an important part of the U.S. economy, we will get to the point where it's going to be very difficult for any court to shut this down altogether.

**Keith Barnett (16:19):**

Exactly right.

**Stephen Piepgrass (16:26):**

We may see changes at the margins, but I think it's hard for anyone to imagine a court saying, "You know what? We're gonna stifle this dynamic new market that has just begun to develop in the United States and that a lot of investors are very excited about and that brings with it the ability to do things like hedge, just like we were talking about in those Minnesota cases." Lots of interesting activity. Thank you for joining me. I hope our listeners enjoyed this as we brought them up to speed on what's been going on with the prediction markets.

**Keith Barnett (16:58):**

And there'll be more to come.

**Stephen Piepgrass (17:00):**

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