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THE RISE OF PREDICTION MARKETS: INNOVATION OR SPECULATION?

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CONVERSATION

THE HON. JEFF MERKLEY (D-ORE.)

U.S. Senate

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KLEIN: Good afternoon. My name's Aaron Klein. I'm the Miriam K. Carliner chair and senior fellow in Economic Studies at the Brookings Institution. And it is my privilege and pleasure to welcome everybody here today for what I think is an incredibly topical, interesting, and depending on what you wagered on today's event, potentially profitable conversation on the rise of prediction markets.

This has been a very meaningful month for me both personally and professionally. Personally, I turned 50 just last week and professionally, this marks 10 years for me at Brookings, so exactly 20% of my life. And I was thinking about that because when the year I turned 50, I'm a bicentennial baby.

Maryland became the 12th state to legalize lotteries. Today 45 states have lotteries and one of those five that doesn't is Nevada, which I think we can say pretty safely say, is a place you can, you can get a bet in. During these 50 years, you could argue that the growth of legalized gambling has been one of the largest policy changes in society.

It has done so quietly and stealthily from an it has done so clearly through state referenda and legislative action, as well as through the judiciary. Most recently in the Supreme Court invalidating a 1990 statute precluding wagering on sports at the state level, except for two places that were grandfathered in, in Atlantic City and, and Nevada.

And now we have a situation where, from my couch on my 50th birthday, I could have bet upon just about anything. Not only could I have bet upon sports games, I could have bet upon the ongoing war we were having in the Middle East. I could have bet upon my local elections and my beloved Montgomery County, Maryland, which keeps making the wrong electoral choice in my opinion. And we could have done it on almost anything.

Sometimes these are done clearly through gambling markets that are done. Other times they're done things through things that are called prediction markets, which run on something called swaps, which we're gonna discuss, and contracts and what the distinction and difference is.

But what I want to ground our conversation in is two simultaneously, but slightly different concepts, which our distinguished panel have experts in both. The first is the rise of gambling as a form of entertainment, as a form, for some people, of profession, as a form of the financialization of our society. As we debate between what is a financial instrument or contract, verse, what is an entertainment wager or bet?

The second broader context upon that is the growth of tech, of of financialization, separate and apart from gambling, allowing markets to be created in hereunto for things. For anybody out there who lived through the financial crisis like myself, I was scarred in that experience working first in the Senate and then in in the Treasury, we had massive debates upon the purpose of some of the financialization that had gone around the housing market and the derivatives market more broadly. Derivatives once famously called a time, a ticking time bomb of financial destruction by Warren Buffet. Eventually that time bomb went off in the financial crisis in 2008.

Nonetheless, anybody here book their summer travel flights yet maybe Thanksgiving or Christmas to go home? You, the airline that did that probably could tell you what they were gonna charge you because they'd done a fuel hedge and a financial instrument about the future cost in order to know their certain business model.

So we have these different questions about what financial products are, what gambling is, what are useful financial innovations, what are societal changes and morals about fair ways to spend your hard earned cash for entertainment and or necessarily profit if you think you're that much smarter than the rest of us.

So these are juggled thoughts. And in order to unscramble this egg, we're gonna bring together a panel that I'm gonna have the pleasure to introduce. And as I introduce them, they're gonna take the stage with a wide variety of expertise. And so, we will start with Patrice Kunesh. Patrice is a visiting law professor at the University of New Mexico School of Law, and we're privileged to have her as a nonresident fellow at the Brookings Institution. She focuses on issues involving economic development in Native communities. And her background there is deep and storied. She was deputy assistant secretary for Native American Affairs at HHS, and in 2023, she was nominated to be chair of the National Indian Gaming Commission. Before this most recent stint in federal service, she was the inaugural director of the center, Center for Indian Country Development and the Federal Reserve Bank of Minneapolis. And let me tell you, the Federal Reserve Bank of Minneapolis does amazing work in Indian country. Work that is groundbreaking, work that is incredibly important that extends beyond just their district, nationally in one of the most important parts of our economy, and sadly, too often forgotten part of our society. She also served as in-house council to the Mashantucket Pequot Tribal Nation, and is a graduate of Harvard's Kennedy School. Patrice, please come on up and join us. Thank you for coming all the way from New Mexico.

Next we're gonna have Christy Goldschmidt Romero. Christy served as a financial regulator under four United States presidents. She served as a council at the Securities and Exchange Commission, a special inspector general of the TARP program at the Treasury Department, a program that I worked on and had the, I can tell you that she was by far our best inspector general and she was commissioner of the Commodities Future Trading Commission, the most recent position she had, although during that tenure she was also nominated to be chair of the Federal Deposit Insurance Corporation. I think we're seeing a clear trend in trajectory over a stellar career. She's teaching at Georgetown University Law Center. She's a senior fellow at the Atlantic Council and a dominant voice in financial regulation, particularly in cryptocurrencies, securities, commodities, and global markets. A proud JD from Brigham Young University. Please welcome former Commissioner Goldschmidt Romero.

And now we have Jonathan Cohen. Jonathan leads the American Institute for Boys and Men's gambling policy efforts. He's the author of two books, "Losing Big: America's Reckless Bets on Sports Gambling," and "For a Dollar and a Dream: State Lotteries in Modern America." Before joining the American Institute for Boys and Men, he served as a senior program officer at the American Academy of Arts and Sciences, where he led a cross partisan commission on the American economy and projects focused on democracy. He holds a doctorate in history from the University of Virginia and has joined us from New Haven, Connecticut. Thank you, Jonathan.

Alright, welcome. So let's start by talking about what these prediction markets are and how they differ from traditional forms of, of, we can center this either on investing or gambling. Commissioner Goldschmidt Romero, or former Commissioner Gold Schmitt Romero. How are, what is a swap? How are these prediction markets operating as a swap?

And what does it mean in terms of how they're categorized under US financial law?

ROMERO: Well first of all, thanks for having me. It's always nice to be at Brookings. It's always nice to be with you and with my fellow panelists. I think once a commissioner, always a commissioner. So I think, I think that works.

So the CFTC regulates derivatives and derivatives are basically used for two things, price discovery, and hedging risk. Right? So after the financial crisis, Congress expanded the CFTC's jurisdiction to include swaps. What are swaps? Swaps are a financial contract where the payment is dependent upon some occurrence or non occurrence of a, of an event or, or a contingency. Okay. Well, so far that sounds like event contracts. Right?

Now there's a second part of that definition, and this is where the rubber meets the road. It has to be associated with a potential financial, economical, or commercial consequence. And that, that situation right there, that definition is where a lot of times the CFTC should be looking at particular contracts and determining whether they meet that, think about it as that hedging purpose that we talked about before.

So, if I think about, if we just think generally about the, just the definition of swaps, let me just start there and just say, okay, well, if there was a contract for the outcome of a sporting event or how a particular team or player performed, maybe you might be able to argue that there's a potential financial, economical or commercial consequence maybe. But then there was a contract for like the color of Gatorade that was dumped on the coach's head after the game. So the question is like, does that rise to the same level? Is that a swap? But even though there was a contract, the question is like, well, where was the CFTC in determining about letting that contract go through?

Now there's this kind of strange situation that most people don't realize. The CFTC doesn't actually approve contracts to go through the exchange, just self certifies that they've met the laws and they've met the rules. We call 'em core principles. And then after 24 hours they can list. But the CFTC can say, hey red flag, we have, or yellow flag, we have an issue and we wanna talk to you about it. So the first thing is that the CFTC should be looking to see, does it really meet the definition of a swap? Do we have that second part of the definition?

We talked about the, the hedging part of it. If you think about it in the traditional sense, the fuel, the airlines with the fuel, like you were talking about, maybe there's a second area and an issue where the CFTC has jurisdiction and authority. And this is that Congress and the Dodd-Frank Act, when they gave the CFTC authority over over swaps and they knew that it had included event contracts, came up with basically a special rule that's in the Commodity Exchange Act. And that is Congress enumerating categories that it thinks are against the public interest, war assassination, terrorism violation of state law and gaming. And there's some back and forth in the legislative history about what gaming means.

And so when you have a situation, like for example, there were contracts related to the, the ouster of the, the leader of Iran, then there becomes this issue. Does that fall under war? Should that contract have gone out? And so it's interesting because the 3rd Circuit just a few days ago, ruled in favor of Kalshi in a, in a preliminary injunction. And the court cited to this authority that the CFTC has been given to look at these enumerated categories and determine whether contracts fall within it. The CFTC, by the way, can also create new categories through rule making. But then said the CFTC is basically choosing not to exercise that authority. And so I think that's what we have now.

So then if we think about it from a swaps perspective and you're trying to define what is, what is a swap and what's not. You gotta have that financial, economic, or commercial

consequence or the potential for it that does not define what is gaming. And we, when I was at the CFTC, we proposed a rule on that. That rule was then has been withdrawn.

KLEIN: So Congress gave the CFTC the authority to not allow swaps on gaming,

ROMERO: Right.

KLEIN: but the CFTC is not currently using that authority. To the contrary, they seem to be like "game on," signing a MOU with Major League Baseball. And I think the commissioner of the CFTC, the current chair was out there saying, let's game. Sports gambling has become the largest ones of these contracts as the markets currently are. And so instead of just going on a sports gambling site and doing a simple sports gaming bet, which many states allow, we now have this swaps contract, which settles as a one if a dollar, generally a dollar if your team wins, zero if your team loses, and then your odds are based on how much you paid for the, for the contract.

Sports gambling has been around for, for a while. Commissioner Kunesh, can you describe how sports gambling works in the US today and how turning sports betting into swaps upsets the status quo?

KUNESH: Sure. I have to say I, I'm not a, a gambler and I've never done sports betting of sorts.

COHEN: You should, it's fun.

KUNESH: That's what I hear. It's interesting when we compare what sports event contracts are to sports betting and in the Kalshi world, they would say that sport event contracts are peer to peer. You're, you're one, you're going after each other on a prediction market on a particular outcome, yes or no. Who's gonna win the Masters? So and so.

So sports betting or sports wagering, you're, you're betting against a bookmaker, not your peers, but against a sports a, a bookmaker. And the pricing also differs. Whereas in the prices in, in sports event contracts, look at probability, 62 cents is, equates to like 62% that so and so's gonna win the Masters. Whereas in sports wagers, the odds are set by the bookmaker. So you've got some pricing differences, you've got a structural difference, and you also have a revenue difference. And that revenue differences that the funds or the revenues for sports event contracts on a prediction market are from the transaction fee that the prediction market platform, charge. Whereas the revenue from sports wagering comes from the bookmaker's margin.

And of course, we just heard about the regulation CFTC for prediction markets, whereas that's sports betting is legalized by the Supreme Court. We have state regulations. Or in the area that I'm involved in Indian gaming, you'd also have Indian tribe, Indian tribal governments regulating sports betting on Indian lands.

And so I also think there's, there's a market scope difference as well. Prediction markets are ubiquitous, they're available anywhere, anytime, regardless of jurisdiction. Whereas sports betting is confined to the jurisdiction of the state or the tribe in which it is permitted. So there are significant differences, but functionally, I believe sports event contracts are almost indistinguishable from sports betting.

COHEN: Can I, can I just say this may trouble a little bit of that, of that definition because on, I, I think with prediction markets it's really easy to look to look at them as what they are on paper and assume that that's what they are, and then look at them in the real world when they in fact behave somewhat differently.

And I think in this case, you just referred to the peer-to-peer nature, for example, which nominally on paper, these are advertised as peer-to-peer exchanges. If I buy a contract that Dwayne the Rock Johnson is gonna be the 2028 Democratic presidential nominee, someone else is on the other side of that contract, which you can actually buy on Kalshi that says he's not, or if I buy Gavin Newsom, someone else can buy, is on the opposite side that they're not.

But in fact, there are these institutional investors called market makers that operate behind the scenes that both provide the initial liquidity into the market so that there's somebody somewhere dumb enough to take my money that Dwayne the Rock Johnson is gonna be the Democratic presidential nominee. But also we don't know --and maybe you do and you just won't tell the public or the, the CFTC knows and won't tell anybody-- but, but it's a black box into the degree to which these, these institutional investors, these basically hedge funds are operating. So that again, you have the illusion, I think, sometimes of a peer to peer.

ROMERO: Yes, yes, yes.

COHEN: But in, in practice sometimes it's like me against a bunch of guys in like blue shirts and khaki pants in a New York, in a New York office somewhere like, who are gonna bilk me out of every dollar that I have.

KLEIN: So I think that's a very important point. I like to gamble. I grew up gambling. I had a single mom who used to drop me at her father, my grandfather's. He was a retired musician and would take me to the horse track. And the horse track's a para-mutual wagering system, just like what, what you described, which is the track takes out a share, and then the odds on the horse are based upon the amount of money that everybody else is putting in.

And those odds vary right up to, and sometimes increasingly now, after the race is started. Which is very different than a a, a bookmaker, but the track isn't actually taking a position. That's why the odds are fluctuating. What you're saying right, is and I think one of my favorite events contracts, which is not sport, is "will Jesus return?"

COHEN: 4%, 3.9% right now.

KLEIN: Right. And so in that situation, right, it's, somebody's making a, a, a position and somebody else is basically willing to gobble that on the other side; it may not be directly in that relation. There's now a derivative of this position, which if you want to get really wild, is a wager that will settle one or zero if the "will Jesus return to earth" hits 5%. Which one could then imagine is easy is could be manipulated, would you say, by the ?

COHEN: Designed to be manipulated I would say. This is only on Polymarket, so technically not available in the United States, but yes.

KLEIN: Could you explain how it's designed?

COHEN: Well, it's mean to be, to be manipulated, meaning? So yeah. The idea, and this is true, I, I think for all sorts of markets and explains their, the unique susceptibility of prediction markets relative to something like traditional sports betting, which is if I got a bunch of friends together and convinced everyone to bet on the fact that Jesus Christ will return in 2026, then I could make a bunch of money on the derivatives market because all my friends investing in whether Jesus Christ will return will drive that price of that market up. And then my price, my market on will Jesus Christ return hits 5%, boom, and then I cash out.

It's like basically the rug pull version or, or what the rug pull scheme in crypto. But one could use theoretically, a following on Twitch or something to get a bunch of dumb investors to put a bunch of money into a dumb market and then take all their dumb money.

KLEIN: Right. Or in this case, you're all in it together and you're all,

COHEN: Or, and then Jesus returns and you're gonna be in big trouble. But until, yeah,

KLEIN: No, no, no, I meant that you and your friends are in on it together.

COHEN: Right? Yeah. And you can convince the, but this, the, the most, the craziest version of this is theoretically the opposition leader in Bangladesh or whatever could buy a, could put a bunch of money into the contract that says, oh, Bangladeshi prime minister out in 2026. And then it looks like someone in Bangladesh has inside information about the ouster of the Bangladeshi prime minister, and then that could drive a political cycle that might actually ultimately result in the ouster of the Bangladeshi prime minister. And all it took was like \$50,000 on poly market to manipulate the market.

KLEIN: What do you think of the, we've turned to elections now.

ROMERO: Yeah,

KLEIN: That was, that was something you faced in your--

ROMERO: Yeah, yeah. Yeah. So I think so my largest concern has always been elections. So one of the things that, that I think is important in the, to the extent we have a market, we need to have integrity in the market. This is a regulator's job, right? Ensuring that there's surveillance and oversight and that there's rules against insider trading and kind of all of that.

And one of the things that I, I do think is fascinating and is a good thing that the CFTC just recently did was start to lay down kind of some, some guidelines and rules about, like, for example, in sports contracts, there are some, contracts where it might be subject to manipulation. It may be like, and their two examples are, the first is like the injury or sportsman, unsportsmanlike conduct between players. Or, the second situation is a small group of people can determine the outcome, right? So I think that's all related to integrity. And, and what the, what the CFTC did was just recently did a memorandum of understanding with the, the Major League Baseball to say, okay, we're going to hook up our exchanges with the league and they're gonna work together. Basically the, the exchanges are gonna look to the league's integrity standards.

And so, and my thought on this was great because the CFTC is not, are not experts in baseball in the underlying, right, in the underlying contracts. Well, the CFTC is certainly not an expert in elections. Or, or they're, they're experts in markets. And so one of the concerns

really is sort of like if, to the extent that there is manipulation, what is the, and what are the stakes of that outcome if it's for an election? And I think for me, when it came to elections, that was the drawing line. The stakes were so high for elections. If that market was manipulated, that for me, that was the line to draw in the sand.

And at the time we were doing this rule making, this was before there were sports sports contracts trading in, in the prediction markets.

KLEIN: So, get back for, for a second on the, on the, when many states went and legalized gaming, and this was very true in Maryland, the idea was that it was gonna be taxed and it was gonna go to revenue, often education. Sometimes I think it went to the Maryland Stadium Commission was, was, was a big proponent. But different states had different, it was a, it was a tax revenue basis, right, that was driving it in the state and local government. The swap stuff is, is a federal, there's no--

ROMERO: Yeah.

KLEIN: It bypasses all the state and the tribal elements. Commissioner Kunesh, can you talk about this? 'cause it's easy to focus a little bit on the state element, but tribal gaming has been one of the biggest changes also since--

KUNESH: Since 1989.

KLEIN: Right?

KUNESH: Yeah.

KLEIN: And the growth of tribal casinos and the growth of revenue in, in that space. But it extends to in sports gaming as well, right. Is it, can you talk us through a little bit about how some of this gaming revenue impacts and some, some of this movement from a state-based system to federal stuff, would, would impact tribes?

KUNESH: Absolutely. So, tribal governments are sovereign nations. And they have authority to offer gaming on Indian lands, which essentially is the lands within their, their, their, their reservation boundaries pursuant to the Indian Gaming Regulatory Act, which was enacted in 1989 following a Supreme Court decision Cabazon Mission Band of Indians versus California, in which the, the Supreme Court confirmed that tribes have the inherent authority to offer gaming.

And once that decision was out, states were very nervous because they could see that that tribal gaming in one form or another would take off like wildfire in their fire. And there were tribes, obviously Cabazon; Florida, the Seminoles; in Connecticut was the Mashantucket Pequot tribe that I used to work for and very, very popular.

So tribes and had to really, contain their, their, their joy because states got together and lobbied Congress to pass the Indian Gaming Regulatory Act, which is what it is. It regulates gaming on Indian lands and requires a tribe to have a compact with the state in order to do this gaming.

Now IGRA sets out the most comprehensive regulatory scheme for gaming in the nation, probably in the world. And it's not just that the tribe has to have a whole array of its own

internal control standards, but there are standards in the state. And if a state doesn't allow gaming, if a state doesn't allow sports betting, for example, tribal governments are not allowed to do that.

So, today we have about 10 states that allow tribes to have sports betting through compacts. A couple states allow tribes who have exclusive rights to offer sports betting. For example, Florida, the Seminole tribe has the right to offer sports betting anywhere in the state as long as those servers are located on Indian lands. Just this, this past week, the state of Wisconsin has authorized sports betting and has limited that sports betting authority exclusively to the 11 tribes in Wisconsin. And they have to figure out how those licenses are going to be distributed amongst themselves.

But to your point, Aaron, gaming revenues have been an enormous impact on tribal communities to the, to the, to their benefit. The tribes often have relied on federal funding through the treaty and trust responsibility of the federal government to tribes for basic things such as healthcare, education, law enforcement, roads, and, and other types of infrastructure. But the federal government has woefully, consistently underfunded tribes and, and disregarded their treaty trust responsibilities. So gaming revenue has been the only source of revenue for tribes because in addition to, to just not general economic development reservations there's just not been a enough return on investment. Nor can tribes really tax like states can, like counties and cities can. So in lieu of taxing tribes really need an opportunity for economic development.

In 2025 Indian gaming saw \$44 billion in revenue. And most of all of that goes back into funding essential services. And not just that this money is, the, the, these funds are going back into the community, building homes and, and supporting early childhood development center and supporting elder care. They're actually transforming people's lives. Native people had been on the lowest socioeconomic strata with, with, chronic illnesses, the lowest mortality and and often forgotten as the other in any sort of economic statistic. So gaming has actually transformed lives. Native people are healthier, they're attaining higher levels of education. They've reduced their smoking, they're reduced their diabetes, they're actually more civically engaged. And all of this has been supported by data.

So I believe, and many in Indian country believe that prediction markets, especially these sports event contracts, present an existential threat, a, a seismic impact to, to Indian tribes, the gaming revenue being siphoned away and completely unregulated in, in, in most respects.

KLEIN: So it's incredibly important insight because I think often this conversation gets very focused on on the markets and the betting and you don't think through the state and tribal elements of that. And I, I'm, I'm very pleased to hear that perspective that I think has been lacking in this broader conversation.

Flipping the coin for a second, from the government and the funding of gaming profit on our current state and tribal based gaming to the users who are making the bets, I find it interesting: is it correct that the two men on the panel acknowledge that they gamble a bit?

ROMERO: Well, I will say I, I started my career with a clerkship in Las Vegas, and so it became quite common. I wanted to eat in a restaurant. I had to walk through a casino, so it, I have done my, a little bit, a little bit. Yeah.

KLEIN: But, but, but Jonathan, you've done some actual research in and hard data on the, who's gambling

COHEN: Yeah. Prediction markets and, and generally, the, the, the stereotype, fits the bill in terms of, this being not only but a, a male activity, and I'll talk about gambling writ large and then prediction markets specifically.

But, as of last year, 49% of American men between the ages of 18 through 49 had a sports betting account on their phone. And this is,

KLEIN: Anybody wanna own up?

COHEN: I have three. I have, I have three, so it's fine. And this does not include Texas and California, where sports betting, legal, online sports betting is not technically available, but through prediction markets. And so,

KLEIN: So that's 49% of states that allow it.

COHEN: 49%. 49%. No, 49% of all American men. 'cause if you live in California, you drive over the border of Arizona, you download the app or you--

KLEIN: That's a little hard. Yeah. Like California, I think of, I think of America as like one group of states like Maryland where you, are constantly being invaded by your border neighbors. Another group like Texas and Florida and California, where like, it's really, there aren't that many people who live by the borders.

COHEN: You know, the, the bestselling lottery, California lottery outlet in the state is right over the border from Las Vegas, is because Nevada doesn't have a lottery. So they all drive over to the right over the border to buy their lottery tickets.

But our, so our polling that we did recently--

KLEIN: Nationally, nationally, half the men between 18 and 50

COHEN: Exactly. Have a sports gambling account. And I think roughly we would say maybe 30, ranges between 15 and 30% of all Americans have gambled on sports within the last year. Just again using a traditional sports betting platform.

And then our did indicates, at least our polling from --things change all the time-- so this is from late February, early March, that when it comes to prediction markets-- no offense to the people in this room, but like the Washington bubble and like the Twitter bubble is a little bit overinflated in terms of your familiarity and your willingness to come to a panel in the middle of the day at Brookings probably says a lot about your familiarity with, with prediction markets-- but roughly 20% of Americans said in our poll that they're familiar with prediction markets and only about 30% of 18 to 24-year-old men were willing to say the same thing. Again, if you've been on Twitter anytime in the last year, your familiarity is like 150% 'cause they're the most annoying people in the universe and they won't shut up about prediction markets on the internet. But it is not, not quite what it seems, but that is the, the purpose of these sort of integrations with, with sports leagues that, that the commissioner mentioned, with, with news agencies trying to socialize more people, trying to get 19 year olds in Utah who don't have access to legal gambling 'cause they're too young and because they live in a

state without access. But lo and behold, they actually do have access thanks to the advent of prediction markets.

KLEIN: Sorry. So yeah, so there are five, five states out and Hawaii would be the one--

COHEN: Five, no, five states with no lottery. And then there's 18 states with no online sports gambling. 10 states with no sports gambling at all. Legal, the licensed sports license gambling.

But, and I'll just say our study, our poll show, actually the, the theory for a long time was that this was just a substitute, right? This is 19 year olds in Utah, 19 year olds in, 19 year olds in California who don't have access. But our studies show a no difference in familiarity or use of prediction markets between people who live in states with online sports betting and those without. So the, the sense that these are direct substitutes from one another seems to be a little misplaced.

And there actually are people who are using both and who are, maybe they're just trying Kalshi for the first time, 'cause it's available here in DC, but it might be something different going on.

KLEIN: So, if what we're talking about the user base is heavily young men, let's compare that a little bit to the investor user base that the CFTC is generally regulating with complicated derivatives and swaps and institutional investors. Former Commissioner Goldschmidt Romero you see the current CFTC Chairman Selig, who's publicly welcomed prediction markets and said, bring it on, we can regulate this. Does the CFTC of the budget, staff, resources and familiarity with how to regulate markets geared towards retail investors who are predominantly male and under the age of 50?

ROMERO: Well, let me just say it's already starting, and it's not just for prediction markets, but it's for crypto, right? Because up until 2024 the only regulated trading in crypto was, was through the CFTC which started with Bitcoin futures. I see a former Chairman Giancarlo in the back there who started that. And with that, started to bring, with crypto, more of the retail focus coming into the CFTC. Whereas traditional derivatives, you're not really gonna have a lot of people trading in oil futures. So you're starting to see more and more of that.

Now, I think to the extent that Congress gives the CFTC authority over what we call spot market, Bitcoin and other crypto, you're gonna see a huge jump in retail and investors come in and I think prediction markets are bringing a huge jump in retail.

So my concern all along that I've, I've said over the many times, over the last few years is that I, I don't think that, sort of our playbook was sufficiently geared towards retail investors. And I said like, look, what Congress needs to do first is give us a definition of retail. The CFTC did not, does not have a definition of retail. Give us a definition of retail.

Now some things, some customer protections or other roles would apply to all, but there might be certain things for retail. Right now there is for retail, for what's considered to be retail, it has to be on an exchange, for example, some sort of protection in that way. And I think there can be other things like that. For example, just very, very clear disclosures. What am I buying? What's the risk? What do I need to know about this? Some, some basic sort of things. I'm not saying pull over the SEC's rule book for retail. I'm just saying if you're going to be, really expanding in a retail market. So to shift the culture a bit, shift the playbook a bit. So I think that's certainly needed.

Now if, if it expand, if Congress gives 'em authority and expands to crypto, they're gonna need a lot more staff. They're gonna need a lot more resources. Even if that doesn't happen, they're gonna need a lot more resources because the SEC is basically saying a lot of these are not securities in terms of crypto.

So we already have this huge idea of the potential that more contracts, crypto, derivatives contracts come under. Now we throw on prediction markets on top of that. So now we've got more coming for various reasons. Some new coin, some prediction markets. You have more and more people coming, and I just want them, anyone who comes in, I love having more people come into markets. I'm a markets person. I believe in markets. I want them to understand what they're getting. I want them to understand their risks as best as possible, and then they can make a choice.

Now, let me tell you something that is really, really needed besides resources, which they absolutely need to go in this area, and besides a shift to this more kind of retail customer playbook, and that's, that is this: the CFTC, the commission is made up of one person right now, not five like it is supposed to be.

This stuff is hard. It's new, it's nascent, it's complicated. The tribal, the tribal issues and the tribal law. I've been getting more into and reading about that. It's just hard. And even when we had, we, we had Kalshi, we had PredictIt and we were trying to get our hands around how do we do this? What's the right approach, right? How do we, how do we work? We had states and, and tribes and, and all of this. And it's like, we had elections and how do we do this?

And there is just the idea of if you can have a full five, full five commissioners, bipartisan basis, there's the, the tension and the pushing and pulling, but there's also a lot of agreement. It didn't break down by party. I would be in agreement with people who are Republicans. I'm a Democrat. And I think what that eventually gets you is a more durable rule book, a more durable way of moving forward. And what do I mean by more durable? More long lasting, right? Because if what we're going to have is every four years, the rules flip, what kind of clarity does this give to anybody? Whether it's to the markets, whether it's to the prediction market companies, whether it's to the tribes or the states or the, the gaming commissions or any of that.

And so we've gotta at least start with that. Get a full five. Not one person make a, making a decision, which is hard on that one person, right? That person didn't choose that, the chairman.

COHEN: Especially when he spends all his time going on podcasts. Imagine how many more podcasts you guys could go on if there were five full commissioners doing it instead of just one.

ROMERO: The good news is, the good news is along with the podcasts is they're starting the rulemaking, which I think is great. But rulemaking with one person is very, very hard. And again, this isn't his choice, but this is what we need. We need to have--

KLEIN: well, it's the president's choice.

ROMERO: It's the president's choice.

KLEIN: The president hasn't nominated a single Democrat, a single minority member

ROMERO: That's right.

KLEIN: to any single commission

ROMERO: Or even two more Republicans.

KLEIN: Correct. So there, there's--

ROMERO: And that's what needs to happen.

KLEIN: Not making a choice is a choice. The Democrats chose not to prioritize the Office of Financial Regulation and didn't move forward on a well-qualified nominee. And now that office is being gutted by the Treasury Department and some of them are running around going, this office was so important. Well, if it was so important, why didn't you move the nominee? So, inaction is a choice.

And the choice that's being made, as I hear your answer to the question is, they don't have the resources, they don't have the staff, they don't even have the number of commissioners that would be ideal to tackle this challenge?

ROMERO: I think they need to get there. The markets are scaling up and it remains to be seen how big they get. But we've certainly seen, a, a huge implosion, a huge number of users come in. Look, I believe in the CFTC, I think the CFTC is fantastic. I want them to be up to doing the task and to have everything they need to be up to doing the task.

COHEN: And I know things change and agencies change, but like looking historically, the agency was just not designed, initially, in the 1970s to, to be dealing with retail investors. And there's a Barron's report, just to your point about staff, that the, we went from 20 lawyers in the Chicago enforcement office to zero. Right now at a time when, as the commissioner said, the, the, the threats of insider trading and, and are, have never been more nascent because of these new markets. And it seems like the, the single commissioner that we do have who sees his job is to like just give a green light to the companies at basically every turn. Is my interpretation of, of how he, his, his podcast appearances.

KUNESH: There is Congress and--

COHEN: Really?

KUNESH: --there is, there, there, there is a congressional interest in this,

KLEIN: The senator's coming, Senator Merkley will be here.

KUNESH: There is a congressional interest and, and that is legislation. We have about a dozen or so US senators sending a letter or a couple letters to the CFTC, voicing their concern that sports event contracts are equivalent to, to sports betting and this is a intrusion into Indian gaming.

And just recently I think it was Senator Schiff and Curtis introduced the Prediction Markets Are Gaming Act. Now whether that gets any traction, I don't know. But there is some, some strong interest in Congress to address these issues. And there's also the courts and in, in, in

litigation, we have Kalshi now suing, I think three states directly, states suing Kalshi, Robinhood, and Crypto. About 24 tribes have participated in those lawsuits as amici supporting the state's position in, in, in many respects. And then we have two tribes that have actually filed directly against Kalshi saying that this is an infringement on tribal sovereignty.

And what this is going to come down to is the definition of gaming. Are sports event contract swaps, financial instruments or are they really gaming. And, we have the CEA, the, the Commodities Exchange Act coming up directly against the Indian Gaming Regulatory Act. I think tribes have have a better argument under the Indian Gaming Regulatory Act. It's very specific. It's earlier in time. It's much more comprehensive. Speaks directly to tribes as sovereigns and their authority on Indian lands. And we were talking about this earlier, the CEA actually has legislative history that speaks to these prohibitions on gaming.

So, we have courts and we have Congress, and we have the commission.

ROMERO: Yeah. Well, so, it's really interesting as I've started looking more at the law on the, the IGRA and tribal sovereignty, and I, I do think the tribes are in a bit of a different position than the states, to be honest. As I've been, I've been looking at the laws, but I do think it's important for, for Congress to be clear about what it wants. Particularly we're in a post-Loper Bright era where agency, agencies are supposed to be following the clear direction from Congress.

And as we were working on a rule, proposed rule, on event contracts in 2024, and we were looking at elections and sports events and other types of events as to what should be allowed or not, it, it was important that we looked at the legislative history and saw a colloquy between Senator Feinstein and Senator Lincoln about their thought that the gaming would include the Super Bowl and the Kentucky Derby and, and that sort of thing. And I'm not saying it was like the thing that, that drove everything, but as, as one of the factors of what an agency is doing is trying to look at congressional intent.

Now some would say that's not congressional intent, it's just two senators, but it's in the record and that's what we had. And so, I was comfortable in using that to say that the the sports events would, would fall under this under the, under gaming.

KLEIN: So it's not just, Sarah Lincoln was the head of the title on that section of Dodd-Frank while I worked for Senator Dodd and the Senate Banking Committee. The United States Senate is an amazing place, one in which the Securities and Exchange Commission falls under the jurisdiction of the Senate Banking Committee and the Commodities Future Trading Commission falls under the jurisdiction of the Senate Agriculture Committee because commodities have a historical base in their agricultural nasis.

And so even though I think the United States is the only G-20 country in the world that has two different capital market regulators, those two different capital market regulators have two different committees of jurisdiction. So Senator Lincoln is not just a, any one of the 100 senators there, she was the author of that title or the, the chair of the committee upon which it came out.

But beyond that, I know I'm with some law professors and you're comfortable discussing law. And I get that, and law's important, but we're in Economic Studies here in Brookings. And as an economist here, I'm trying to understand how we should think about this on a broad policy level. Investing is about, with the, the core concept of investing is if you do it right, it's

profitable over time. In the long run, we can debate on a risk adjusted return, but investing is taking money, using it for productive means that benefit society and growing your pool. Gambling is with entertainment. Gambling is fun. If you do it right, you can do okay depending on the game. But in the long run, you don't really make money on blackjack. And maybe if one or two people can professionally, the masses at the table, the house has an edge, pretty hard to make money at a horse track even in a parimutuel system if, if you're gonna handle that.

Congress has at various times said gambling is federally allowed, is federally not allowed, or it's up to states or tribes. When I was in Congress, there was a boom for online poker. Anybody here play online poker in the two thousands? Right. Right. Alright. I guess just you're a younger crowd, right?

ROMERO: There's two, there's two of you.?

KLEIN: But it, it became wildly popular, particularly with young men, and Congress outlawed it. With over 90 US senators using the payment system to get rid of companies like Poker Stars, et cetera, which flourished in Europe. I might add, much like this prediction market.

How should we think about the, first of all, are prediction markets in sports intellectually distinct from gambling in sports? And the same in invest contracts and other things? And if they are investing, can, how is it different if they're gambling? How should we think about federal legalized gambling and what the optimal level of gambling ought to be in society? And if they are gambling, why are they being regulated by a financial market and not by gambling regulators? 'cause what Commissioner Kunesh said is, the structure to regulate a casino is very different than the structure to regulate an exchange.

ROMERO: Yeah. Look, I, I think this is the way I think of it. I do think it is up to the CFTC to make it-- on their part, I'm not saying it for everything-- it's up to the CFTC to be looking at which things actually are a swap. I'm gonna start with that. I don't think that is being done in the same way that it was, now, that it was being done before.

KLEIN: Is the color of Gatorade to your first example? Is that a swap?

ROMERO: I am having a hard time finding a, economical, financial, or commercial consequence to that. And so that's the question. If you have things out there, we've talked about a couple of different examples that you think, okay, does that really sound like you're hedging something? What are you hedging? Right?

And so I do think there needs to be this line that's drawn, that makes it now hedging in a financial transaction is perfectly acceptable and that is part of investing. And so to the extent you, you do that and you have that, and you've met that definition, then I think number one, then we are in swap land, then we're talking about a swamp, a swap.

And then we have this situation where on top of that you have the public interest argument, the public policy argument. And that is where Congress enumerated gaming and needing a definition of what gaming is. Now, I hope the CFTC is about to have one of those because they've started this process to have rulemaking, but they need to define what gaming was. We started it. We started that the, the current commission revoked, withdrew what we had started. But there needs to be some definition of gaming so that everyone is clear on what falls within and what falls without. And right now it's not so clear and it's muddled by the fact that we have these color of Gatorade type contracts.

KUNESH: Do you think that this is a question of fact for the court in this litigation mode that we're in?

ROMERO: I think, I think it's, I think it's a question of fact for the court. I think it's a, a policy that Congress should give clear direction and I think the CFTC should, should play its role and do what it's supposed to do to make sure we have swaps and to make sure, and then to exercise their authority that they have over, over, over gaming. But I, I think right now, as the 3rd Circuit just said last week, they're not exercising that authority.

KUNESH: The 9th Circuit is coming up.

ROMERO: Yeah.

KUNESH: California, Nevada, and, and we may have a circuit split very soon going up to the Supreme Court. So whether the commission does it again or the courts do it, I, I think something's imminent.

ROMERO: Yeah. I'm not the commission, by the way.

KUNESH: Oh.

ROMERO: Every time you put your hand out to me, I'm like, that's not me.

COHEN: The CFTC right over, yeah, CFTC right over here.

ROMERO: I, I'm not there now. I do, I do love the commission. But I do think the clarity is needed. I think the clarity is needed for states, for tribes, for leagues, for, for everyone. For users. I think having clarity would be a really great thing to have.

COHEN: I'm not a law professor, so I'm gonna use my discretion to say that I'm just gonna treat it like, like a mother-in-law test, right? Like, could I explain what a prediction market is to my mother-in-law in a way that did not make it sound like a gambling product? And I think the answer is no. I think, I don't know how you could explain an event contract on the outcome of the Philadelphia Eagles game that doesn't just make it sound indistinguishable from a sports bet, especially if you think about the fact that it is not a pure exchange model. That there are these institutional investors who you're pieing from, who are playing the role of a sports book.

KLEIN: So do you think --

COHEN: Not that we should litigate based on how, what I can speak to my mother-in-law--

KLEIN: No. I under, I understand. But, but this is a panel of, of, of expert opinion and there was a world in which you couldn't legally bet on sports. Then there was a world in which you could legally bet on sports, but you had to go to a tribe or another lawful gaming place, or this or that, right. Now there's a world in which you can bet on sports, on your phone if your state allows it. And then there's a world in which anybody can bet on anything because they're all federal swaps and the regulator has decided everything's good. And we're gonna define swaps to be color of Gatorade, length of the national anthem, which would be another one. What does that mean for society if we end up in the latter, Jonathan?

COHEN: Yeah, I would say, this is the sort of the classic American formula by the way, of just like allowing some market or some product to be unleashed on the populace. And then realizing the negative externalities that came from it. Oh, whoops. Guess we got all West Virginia addicted to opioids. Like, oh, whoops. I guess we like allowed really unnecessarily lethal doses of THC in like legalized marijuana and we need to roll some of that back, and only after the fact, after lives have been ruined, bombs have been dropped on Iran, a bunch of people made a bunch of money on it through Polymarket. Only then do we realize sort of the mistakes and only then.

And I know this is part of the, the challenge of, of regulation, of needing to keep up with markets that sort of move faster than the power of, of, of certainly any district court. I think it speaks to the, the, let's call it the gamification of American culture at large.

I think there's, there's always been this sort of strain of the American dream that is not tied up with the meritocracy and that is not tied up with hard work, that is tied up with gambling. This idea that if you can't make it through pluck, that you can make it through luck. Which is why we've had lotteries that, really were fundamentally necessary to build the first infrastructure in the colonial, in colonial America. And this is in some ways new and crazy and weird that you can bet on Taylor Swift album sales or gas prices in Miami tomorrow. But it's also just the latest manifestation of this. And why should we be surprised that, when there is a war and there is a website that lets you bet on real world events that people are gonna gamble on war?

And so I'm not saying that's necessarily a, a good thing. It's certainly not what the Supreme Court envisioned in 2018 when it allowed states to legalize sports gambling for themselves. But I do, I do think it's like the natural progression, and there's no one, and there's no agency, there's no anyone who's like, alright, we're good. Like, we've got enough gambling. We're done.

In 1999 and a Federal gaming commission said that we should stop the expansion of gambling until further review could be done. And clearly, clearly nobody at Brookings or anywhere else listened to that.

KLEIN: So, so I'm gonna, I'm gonna invite a question or two from the audiences.

While they go, I will point out that it's not a fait accompli, the interstate gambling the Online Poker Act nipped that thing in the bud. It hasn't come back today. You still can't bet, you still can't run poker online while you can bet on your Taylor Swift album because of that law. That really did kibosh the, the poker thing, and, and so the fait accompli, like only then blah, blah, blah, it's not, it's not a, a universal outcome for, for good or for ill.

We got time for, alright. I, I see these gentlemen, we'll take them together. Right there and then, then him, and then, yep.

AUDIENCE QUESTIONS: Thank you. Good afternoon. My name is Benjamin.

KLEIN: Thank you. Questions?

AUDIENCE QUESTIONS: Yep. I'm a master's student here American University School of International Service.

My question is for you, it's kind one based on your personal opinion, but is this an epidemic that we're seeing amongst young men? Because really the precedent that this is setting for the next generation is very dangerous. I've witnessed it myself. What do you think, as props are being boosted for people's sports spending, prediction markets, risk-free bonus bets, things of this nature. Is this an epidemic?

KLEIN: Is it an epidemic? And then upfront.

AUDIENCE QUESTIONS: Good afternoon, and thank you very much for this discussion. Commissioner, you mentioned that the the 9th Circuit, California specifically is going to hear the hear a, let's say, Kalshi case or something like a Kalshi case, maybe Polymarket case later on this week. The 3rd Circuit last week ruled in favor of the CFTC. So here's query, prediction: what is the likelihood that the Supreme Court is going to take up if it is a split decision? If, if it, if there are split circuit decisions, what's the likelihood that the Supreme Court will take it up this term or certainly next term?

KLEIN: All right, epidemic, and is this, is the court gonna take the case.

COHEN: I can do epidemic, certainly I'd defer-- Well, on the, on the epidemic front and the data we have does not include yet the rise of prediction markets, but I was already, not to toot my own horn, but I was already sounding the alarm of gambling as a public health concern before the advent of prediction markets, which defacto lower the age of access to gambling from 21 to 18, put it in a whole bunch of new states, don't have any of the same guard, not, and trust me, the guardrails on sports gambling are woefully inadequate, but at least they exist. And on prediction markets, they basically don't.

And I can just say in states that have online sports gambling, again, this is not prediction markets, but you see a 28% on average increase in personal bankruptcies, a rise in auto loan delinquencies, use of debt consolidation loans, reduced debt and investment, reduced savings and investment in low income households, five to 10% increase in Child Protective Services calls. So sports gambling was already not great. And then we have this sort of new, even more technically, technologically supercharged version of it that isn't even about sports anymore, and that is available to younger generations. So.

ROMERO: Let, let me, let me just add something on this. And, and this is the way I think about the prediction markets. And someone asked me why all of a sudden did they, have they just blown up? And here's my, here's my own thoughts on this having, having regulated it and seen it blown up during that time.

People have gotten into a situation where they don't trust, where they get their information from. They don't trust traditional sources. They don't trust news media, they don't trust universities, think tanks, the traditional places. And so they're looking for different places to get information. And all of a sudden you see people on social media taking as fact things that are posted by someone they don't know who this person is at all, and taking that and passing it along. So what we have is this situation where the wisdom of crowds in terms of data and knowledge and information is replacing the traditional information sources.

And then you look at prediction markets and my gosh, the information, the data. I think about it from an AI perspective and think how much data is there for AI, but it's another source of information. Is, is it the right source? I don't know. How should it be regulated? Should have integrity, all of these issues.

But I think about it in a bit of a different way than, and this is just probably because of our different career paths, but I think about it from an information perspective and and maybe this is less about some young men, but I know some young men who are looking at this from an information perspective as well.

COHEN: No, I think it's understandable. It's just a question of the results could be public health.

ROMERO: Of course. I, I leave that to you.

COHEN: Thank you. Thank you.

KUNESH: As to whether the Supreme Court will take this case, there will be, I do think there will be a circuit split. I do think I'm not good at predictions, but from a, from a substantial legal perspective, I think the 9th Circuit will will, will look to states' rights. And this is a traditional states' rights area, 10th Amendment. We've got Nevada, California, stakes are very, very high.

I do think that it's an important legal issue as well as a social policy issue. We have this legislative history bit, but we don't have much development from the commission. So on the one hand, yes, I think there is a definite, there will be a definite court split, a, a really good candidate for the Supreme Court to look at with some really good material. On the other hand it may not be ripe enough for the court to, to get involved in.

ROMERO: I agree. I agree.

KLEIN: We, the senator has joined us. So let me thank you the commission, the panel. You guys were fantastic. I I, I am happy to make a prediction and I will bet that there'll be a lot more of these conversations featuring your voices 'cause you all were fantastic.

If you can help me welcome Senator Merkley to the stage.

MERKLEY: Hi there. Great to see you, greetings, greetings..

KLEIN: Senator Merkley joins us. Thank you very much, senator.

MERKLEY: Hi there.

KLEIN: It's a pleasure.

MERKLEY: Right here?

KLEIN: Yep. Right here. Senator needs no introduction to, to you all, but he joined the United States Senate from the House of Representatives as a speaker in the state of Oregon, and has been there since 2000 and, and elected in 2008.

I remember when you joined in 2009 as a junior member of the Banking Committee where I had the privilege of working at the time for Chairman Dodd. And you served on the banking committee and have continued as a, as a leading voice in financial regulation and economic

policy serving on the Appropriations Committee and on the Senate Budget Committee. And just being a, a voice of integrity, of thought, of leadership and now we find ourselves ready to make some predictions.

MERKLEY: Alright.

KLEIN: So senator, you are an incredibly busy man with a wide variety of things on your plate, yet you've decided to focus on prediction markets, drafting, I think several pieces of legislation with your, your colleagues and, and chosen to introduce this. Why is this topic merited so much of your time and attention?

MERKLEY: Well, it really all began with my concern about the integrity of our elections. So back a couple years ago, we had the situation where Kalshi and others were hoping to lift the, the framework that restricted them to essentially research level wagers being placed and create a much and an unlimited betting casino if, if you will.

And the election piece really concerned me because here you have the possibility of people making big bets on elections. But then under our system of campaign finance, you have regular campaign donations, but you also have what we call dark donations or dark money, and that's under Citizens United where if you donate to the friend of the candidate to run a parallel campaign, you can do it secretly and you can do unlimited sums. So if I have a big bet placed on a race, I can also then go in at the last minute and launch a smear campaign to make the outcome match my bet.

So suddenly the spending in campaigns isn't about electing the individuals who will best serve our nation. It's about winning a bet, and that's a, a serious form of, of corruption of elections in the United States. So that's when I got involved with the CFTC and said, look Congress gave you the ability and the responsibility to block this type of event contract because the law that laid out your arena said you have the ability to stop things that are not in the public of interest, involving assassinations, involving wars, and involving gaming. And gaming is betting on the outcome of a contest. And election is a contest. And it also said, and you can block anything similar if in your judgment it's not in the public interest. So there was even additional flexibility that Congress had given to the CFTC to say, hey, these areas should not be areas that that you're engaged in.

Think about what Commodity Futures Trading Commission was. It was about being able to sell your pork bellies or buy pork bellies in the future at a specific price. You sell or you buy. And that serves a business world very well. Or perhaps being able to lock in certain risk concerns related to exchange rates or related to interest rates, but certainly wasn't about opening a casino.

KLEIN: Former Commissioner Goldschmidt Romero was just here talking about the definition of swaps and she said, it's, it's a stretch to talk about who's gonna win the Super Bowl as a financial or economic consequence, but then you're allowing a contract on the color of Gatorade that's dumped on the head coach. How is that an economic swap?

MERKLEY: Yeah. Well, and we're, we're, we're now seeing, you can bet on anything, anywhere the color of the, the president's tie whether or not an individual is going to attend the Super Bowl event. And that, that actually got some press because it was Jeff Bezos stepson, I believe that told his, his club at college that his, that Bezos was or wasn't going to attend. And so everybody in the fraternity basically placed bets on it. But just an, it's an, a little bit innocuous in those, those areas. But what we have is the CFTC, which was

supposed to be enabling you to lock in prices to buy and sell or economic certainty is suddenly a massive gambling operation.

KLEIN: So how does the legislation that you've introduced fix those problems?

MERKLEY: Well, the two pieces of legislation are introduced: one is the who and that that is started with my work on stock trading and then evolved right into this area, which is saying members of Congress, you want the public to see both that there isn't corruption or kind of smoke that suggests the possibility of, of corruption in activities. So members of Congress, disclosure by family members and by senior staff no betting by senior members of the administration.

It does, I wouldn't say it's a comprehensive solution because information can go fast and freely and to a lot of places, but at least it says at the senior levels of the executive branch and the congressional branch, there's not going to be direct profit engagement either in trying to utilize the, the insider information you have, the privileged information you have, or in trying to influence the outcome in order to match the bet you or your friends have already placed. So that's the who part.

And then on the what part, I tried to cover the four areas that I had mentioned and those four areas being government and military decisions, election, and then finally sports.

KLEIN: Sports. Yeah. The, the questions on insider trading I think are not well understood and appreciated because I think we have this idea that insider information is not allowed when in point of fact the law is much more narrow as it relates to what constitutes insider information. 'Cause it envisions a concept of stocks and bonds and companies. And anybody here is old enough, I've already dated myself once, and remember the movie Trading Places. But the, the, the, the premise is that they, they find out the secret information on the amount of orange juice that's been made so that they can sell orange juice futures. The actual Eddie Murphy Dan Akron movie is a commodities based premise. And that was about this insider information on the number of oranges, right.

Now, if we have a bet on how long this panel goes, can you and I place a wager on that and keep talking? Is that insider information? If I have that wager, if I have that control, the laws as I read it isn't very clear that I would be considered, that that would be considered insider trading today?

MERKLEY: No, I will say so Kalshi has tried to start addressing this concern. And there was a case in, in California involving somebody running for, for governor who then was, was making a bet on, on that race. And--

KLEIN: This isn't the person that most recently dropped out in California, is it?

MERKLEY: He did drop, this individual did drop out of the race actually, after being--

KLEIN: In the last 48 hours?

MERKLEY: I'm not sure.

KLEIN: No. All right.

MERKLEY: It just happened. But and so he, he was basically based on, I gather, and I don't have all the details, but based on items that are in the fine print on Kalshi, he violated their rules and he was, he was, he was fined. But those, that structure, whatever Calci does on its own, it's mostly about trying to clean up the public image while not addressing this--

KLEIN: Right. That's not a legal issue. That's a contract.

MERKLEY: That's a contract.

KLEIN: They're deciding not to pay out on a contract. And there've been a few high profile questions where it's not clear.

One of the prior panelists, Jonathan Cohen made the point that a lot of times these things are marketed as peer to peer, but there's actually an institutional hedge fund, a position on the other side of the market, which is a little different than the the old perimutuel wagering that I grew up at the horse track with.

MERKLEY: Right, right. I was thinking about, so I asked my team, well, is there a bet on my, I'm up for election? Is there a bet on, to be placed, a wager to be placed, an event contract on my election? And the answer is yes, but it's framed in terms of will a Democrat win the primary or not? And my primary's in, in May, May 19th for anyone who is interested in placing a, a wager on that. And then of course the, whether or not a Democrat or Republican who will win the, the general election.

But it just, it's like people out there are hoping and thinking about, well, do I have any special information? Do I have friends who, who know what is happening with the opponents and Jeff? Maybe that's, at what point does a company become insider information? I dunno, at what point does a bet become large enough that you now are really seeking to change the outcome. I think I will start knocking on doors on this local race where I'll try to convince the person who is running to drop out.

KLEIN: Well, look, when I, when I ran for the Maryland State House, there was a whole question of whether my campaign was, was viable or not. And if you weren't part of the machine getting all the little machine endorsements, which I wasn't, there was a question of viability. I remember when I went, back when there was a newspaper called the Washington Post that would do endorsements in local political races and say, Aaron, how do we know you're a serious guy? And they would look at your fundraising. That was a proxy for, for your serious. Now you could go and say, why bother raising all this money? I'm just gonna move my odds in this thinly traded Kalshi market. And look, I'm the, I'm the front runner.

Let me, let me, you, you talked about election integrity and we've talked a little bit about states. Let's take a little step back 'cause gambling has always been, to some degree, a states decision. I started this conversation when I, when I was born 50 years ago, Maryland became the 12th state to legalize a lottery. And today there are 45 states have lotteries, one of the five that doesn't have, Nevada. And I think we can say gambling's going on there. Sports betting is not allowed in California or Texas. A lot of states, and Commissioner Kunesh described tribal nations that have focused the revenue from gaming for state governments and tribal governments.

When you move to federalized swaps, all of that goes away in, into federal. Maybe it's capital gains tax into the general fund, but to my knowledge, you've served in the state House, you've served in the Senate, is this, where's the states' rights -federal element of

gaming and what are the consequences if we move this from a state and tribal issue to a federal issue? How should we as a society think about this?

MERKLEY: So the gaming has very much been thought about as a, a state area not delineated in the Constitution as a federal responsibility. And obviously, now we're in a world through the CFTC where there's now this massive federal, federal gaming market, including the sports side. And it's on the sports side that states are particularly touchy about this, saying, please, federal government, shut down the sports side. Like, like this is important to us, the revenue for it.

And, and the, the ethics, Utah doesn't allow gaming and they as a state say, we, we think this is a a, a bad influence, a bad effect for public policy. We don't want it here. And that's been considered their right to do that. I remember back when I was in the state legislature, I was not yet in, in leadership. I lobbied the the governor not to use authority that he had to allow betting. Basically we had video poker, but we didn't have video, whatever the other version is where you line up the apples and the, and the--

KLEIN: Slot machines.

MERKLEY: Slot machines. We didn't have video slot machines, and all of the research showed that for every dollar that is raised for the state, you do \$3 of social impact, negative social impact. People, I, I was part of three different organizations where people stole. From the, the treasury because they had an addiction to gambling. Now we have an additional challenge with youth. Youth are very excited. And I remember, I remember being in high school where people would be, taking paper at the lunch table to place a, a few bets. And it was kind of like, well, do I want to bet on the Saturday game? And, and, but now it's just, it's coming up adver, direct advertising on, on kids' smartphones. It is a pervasive influence affecting our youth and the addiction of, the adrenal addiction of gaming is a social issue.

So I feel like states should, should have this, this, right, to these make public policy around this, this issue. And the federal government shouldn't take it over. But those are, those are real impacts. A legitimate public policy debate concerns with now the CFTC essentially opening up this massive gaming market.

And by the way, the, the CFTC first of all said no to the election betting, and then they went to a district court, and the district court proceeded to say, you know what, under the Chevron decision of the Supreme Court, we're not confident that the court would find gaming to include betting on elections. In other words, the argument making that may, on the positive side of including it is the law that said you can make, you can ban things that are not in the public interest in the area of gaming or anything similar. Seemed to me like pretty broad discretion had been handled to the CFTC, but this district court judge said no, not, not sure because the Supreme Court only wants under the, the new Chevron standard to be exactly the interpretation that the Supreme Court would make, and I'm not sure they'd make that.

So he, so basically that that judge struck it down and did not issue a stay. And then a new administration comes in and suddenly the door is flung wide open. So that's the history of, of how we got here.

KLEIN: So that's incredibly illustrative as you talk about the fact that the act permitted the CFTC to do something and then a court, through this activist Supreme Court that we've had, and then an activist lower level court went in. And you are sitting here in Congress, right?

The great Article One, the situation where you're writing laws and then you need somebody else to implement them and then somebody else to enforce them.

And I wanna draw a little bit on your legislative experience because going through the Dodd-Frank Wall Street reform and consumer protection process in which this, some of these things that you're mentioning right now were addressed in the Commodities Future Swaps Commission. But you were really the legislative author of something known by by the in the financial regulatory world is the Volker rule. And this was the idea put forth by former Fed Chairman Volker that tried to separate speculation from market making among the now merged investment and commercial banks. And Volker said that he envisioned the rule taking about two and a half pages and being pretty simple and straightforward. And he had an idea. You, and, and, and some of your colleagues, notably Senator Levin, actually made it happen and put it in legislative language.

And then it went to the regulators, and I think it took five years to, for them to produce 600 pages of a rule that is most people, or many people on all sides have criticized as overly complex, expensive to implement, and possibly inefficient at, at achieving the goals you laid out. So what lessons do you take from that experience as a legislator in going through with this simple idea, getting the success of actually getting it enacted. There were a lot of people that weren't too supportive of that, some of whom may have been my colleagues in the administration. And then the limits of watching regulators implement that on the ground. And how has that experience that you've had shaped your way of addressing your approach on financial markets?

MERKLEY: Well, just to back up to Volker for a moment. Essentially one factor in the, the meltdown of 2008 in the economy was highly leveraged bets, basically by large banks. And the Volker thought was that having highly leveraged bets through that product we call a derivative, which is basically placing a bet on the future price of something, it creates enormous risk for a banking meltdown. And that if we should have banks in the business of collecting deposits and making loans, but not create the type of risk where the entire banking system, so central to economy, is at such a precarious state. And that was, that was the philosophy of it. And it did seem pretty straightforward.

I recall when when a team member of mine came to me and, and gave me a Group of 30, I think it was called, report, and said, read this. This is a huge risk. It's part of the meltdown we're facing right now. We've gotta, and I'm like, well, I'm not a Wall Street guy. And so, he, but he came to me three times and I finally said, yes, you're right. I've read the article, it's a big risk. Let's try to tackle it. And it was still a shock to me that we did pass that, that that rule. I was finally in a conference committee at the end. We didn't pass it on the Senate side. I went to the House side and got Barney Frank's support. Chris Dodd was, was supportive and you're probably working for him. You probably helped make that happen. Thank you very much. But we got it in, in, in conference. And it does tell a story of how hard it is to do any form of regulation where there are powerful players as big as Wall Street banks that don't want it to happen. And but we made it, and I'm hoping that in this case we can do it.

And, but here is the challenge. If we had simply had the CFTC be able to follow its initial course and say, you gave us this authority, it's not in the public interest. It's certainly gaming or something similar to gaming, and had been able to appeal that up. But after there was no stay, then the new administration didn't want to appeal it. In fact, the president's son is serving as an advisor and getting paid, who knows what for to, to help promote this this industry.

So now we have the companies having made billions of dollars, or at least there's billion, billions dollars of bets and I'm sure a lot of money made. And so now we have that massive pool of powerful interests that are going to make it incredibly hard to get legislation to the floor. I mean, recognize, and this is really goes to the dysfunction of the Senate and the House, because the majority and minority leaders on both sides, their major goal is to keep their group in power, and they have an inherent concern about taking on powerful groups that will weigh in with tons of money, especially post Citizens United this has been accentuated. And think about, for example, Sherrod Brown running in Ohio last election, last major election, and he had blocked the deregulation bill for crypto. They put a group of crypto executives, over just a few days put \$40 million into that Senate race. And then what happened after Sherrod lost, that same group came to Congress and quickly passed a deregulation bill. Because members are terrified of \$40 million being put into their races.

And it, it shows how hard it will be now, I think, for us to develop the momentum to tackle this public concern because there are now groups, primarily Kalshi and Polymarket that have so much money at stake that they will invest enormous sums to keep, to keep this golden goose laying the golden egg.

KLEIN: Well, I want to turn to the audience for, for, for questions while we still have you and, and as they get, I just wanna take a step back and ask you a big picture question. 'cause, 'cause what you're saying is, is concerning me, the, the integrity of our country, you've touched upon it in many different ways.

I think about the integrity of our financial system, as a finance, as a, as a think tank person thinking about regulation and markets, and I always am tried to be guided by a, a, a north star, which is that finance is a means, not an end. It's a means of connecting savers and investors with risk takers who are producing great things.

When I think about the value of derivatives, I think about buying a plane ticket to go see my family over the holidays and the airline needing to hedge jet fuel today. And that's the value of finance. And I think sometimes we get lost when we think about finance as a ends. The goal is to create financial products for financial products' sake.

Markets are there to serve people. People are not here to serve markets. But then I get caught up in these prediction markets. Sometimes I can see an economic purpose. You laid out the economic purpose in, in the statute. But the CFTC seems to be reading economic purpose as well. If you can have fun betting on it, that serves an economic purpose.

And so, how do you see, what do we need to do to protect our financial system from, at best, a form of wagering and entertainment, at worst, you reference the unstable speculation that brought down our financial system with derivatives playing a key role. I might add those same derivatives were deregulated at the end of the Clinton administration over the objection of a then progressive CFTC commissioner, chair. What do we need to do to stop this financialization?

MERKLEY: Okay. That's a very broad way of putting the question. So I'll, I'll try to just say, we have to have a functioning legislative process. And when it is hard as it is now in the Senate to get an issue to be voted on, it --because it takes unanimous consent now to put up an amendment and it, it, it --therefore, unlike the Senate that I first saw quite a few decades ago, I, I hesitate to admit that I was here for the bicentennial when I was an intern for Senator Hatfield and I worked the, the, the tax reform bill of, of that year. Now I'm gonna be here for the 250th. You cannot recognize the Congress as being anything similar. There were 125 votes on that bill that I oversaw for Senator Hatfield, and not one of them was a

supermajority vote. You need now a supermajority to sneeze. When there were supermajorities, and they were rare, they were on final passage, they were not on nominations, and they were not on motions to proceed and they were not on amendments.

And so we have a calcified process, which I think serves the powerful in this country very, very well because they have the lobbyists, they have the campaign influence, they have the lawyers, they have the media campaigns to drive through the changes that they want and get them inserted into sometimes massive thousand page bills. Whereas grassroots America fighting for lower prices and perhaps fewer wars, they can gin up energy, grassroots energy. But you can only do that so long 'cause you are living your life. That's the whole point of representative democracy is, is you vote for somebody to be their full-time to advocate for the things you believe in because you have children to raise. You have a job to go to. And so we have created a system where now it's more like government buy-in for the powerful than buy-in for the people.

So broadly I would say we have to do some major reforms. First of all, we need to reverse Trump versus the United States where the president can no longer be convicted of a crime because he can't commit a crime because the Supreme Court said it's not a crime as long as there's a government stamp on it. And combined with pardon power, the whole executive branch is operating outside the law. So anything I suggest for how we actually pass laws can be ignored by the executive branch, unless we have the reform. We have to take on Citizens United and this dark, vast pool of money that's just flooding in on behalf of the, the, the powerful and, and has huge persuasive effects both on the outcome of elections and how people behave after they're elected.

So it's, I'll just stop there 'cause you can see it, it quickly grows into a very broad sense that our democracy is way off track, even before President Trump undertook a massive effort to convert us into a strongman state, which is, we could spend a whole nother session on that.

KLEIN: That's, that's a whole other thing.

I think I have a, a question over here. Okay.

AUDIENCE QUESTIONS: Thank you. And thank you senator for your work. Robert Sherretta with International Investor I've seen firsthand how easy it is for insider trading to take place on Wall Street. And now what I see with the prediction markets is that this is broadening so that you've got members of the military, intelligence community, and let's face it, Congress, having even more access to these possibilities with insider knowledge than they've ever had before. What are the chances of getting legislation through when you've got so much temptation on the part of some members to benefit from the way things stand now?

MERKLEY: Yep. Well, I don't think it's impossible. And I'm, I'm thinking about stock trading right now. It's over a decade ago that I spearheaded the effort to say members shouldn't be trading stocks. We had several scandals in between. We have gained momentum and I had a very bizarre experience of the president's State of the Union speech in which three progressive arguments that I've put forward, and one of them was to stop stock trading by members of Congress, the president gave, included in his, in his his speech.

And so there has, momentum has grown. We have found some partners across the aisle, and I'm talking about stock trading right now, as there have been scandals, and, and just more recognition of this in campaigns of people saying, really, are you still for getting elected

and, and then you want to be able to bet on drug stocks while you're voting on drug stock legislation? And so forth.

And so, momentum has built, but it's going to take, I think, an election of an executive who's willing to put real muscle into this. I mentioned Trump did raise the stock market issue. He didn't raise prediction markets in his speech, but his heart isn't really in it. He's not like, I want this, this reform done. And so it's going to take, it's going to take House, Senate, like we did with, with Dodd-Frank. It took a national meltdown of the financial markets that had profound impacts to get Dodd-Frank passed. It took states having only three quarters of their, their citizens insured to be able to expand Medicaid and create tax credits to help middle class people buy insurance on the exchange, which were the two pieces, the real heart of of Obamacare.

So, so yes, it's possible. A really big scandal in this coming election would probably help and a significant effort for people to raise this issue in congressional elections and demand to know where their candidates stand would, would be helpful.

KLEIN: So at the risk of starting a scandal, for those who bet that this event would go long, I'm going to say thank you very much, senator for --

MERKLEY: Thank you all very much

KLEIN: -- joining us and end this on time.