A Functional Analysis of Prediction Market Regulation

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Abstract

Prediction markets such as Kalshi and Polymarket have grown explosively, yet the analysis of their welfare effects and regulatory treatment has not kept pace. This article proposes a functional framework built on a taxonomy of users: exogenous informed traders, who hold superior information about events they cannot influence; endogenous traders, who can influence those events; and retail users. While platform self-regulation can address many concerns, information revelation and hedging are public goods that financial regulation should protect. Gambling regulation and sector-specific rules can curb harmful endogenous trading, protect retail users, and address moral concerns.

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Introduction

By the close of the seventeenth century, a coffee house on Lombard Street had become the unexpected heart of London's marine insurance trade. At Edward Lloyd's establishment, private underwriters pledged to cover a ship's losses in return for a premium. They soon discovered that they could write the same policies 'interest or no interest', letting speculators wager on vessels they had never laid eyes on.[2] This emerging insurance industry thus doubled as an embryonic market for event risk, whereby anyone could take a position on the occurrence of a real-world event without holding any stake in it. The British Parliament put a stop to this practice in 1746, declaring every such 'gaming, or wagering' assurance 'null and void to all intents and purposes' and confining marine insurance to those with a real stake in the voyage.[3] Centuries later, the role in the financial crisis of credit default swaps, which let speculators insure bonds they never owned, revived similar debates on the merits of limiting financial contracts to parties with a genuine stake in the underlying risk.[4]

Insurance and financial markets, at once central engines of economic growth and havens for speculation, have long sat at an uneasy frontier between productive activities deemed legitimate and those akin to pure gambling. Investing and gambling share much of their economic substance and raise overlapping moral and protective concerns, and the two categories accordingly resist any clean conceptual boundary. This leaves regulators with the persistent challenge of promoting virtuous practices while discouraging functionally identical ones deemed socially sterile.[5]

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[2] Frederick Martin, *History of Lloyd's and of Marine Insurance in Great Britain* (Macmillan 1876) 137-138.

[3] ibid 139-141; Marine Insurance Act 1745 (19 Geo 2, c 37) (An Act to regulate Insurance on Ships belonging to the Subjects of Great Britain, and on Merchandizes or Effects laden thereon), effective in 1746.

[4] A long-standing literature on the delicate distinction between insurance and financial instruments was revived after the 2008 crisis, with several authors calling for tighter control of (or outright bans on) purely speculative practices. On this topic, see Eric A Posner and E Glen Weyl, 'An FDA for Financial Innovation: Applying the Insurable Interest Doctrine to Twenty-First-Century Financial Markets' (2013) 107 Northwestern University Law Review 1307; M Todd Henderson, 'Credit Derivatives Are Not "Insurance"' (2009) 16 Connecticut Insurance Law Journal 1; Timothy E Lynch, 'Gambling by Another Name; The Challenge of Purely Speculative Derivatives' (2011) 17 Stanford Journal of Law, Business & Finance 67; Timothy E Lynch, 'Derivatives: A Twenty-First Century Understanding' (2011) 43 Loyola University Chicago Law Journal 1; Lynn A Stout, 'Derivatives and the Legal Origin of the 2008 Credit Crisis' (2011) 1 Harvard Business Law Review 1; Roy Kreitner, 'Speculations of Contract, or How Contract Law Stopped Worrying and Learned to Love Risk' (2000) 100 Columbia Law Review 1096.

[5] Linus Weidner, 'Gambling and Financial Markets A Comparison from a Regulatory Perspective' (2022) 7 Frontiers in Sociology 1.

Prediction markets push that boundary further than ever into contested territory. These markets allow users to trade 'event contracts' whose payoff (one dollar if the event occurs, zero otherwise) depends on the realisation of a real-world fact such as an election outcome, the result of a football match, or the occurrence of a geopolitical event.[6] Users wagering that the specified future event will occur can buy 'yes' contracts from (or sell 'no' contracts to) users betting that it will not.[7] Because event contracts are traded by users with different information and beliefs, event contract prices are conventionally understood as reflecting the market's aggregate probability estimate of the event.[8] On this reading, a contract on the FIFA World Cup Winner paying one dollar in case France wins and trading at $0.17 can be interpreted as the market's belief that France has a 17% chance of winning.[9]

Until recently, prediction markets were largely confined to not-for-profit projects carried out for research and educational purposes.[10] However, two commercial prediction market platforms, Kalshi and Polymarket, have seen explosive growth in recent years. Combined trading volume across the two venues reached nearly $12 billion in December 2025, a more than 400% year-on-year increase. Kalshi raised funding at an $11 billion valuation in late 2025, and Polymarket at $9 billion.[11] While prediction markets can in principle adopt various microstructures,[12] both Kalshi and

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[6] See eg Justin Wolfers and Eric Zitzewitz, 'Prediction Markets' (2004) 18 Journal of Economic Perspectives 107, 107–108; Kenneth J Arrow and others, 'The Promise of Prediction Markets' (2008) 320 Science 877.

[7] Constantin Bürgi, Wanying Deng and Karl Whelan, 'Makers and Takers: The Economics of the Kalshi Prediction Market' (CESifo 2026) Working Paper, 2.

[8] Anthony M Diercks, Jared Dean Katz and Jonathan H Wright, 'Kalshi and the Rise of Macro Markets' (Board of Governors of the Federal Reserve System 2026) FEDS Working Paper, 2. For challenges of this idea, see Justin Wolfers and Eric Zitzewitz, 'Interpreting Prediction Market Prices as Probabilities' (National Bureau of Economic Research 2006) NBER Working Paper 12200; Charles F Manski, 'Interpreting the Predictions of Prediction Markets' (2006) 91 Economics Letters 425.

[9] See eg Polymarket, '2026 FIFA World Cup Winner' <https://polymarket.com/event/2026-fifa-world-cup-winner-595> accessed 18 May 2026.

[10] See in particular the two no-action letters issued by the CFTC's Division of Market Oversight to the Iowa Electronic Markets in 1992 and to PredictIt.org in 2014: CFTC Notice on Prediction Market Rulemaking 28-29; KalshiEX LLC v Commodity Futures Trading Commission 5.

[11] David Yaffe-Bellany, 'All Bets Are On: The Rise of Prediction Markets' *New York Times* (19 January 2026) <https://www.nytimes.com/2026/01/19/technology/polymarket-kalshi-prediction-markets.html> accessed 18 May 2026.

[12] There is ample literature theorising the various possible microstructures of prediction markets and their respective advantages and drawbacks. The literature distinguishes at least four microstructure models: continuous double auction (CDA), pari-mutuel, market scoring rules (MSR), and intervention of a dealer or bookmaker. See for instance Wolfers and Zitzewitz (n 6) 120-122; Erik Snowberg, Justin Wolfers and Eric Zitzewitz, 'Prediction Markets for Economic Forecasting' in Graham Elliott and Allan

Polymarket operate continuous limit order books (CLOBs) analogous to those of most equity markets.[13] Many of the characteristics of traditional equity markets therefore carry over to prediction markets.

The recent boom in prediction markets has revived the questions raised by the Marine Insurance Act and the many pieces of gambling and financial legislation enacted across jurisdictions in the centuries that followed. Numerous jurisdictions today restrict or forbid access to prediction markets, either by treating event contracts as unlicensed gambling or by classifying them as commodities or derivatives. In the UK, event contracts qualify in principle as betting pursuant to the Gambling Act[14]—meaning that offering them without a licence to consumers in the UK constitutes a criminal offence[15]—unless the said bets are a regulated activity within the meaning of the Financial Services and Markets Act (FSMA) 2000[16]—which requires an authorisation or exemption.[17] France's National Gambling Authority (ANJ) ruled in October 2024 that Polymarket might provide an illegal online gambling service in France and secured Polymarket's blocking of French IP addresses.[18] Belgium's

Timmermann (eds), *Handbook of Economic Forecasting*, vol 2A (Elsevier 2013) 660–61; Robin Hanson, 'Logarithmic Market Scoring Rules for Modular Combinatorial Information Aggregation' (2007) 1 Journal of Prediction Markets 3. Although this article focuses on the predominant CLOB structure, most of its conclusions can be transposed to other market structures.

[13] Polymarket, 'Prices & Orderbook' <https://docs.polymarket.com/concepts/prices-orderbook> accessed 19 May 2026, 2; Kalshi, 'The Orderbook' <https://help.kalshi.com/en/articles/13823828-the-orderbook> accessed 19 May 2026.

[14] The definition of betting by the UK Gambling Act is extensive: '"betting" means making or accepting a bet on — (a) the outcome of a race, competition or other event or process, — (b)the likelihood of anything occurring or not occurring, or — (c) whether anything is or is not true': UK Gambling Act 2005, s 9(1). The director of strategy of the UK Gambling Commission expressed the view that prediction markets would likely be considered as offering gambling products in the UK: Brad Enright, 'Prediction markets - here's what you need to know' (*Gambling Commission*, 4 February 2026) <https://www.gamblingcommission.gov.uk/blog/post/prediction-markets-heres-what-you-need-to-know> accessed 28 June 2026.

[15] UK Gambling Act 2005, s 33.

[16] UK Gambling Act 2005, s 10(1); UK FSMA 2000, s 22. Event contracts could plausibly qualify as contracts for difference, in which case activities 'relating' to them could be considered an investment service under Section 22 of the FSMA: UK FSMA 2000, Order 2001, SI 2001/544, s 85.

[17] UK FSMA 2000, s 19.

[18] ANJ, 'Suite à l'intervention de l'ANJ, le site POLYMARKET ne propose plus ses services sur le territoire français' <https://anj.fr/suite-lintervention-de-lanj-le-site-polymarket-ne-propose-plus-ses-services-sur-le-territoire> accessed 17 May 2026; Code de la sécurité intérieure, art L320-1; loi n° 2010-476 of 12 May 2010.

Gaming Commission followed by blocking Polymarket's operations in January 2025.[19] In the United Kingdom, the minister responsible for gambling policy at the Department for Culture, Media and Sport stated in a written parliamentary answer that event contracts of the kind offered by Kalshi and Polymarket fall within the Gambling Act 2005.[20] The European Securities and Markets Authority underlined that event contracts whose underlying is a financial instrument can qualify as 'binary options', whose commercialisation to retail investors is forbidden.[21] Singapore's Gambling Regulatory Authority banned Polymarket based on the Gambling Control Act 2022.[22] Finally, a US district court judgment held in 2024 that the 'congressional control contracts' which prediction market operator Kalshi sought to list, involving bets on which parties would control the US Congress, 'do not involve unlawful activity or gaming'.[23] Event contracts are now broadly considered in the US as commodities under the supervision of the CFTC, although the CFTC's jurisdiction is currently being challenged by several states.[24]

Financial and gambling regulations are not the only instruments mobilised against prediction markets. In the US, several states have issued executive orders prohibiting civil servants and office holders from betting on them.[25] The 119th US Congress has also seen no fewer than fifteen bills addressing prediction markets,[26] targeting, among

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[19] Commission des Jeux de Hasard, 'Liste des sites de jeux de hasard illégaux bloqués par la CJH' <https://www.gamingcommission.be/fr/la-commission/jeux-de-hasard-illegaux/liste-des-sites-de-jeux-de-hasard-illegaux-bloques-par-la-cjh> accessed 17 May 2026.

[20] UK Parliament, 'UIN 117415, tabled on 3 March 2026' <https://questions-statements.parliament.uk/written-questions/detail/2026-03-03/117415> accessed 17 May 2026; Gambling Act 2005, s 33.

[21] ESMA, Public Statement on the Application of the National Product Intervention Measures on Binary Options to Event Contracts (ESMA35-243228190-8148, 3 July 2026).

[22] International Association of Gaming Regulators, 'Prediction markets: Global approaches to an emerging challenge' <https://iagr.org/industry-news/prediction-markets-global-approaches-to-an-emerging-challenge/> accessed 17 May 2026; Singapore Gambling Control Act 2022, s 8.

[23] *KalshiEX LLC v Commodity Futures Trading Commission No 23-cv-3257* (JMC), 2024 WL 4164694 (DDC, 12 September 2024). The CFTC appealed but later filed a motion for voluntary dismissal, leaving the district court's judgment as the final decision on the merits: *KalshiEX LLC v Commodity Futures Trading Commission No 24-5205*, 2025 US App LEXIS 11094 (DC Cir, 7 May 2025).

[24] CFTC, 'CFTC Reaffirms Exclusive Jurisdiction Over Prediction Markets in Sixth Circuit Amicus Brief', Release Number 9230-26, 12 May 2026 <https://www.cftc.gov/PressRoom/PressReleases/9230-26> accessed 17 May 2026.

[25] See eg Illinois, Executive Order 2026-04; California, Executive Order N-4-26; New York, Executive Order No 60 of 2 April 2026.

[26] For summaries of Congressional action and the current state of US law in the field of prediction markets, see Congressional Research Service, Prediction Markets Legislation in the 119th Congress,

other topics, the prohibition of event contracts on sporting events and casino-style games,[27] on political elections and other government action,[28] and on terrorism, assassination, war, or an individual's death.[29] Four further bills aim to impose restrictions on the trading of event contracts by federal officials in possession of material non-public information,[30] and another contemplates the creation of a new regulatory framework under the Attorney General and the States focused on underage users and consumer protection.[31] In this context, the CFTC solicited comments through an advance notice of proposed rulemaking,[32] which culminated in June 2026 in a notice of proposed rulemaking that both assesses the case for new regulation and proposes amendments to its existing rules on event contracts.[33]

These numerous initiatives come at a time when the understanding of prediction markets remains nascent, with thin empirical evidence and no systematic theory of their welfare effects. This article begins to fill this gap by proposing a theoretical framework for analysing the welfare impact of prediction markets and the case for (not) regulating them. It adopts a normative and functional approach, clarifying what societal goals prediction market regulation can aim to achieve and what instruments are best suited to each of these goals. Because event contracts fit squarely within neither gambling nor financial instruments, the article argues that regulations from both fields and beyond should be used to achieve different objectives. In particular, market failures relating to informational efficiency and liquidity, notably insider trading and market manipulation, should be addressed through the tools of financial regulation. By contrast, professional rules are better suited to governing trading by civil servants and public officials, while gambling laws can address concerns relating to consumer protection and morality.

IF13207 (21 April 2026); Congressional Research Service, Prediction Markets and Insider Trading Law, LSB11406 (3 April 2026).

[27] H.R. 7477; S. 4160.

[28] H.R. 8123 & S. 4226, STOP Corrupt Bets Act; H.R. 7840, Event Contract Enforcement Act.

[29] H.R. 7955 & S. 4115, BETS OFF Act; H.R. 7942 & S. 4035, Death Bets Act; H.R. 7840, Event Contract Enforcement Act.

[30] H.R. 7004, Public Integrity in Financial Prediction Markets Act of 2026; S. 4017, End Prediction Market Corruption Act; H.R. 8076, PREDICT Act; S. 4188, Public Integrity in Financial Prediction Markets Act of 2026.

[31] S. 4060, Prediction Markets Security and Integrity Act of 2026.

[32] Prediction Markets, 91 Fed Reg 12516 (16 March 2026) (advance notice of proposed rulemaking).

[33] Commodity Futures Trading Commission, 'Prediction Markets; Public Interest Determinations' (notice of proposed rulemaking, Commission-approved pre-publication version, June 2026) RIN 3038-AF65, 17 CFR pt 40 ('CFTC Notice on Prediction Market Rulemaking').

The article also relies on a taxonomy of prediction market users organised around three categories: exogenous informed users, who hold superior information about events they cannot influence; endogenous users, who can affect the outcome of the events underlying the event contracts they trade; and retail users, who trade with neither informational advantage nor influence over the underlying event. The boundaries between these categories are not always watertight—a trader may both hold private information about an event and take part in it—but each raises distinct concerns and calls for distinct regulatory instruments. Importantly, these categories describe trades rather than persons: the same individual may trade as an exogenous informed user on one market, as an endogenous user on another, and as a retail user on a third. A campaign strategist betting on the election they work on trades endogenously, but is a retail user when betting on the World Cup final. What matters for regulatory purposes is thus the relationship between a given trade and the underlying event, not any fixed status of the trader.

This article begins by discussing the two principal functions of prediction markets: information aggregation and hedging. Like financial markets and certain betting markets, prediction markets allow investors to hedge against uncertain future outcomes and generate price signals that reveal information about the events underlying event contracts, thereby supplying a public good whose protection can justify regulatory intervention (Section 1). Prediction market regulation can aim to protect these social functions by ensuring that these markets operate efficiently (Section 2). On the other hand, prediction markets can also be a source of social costs that justify banning certain practices and, in the most extreme cases, prediction markets altogether (Section 3).

1 The Social Functions of Prediction Markets

The principal social function of event contracts and prediction markets is information revelation.[34] Event contract prices serve as forecasts of the underlying events, aggregating into a single observable signal the dispersed information, beliefs, and interpretations held by individual traders. Although prediction market prices can be noisy and biased just as on any other market,[35] this signal can be expected to be on

[34] The CFTC treats information aggregation as central to whether event contracts are contrary to the public interest, reasoning that 'event contracts involving games whose outcome depends on random chance—e.g., pure luck—are likely to be contrary to the public interest': CFTC Notice on Prediction Market Rulemaking 112; see also at 97-98.

[35] Snowberg, Wolfers and Zitzewitz (n 12); Manski (n 8).

average more reliable than the forecast of any single analyst,[36] and even than polls in certain contexts.[37] The intuition is twofold. First, because their financial returns depend directly on the accuracy of their predictions, prediction market users have a strong incentive to trade on what they truly believe rather than on what they would like, or publicly profess, to be true. Second, prices aggregate the trades of many such users holding different information and beliefs: whenever the price departs from the probability a trader considers correct, that trader profits by trading against the perceived mispricing, thereby pulling the price back towards it.[38]

Furthermore, the resulting forecasts can be consulted for free by anyone, including third parties who never traded on prediction markets such as companies, investors on other markets, and governments.[39] Prediction markets can thus become 'focal points' that both inform and coordinate the decisions of those who consult them.[40] This public-good dimension distinguishes information revelation as a social rather than a merely private function, and supplies the central argument for authorising at least some forms of prediction markets.[41]

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[36] This idea has been conceptualised in Friedrich A Hayek, 'The Use of Knowledge in Society' (1945) 35 The American Economic Review 519. For an empirical validation of this idea in the context of the Iowa Electronic Markets, which outperformed contemporaneous opinion polls, see Robert Forsythe and others, 'Anatomy of an Experimental Political Stock Market' (1992) 82 The American Economic Review 1142; Joyce E Berg, Forrest D Nelson and Thomas A Rietz, 'Prediction Market Accuracy in the Long Run' (2008) 24 International Journal of Forecasting 285.

[37] There is mixed evidence on the relative informativeness of polls and prediction markets. In favour of polls, see Robert S Erikson and Christopher Wlezien, 'Are Political Markets Really Superior to Polls as Election Predictors?' (2008) 72 Public Opinion Quarterly 190. For the view that markets outperform polls, particularly at longer horizons, see Berg, Nelson and Rietz (n 32). For a mixed account, see David Rothschild, 'Forecasting Elections: Comparing Prediction Markets, Polls, and Their Biases' (2009) 73 Public Opinion Quarterly 895.

[38] While the interplay of these mechanisms strongly suggests their superiority over other predictive mechanisms, prediction markets might well fail to be efficient in Fama's sense—namely, they may fail to 'fully reflect' all available information. While some of the normative recommendations made in this paper aim to *enhance* market efficiency, none of them requires assuming that markets *are* efficient in the first place, whatever meaning is ascribed to this concept. See Eugene F Fama, 'Efficient Capital Markets: A Review of Theory and Empirical Work' (1970) 25 The Journal of Finance 383.

[39] There has been evidence of the usefulness of prediction markets to these various actors long before the rise of Kalshi and Polymarket: Arrow and others (n 6).

[40] This terminology is borrowed from Thomas C Schelling, *The Strategy of Conflict* (Harvard University Press 1960) 75. See also Maksym Nechepurenko, 'Price as Focal Point: Prediction Markets, Conditional Reflexivity, and the Politics of Common Knowledge' (2026) Working Paper <https://arxiv.org/abs/2604.24147> accessed 18 May 2026. On the informational role and 'real-world' impact of prices more generally, see Philip Bond, Alex Edmans and Itay Goldstein, 'The Real Effects of Financial Markets' (National Bureau of Economic Research 2011).

[41] Arrow and others (n 6) 878.

The social importance of information revelation logically depends on the underlying information. Predictions on the US tariff rate on China,[42] top-ranked AI models,[43] and a possible Hantavirus pandemic[44] arguably have a greater welfare impact than the date of Taylor Swift's wedding[45] or Elon Musk's change in profile picture on X.[46] Information revelation about an outcome that will soon be revealed anyway, such as the result of a political election, might also be too short-lived to truly matter.[47] Nonetheless, apparently trivial data, unless purely random[48] (such as predictions of the outcome of a game of roulette) may acquire value when read in combination with others.[49] Finally, other pieces of information, such as the future prices of bitcoin[50] and oil,[51] largely duplicate signals already available on adjacent markets.[52] Yet the fact that

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[42] Kalshi, 'What will the US tariff rate on China be on July 1?' <https://kalshi.com/markets/kxtariffrateprc/tariff-rate-china/kxtariffrateprc-26jul01> accessed 19 May 2026.

[43] Kalshi, 'Which companies will have a top-ranked AI model this year?' <https://kalshi.com/markets/kxtopai/topranked-ai/kxtopai-27> accessed 19 May 2026.

[44] Polymarket, 'Hantavirus pandemic in 2026?' <https://polymarket.com/event/hantavirus-pandemic-in-2026> accessed 19 May 2026.

[45] Polymarket, 'Taylor Swift x Travis Kelce get married by...?' <https://polymarket.com/event/taylor-swift-x-travis-kelce-get-married-by> accessed 18 May 2026.

[46] Polymarket, 'Will Elon Musk change his X profile picture by January 31?' <https://polymarket.com/event/will-elon-musk-change-his-x-profile-picture-by-january-31> accessed 19 May 2026.

[47] This echoes the distinction made by Hirshleifer between foreknowledge (of an event that will soon happen anyway) and discovery ('correct recognition of something that possibly already exists, though hidden from view'): Jack Hirshleifer, 'The Private and Social Value of Information and the Reward to Inventive Activity' (1971) 61 American Economic Review 561. Although theoretically interesting, the distinction between foreknowledge and discovery is one of degree rather than nature and overemphasises the benefits of discovery over those of foreknowledge, which can itself have significant value. For instance, the accurate prediction of an important election in a month might play an essential role in a company's decision to invest in a given country today, even though the outcome of the election will be known soon.

[48] CFTC Notice on Prediction Market Rulemaking 112.

[49] As the CFTC puts it, 'the corn futures market is about more than just corn': CFTC Notice on Prediction Market Rulemaking 93.

[50] Kalshi, 'When will Bitcoin cross $100k again?' <https://kalshi.com/markets/kxbtcmax100/when-will-bitcoin-hit-100k/kxbtcmax100-26> accessed 19 May 2026.

[51] Kalshi, 'Oil Price (WTI) today?' <https://kalshi.com/markets/kxwti/wti-oil-on-day/kxwti-26may1914> accessed 19 May 2026.

[52] Cross-market arbitrage likely aligns the price of event contracts on the pricing of other related financial instruments on other markets, and vice-versa. For empirical evidence of this phenomenon on Polymarket, see Oriol Saguillo and others, 'Unravelling the Probabilistic Forest: Arbitrage in Prediction

an event contract's price is a pure 'linear combination' of information already supplied by other instruments does not render its signal useless, as it may be more legible than a probability buried in confounded 'information vectors' and asset prices. A contract predicting the outcome of a war in a given region, for instance, gives a more direct and explicit signal about that war and its uncertainty than the combination of oil prices and local firms' share prices. In any event, available evidence suggests that the information produced by prediction market trading is more than a linear combination of existing signals.[53]

The foregoing suggests that, although prediction markets foster information revelation in general, identifying which event contracts actually contribute to this function can be very difficult. The welfare contribution of any given piece of information is accordingly impossible to quantify ex ante, all the more so because a significant fraction of price movements in general cannot be reliably attributed to exogenous information.[54] Discriminating between events on the basis of their assumed informativeness is therefore very difficult. In turn, the quantification of prediction markets' informative benefits is bound to be imprecise and a matter of judgment.

Another social function of prediction markets is hedging.[55] Companies and individuals may bet on the future occurrence of an event to hedge against the harm its occurrence would cause. A multinational might for instance hedge its exposure to geopolitical disruption in the regions where it operates by taking positions that pay out if such events occur. A political candidate might bet on their own defeat at the

Markets' (arXiv 2025) Working Paper 2508.03474 <https://arxiv.org/abs/2508.03474> accessed 19 May 2026.

[53] On the information about wars and politics yielded by both traditional financial markets and prediction markets, and the finding that each contributes to information revelation, see Snowberg, Wolfers and Zitzewitz (n 12). On empirical methods for quantifying a given market's marginal contribution to price discovery, see Joel Hasbrouck, 'One Security, Many Markets: Determining the Contributions to Price Discovery' (1995) 50 The Journal of Finance 1175.

[54] For the seminal paper showing this, see David M Cutler, James M Poterba and Lawrence H Summers, 'What Moves Stock Prices?' (National Bureau of Economic Research 1988). See also Jean-Philippe Bouchaud and others, 'Fluctuations and Response in Financial Markets: The Subtle Nature of "Random" Price Changes' (2004) 4 Quantitative Finance 176; Armand Joulin and others, 'Stock Price Jumps: News and Volume Play a Minor Role' (Cornell University working paper) <https://arxiv.org/abs/0803.1769> accessed 22 June 2026.

[55] Section 3 of the US Commodity Exchange Act explicitly states that 'managing and assuming price risks' (that is, hedging) is one of the public interests which transactions in commodities and derivatives fulfil: Commodity Exchange Act, 7 USC § 5 (2025); CFTC Notice on Prediction Market Rulemaking 91.

next election to hedge against it. 'A beachfront property owner […] might purchase an event contract predicting that a hurricane will reach landfall in the area'.[56]

Hedging through event contract trading provides a form of insurance by the market as a whole, where insurance is priced by the market itself rather than by a single actor on the basis of actuarial calculation.[57] As with information revelation, the usefulness of prediction markets to hedging depends both on the nature of the underlying event and on the availability of alternative financial instruments for the same purpose, and the marginal benefits derived from the existence of a given event contract are hard to quantify for the same reasons. Moreover, replicating the payoff structure of an event contract through investments in various securities, such as long and short investments in oil commodities and companies operating in the Middle East to tie the investor's payoff to the war in Iran, likely requires financial sophistication beyond the reach of most individuals and companies. This suggests that prediction markets do have something to contribute to hedging over and above other financial instruments, in line with our earlier discussion of event contracts' informative signal.

Hedging and information revelation might be seen as conflicting. In a classic article, Hirshleifer showed that the early revelation of information might destroy the very uncertainty that mutually beneficial risk-sharing requires. Consider the owner of a beachfront property exposed to hurricane risk. So long as the hurricane remains genuinely uncertain, the owner can insure the property on reasonable terms. Once a prediction market prices the corresponding event contract at 0.9, however, coverage costs nearly as much as the loss itself. In other words, the market forecast has consumed the insurable uncertainty. Thus, according to Hirshleifer, risk-averse individuals 'would actually pay something to a knowledgeable outsider not to reveal, in advance of market trading, which state will obtain'.[58]

While the argument might be true, it hardly provides a valid case for limiting information revelation for the sake of protecting hedging. Information about the risks to which the beachfront property is exposed provides the valuable service of discouraging investment in such properties in the first place, whereas entertaining uncertainty as to this risk for the sake of permitting its insurance amounts to encouraging risky, value-destructive behaviour while passing on its cost to the pool

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[56] *KalshiEX LLC v Commodity Futures Trading Commission No 23-cv-3257* (JMC), 2024 WL 4164694 (DDC, 12 September 2024) 3-4.

[57] For a theoretical discussion of this idea, see Kenneth J Arrow, 'The Role of Securities in the Optimal Allocation of Risk-Bearing' (1964) 31 The Review of Economic Studies 91.

[58] Jack Hirshleifer, 'The Private and Social Value of Information and the Reward to Inventive Activity' (1971) 61 The American Economic Review 561, 568.

of traders. Hirshleifer's argument ignores that fact because, by his own admission, it holds only insofar as additional information has a purely redistributional effect among risk-averse actors with no bearing on the redirection of productive investments.[59] This assumption cannot be sustained in a real-world assessment of the welfare effects of information revelation: contexts in which the investment-redirection channel is weak—where no productive or precautionary decision can respond to the information revealed—are precisely those in which insurance and hedging have the least important role to play. Thus, whenever the information revelation and hedging function of prediction markets conflict, the former should prevail over the latter.

2 Regulations Protecting the Social Function of Prediction Markets

For prediction markets to discharge their social functions of information revelation and hedging, two conditions must hold. First, there must be a reliable way of determining how event contracts resolve at expiry, and of settling disputes about resolution: a contract that pays out unpredictably neither reveals information nor allows for effective risk hedging (Section 2.1). Second, the market must be efficient both informationally, so that event contract prices anticipate the occurrence of future events as well as possible, and in terms of liquidity, so that traders can enter and exit at low cost (Section 2.2).

2.1 Resolution

Most events on prediction markets can be observed with ease. There is usually little ambiguity as to who won an election, whether a rocket launch reached orbit, or when the FIFA World Cup is over. Some events, however, are more open-textured and turn on interpretation. When rapper Cardi B made a cameo during Bad Bunny's 2026 US Super Bowl halftime show, dancing and mouthing words without singing, Kalshi and Polymarket each had to decide whether contracts on whether she would perform resolved 'yes' or 'no'. Kalshi settled the market at the last traded price before trading was paused, whereas Polymarket's mechanism resolved the related contracts as 'yes'.[60]

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[59] ibid 568.

[60] Hannah Vanbiber, 'Cardi B's appearance during Bad Bunny's Super Bowl halftime performance divided prediction markets' *New York Times* (12 February 2026) <https://www.nytimes.com/athletic/7038991/2026/02/11/cardi-b-halftime-show-betting-prediction-markets-controversy/> accessed 24 June 2026; Polymarket, 'Who will perform at 2026 Big Game halftime show?' <https://polymarket.com/event/who-will-perform-at-super-bowl-halftime-show> accessed 24 June 2026.

Resolution—the determination of how an event contract pays out at expiry—matters enormously. The attractiveness of prediction markets, and with it their capacity to perform their social functions, depends on resolution in accordance with what the greatest number of users would, in good faith, agree it should be.[61] Users should be able to understand why a given contract resolved as it did and to anticipate that resolution as accurately as the inherent complexity of real-world outcomes permits.

Predictable resolution depends on predictable rules and processes for enforcing them. When Kalshi refused to pay out bets on the event contract 'Ali Khamenei Out as Supreme Leader?' after his ouster resulted from death, it faced a class action brought by contract holders alleging that the market rules were ambiguous. Kalshi returned about $2.2 million in fees and refunds to users.[62] Kalshi's rulebook now provides that 'if a natural person who is the primary subject of a Contract's Underlying or Payout Criterion dies prior to Expiration, Kalshi may, in its sole discretion, settle the Contract at the last traded price prior to the death'.[63]

Polymarket and Kalshi resolve such questions through diametrically opposed mechanisms. On Polymarket, event resolution is blockchain-based and runs on the UMA Optimistic Oracle (OO) mechanism. Anyone may at any time propose that a contract has resolved 'yes' or 'no' by posting a bond worth $750 to the OO. The proposal opens a challenge window during which anyone may dispute it by posting an equal bond. If the dispute is not resolved at this stage, all UMA token holders vote on the outcome, and after a discussion period a majority vote determines resolution. Whoever the majority sides with—proposer or disputer—recovers their bond plus half the loser's. The loser forfeits their bond, and voters likewise gain or lose tokens according to whether they sided with the majority. Successive votes may be held until the required majority is reached, and Polymarket can itself step in to determine the outcome if no consensus emerges after several rounds. Economic incentives are built

[61] One might argue that the value of users' expectations should be weighted by the amount of money each has staked. Whether or not such weighting is applied does little to alter the conclusions reached in this section, and this article therefore leaves this question aside.

[62] Jack Newsham, 'Khamenei's killing spurs outrage among Kalshi and Polymarket users over claims of rigged markets and insider trading' *Business Insider* (1 March 2026) <https://www.businessinsider.com/khamenei-prediction-markets-kalshi-polymarket-insider-trading-outrage-2026-3> accessed 24 June 2026; Jason Brett, 'Kalshi 'Death Bet' Lawsuit Sparks Push To Ban Assassination Markets' *Forbes* (12 March 2026) <https://www.forbes.com/sites/jasonbrett/2026/03/12/kalshi-death-bet-lawsuit-sparks-push-to-ban-assassination-markets/> accessed 28 June 2026.

[63] Kalshi's Rulebook, rule 6.3(e).

in to deter oracle corruption, notably by making it costly to acquire a token stake large enough to dictate the vote.[64]

Kalshi's resolution mechanism is far simpler: the platform itself 'has sole discretion to interpret a Contract's Terms and Conditions' and to settle accordingly.[65] Where settlement cannot be read off the contract, or where the reliability of the underlying is in doubt, Kalshi may at its own discretion refer the matter to its Market Outcome Review Process, under which an Outcome Review Committee (a committee of Kalshi's own Board) determines the final outcome within twenty-four hours. Its determinations are 'final and not subject to review'.[66] Thus, whereas Polymarket relies on a decentralised vote in which proposers, disputers, and voters are guided by their expectation of the resolution process's likely result, Kalshi relies on a centralised adjudication that is internal to its own governance, with no external appeal, based on pre-existing market rules and Kalshi's interpretation of them.

This article does not purport to determine whether the governance mechanisms implemented by UMA, Polymarket and Kalshi are effective.[67] What matters, from a normative standpoint, is whether Polymarket and Kalshi have the right incentives to adopt the optimal system—namely, one that aligns resolution with the expectations of the greatest number of users. Both platforms earn transaction fees,[68] whose total therefore rises and falls with trading volume, and neither has an interest in adopting rules their users would dislike. Questioning these platforms' incentives thus reduces to asking whether their users care about predictability. As someone betting on an outcome logically wants their payoff tied to that outcome's resolution in a way

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[64] For explanations of these mechanisms, see UMA, 'Data Verification Mechanism: Adding Economic Guarantees to Blockchain Oracles' (draft v0.2, 24 April 2020) and UMA, 'A Decentralized Financial Contract Platform' (draft, 3 December 2018), both at <https://github.com/UMAprotocol/whitepaper> accessed 24 June 2026 (respectively, 'UMA DVM whitepaper' and 'UMA whitepaper'). See also UMA, 'Documentation' <https://docs.uma.xyz> accessed 24 June 2026; Polymarket, 'Resolution' <https://docs.polymarket.com/concepts/resolution> accessed 24 June 2026; Polymarket Guide, 'Voting' <https://polymarketguide.gitbook.io/polymarketguide-archive/basics/voting> accessed 24 June 2026.

[65] Kalshi's Rulebook, rule 6.3(c).

[66] Kalshi's Rulebook, rules 6.3(c), (f) and 7.1.

[67] On blockchain and oracle governance, see Darcy WE Allen, Aaron M Lane and Marta Poblet, 'The Governance of Blockchain Dispute Resolution' (2020) 25 Harvard Negotiation Law Review 75; Kevin Werbach, 'Trust, but Verify: Why the Blockchain Needs the Law' (2018) 33 Berkeley Technology Law Journal 487; Shayan Eskandari and others, 'SoK: Oracles from the Ground Truth to Market Manipulation' *AFT '21: Proceedings of the 3rd ACM Conference on Advances in Financial Technologies* (ACM 2021) <https://doi.org/10.1145/3479722.3480994> accessed 25 June 2026.

[68] Kalshi, 'Fee schedule' <https://kalshi.com/fee-schedule> accessed 24 June 2026; Polymarket, 'Fees' <https://docs.polymarket.com/trading/fees> accessed 24 June 2026.

consistent with their expectations, and uncertainty about the resolution process may deter trading altogether and invite bad publicity, platforms clearly internalise the cost of unpredictable resolution and have a strong incentive to implement rules and processes that are as predictable as possible.[69]

Because platforms thus have strong private incentives to make resolution predictable, mandating any particular resolution process promises little improvement over what competition already delivers. As a matter of principle, the relationship between platforms and their users over the resolution process should therefore be left to contractual freedom. That Polymarket and Kalshi have opted for radically different resolution mechanisms illustrates the value of that freedom: platforms are experimenting with different trade-offs between the speed, cost, and accuracy of resolution, and regulatory standardisation would cut this experimentation short. Suffice it to note that the law should permit the effective enforcement of such contractual commitments—a question that goes well beyond the scope of this article[70]—and that the protection of retail users could justify the implementation of consumer protection requirements, the discussion of which we postpone to Section 3.2.

2.2 Market Efficiency

Exogenous informed trading, understood as trading by users who hold information not broadly available to other users and have no influence over the event's outcome, is what makes information revelation possible. Users with different knowledge and interpretation of the probability of realisation of the underlying event trade together and, in doing so, bring the event contract price to a level implicitly reflecting their collective assessment of the event's probability. However, prediction markets might be subject to frictions limiting their efficiency and, therefore, their function of information aggregation, either due to their structural features or to some users' attempts at gaming these features. This has two regulatory implications.

First, there is no question that manipulation, understood as conduct designed to push prices away from the level reflecting available information, should be forbidden.

[69] The conclusion would differ only in the unlikely event that most users positively valued randomness in resolution.

[70] For high-level discussions of this question, see for instance Lee J Alston, 'Institutions, Institutional Change and Economic Performance' (1992) 18 Journal of Economic Behavior & Organization 142; Peter A Alces, 'Theory of Contract Enforcement' in Peter A Alces (ed), *A Theory of Contract Law: Empirical Insights and Moral Psychology* (Oxford University Press 2011).

Manipulation directly undermines information revelation,[71] the very feature that makes prediction markets socially useful.[72] Manipulation may also bias real-life outcomes whenever decision-makers make decisions based on event contract prices.[73] Because the information generated by these markets is partly a public good, platforms do not capture its full social value and may, as a result, under-invest in detecting and sanctioning manipulative trades. This justifies publicly enacted rules.[74]

The role insider trading rules should play in the exogenous trading context is more ambiguous. While informed trading contributes to informational efficiency, thereby fulfilling prediction markets' social function of information revelation, it also erodes the liquidity of these markets through adverse selection.[75] Liquidity providers post buy and sell limit orders on each 'yes' or 'no' contract, supplying liquidity to everyone else, and calibrate the bid-ask spread and the depth of the order book to their expectation of trading against better-informed counterparts. A 'yes' contract quoting a best bid of $0.49 and a best offer of $0.51, for instance, carries a bid-ask spread of $0.02, a measure of the contract's liquidity. As adverse selection rises, liquidity providers widen the spread to recoup what they lose to informed traders, passing the cost on to the rest of the market (for instance by quoting a best bid of $0.45 and a best

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[71] On the impact of market manipulation on informational efficiency, see for instance Merritt B Fox, Lawrence R Glosten and Gabriel V Rauterberg, 'Stock Market Manipulation and Its Regulation' (2018) 35 Yale Journal on Regulation 67; Albert S Kyle and S Viswanathan, 'How to Define Illegal Price Manipulation' (2008) 98 American Economic Review 274.

[72] Robert W Hahn and Paul C Tetlock, 'A New Approach for Regulating Information Markets' (2006) 29 Journal of Regulatory Economics 265, 277. For empirical evidence on the manipulation of prediction markets, see Itzhak Rasooly and Roberto Rozzi, 'How Manipulable Are Prediction Markets?' (Sciences Po 2025) Discussion Paper 2025–05 <https://arxiv.org/abs/2503.03312> accessed 29 June 2026. The CFTC voiced a related concern: trading in event contracts could 'present a distraction to law enforcement and military authorities and, at worst, be manipulated by wrong-doers to divert attention from planned harmful events'. For instance, an individual planning an attack could buy the 'no' contract to 'create misleading market signals, potentially diverting attention and resources at a critical time': CFTC Notice on Prediction Market Rulemaking 110. For a theoretical argument that prediction market manipulation might increase informational efficiency by encouraging informed trading on low-liquidity markets, see Robin Hanson and Ryan Oprea, 'A Manipulator Can Aid Prediction Market Accuracy' (2009) 76 Economica 304.

[73] supra n **Error! Bookmark not defined.**.

[74] Prediction market users could in theory manipulate the indicator that determines whether a given event contract resolves 'yes' or 'no'. Such manipulation is unlikely to succeed where resolution turns on a publicly observable event, and at any rate is better addressed through the resolution mechanisms discussed in Section 2.1.

[75] Lawrence R Glosten and Paul R Milgrom, 'Bid, Ask and Transaction Prices in a Specialist Market with Heterogeneously Informed Traders' (1985) 14 Journal of Financial Economics 71. On these ideas and their regulatory implications, see Merritt B Fox, Lawrence R Glosten and Gabriel V Rauterberg, 'Informed Trading and Its Regulation' (2018) 43 The Journal of Corporation Law 817.

offer of $0.55).[76] A direct implication of this mechanism is that the combined cost of buying both the 'yes' and 'no' contracts for a given event (ie the sum of the best offers for each) usually exceeds $1, reflecting the bid-ask spreads of each.[77] Thus, while informed traders push prices in the 'right' direction, liquidity providers' expectation to trade with them has an indirect negative impact on liquidity. On the other hand, uninformed ('noise') traders enhance liquidity (as liquidity providers earn on average half the bid-ask spread each time they trade a single event contract with them) but contribute nothing to informational efficiency on average.

Securities law traditionally addresses this issue by imposing disclosure requirements on issuers (which preserves informational efficiency) while forbidding some categories of informed trading by classifying them as unlawful insider trading (which curbs adverse selection).[78] But this mechanism cannot be transposed to prediction markets. What makes information revelation through event contract trading so useful is precisely that, in most cases, no alternative information revelation mechanism can be relied on as effectively.[79] Prohibiting informed trading on prediction markets on the ground that it decreases liquidity would thus be like outlawing the printing press because it consumes ink.[80]

One might counterargue that informational efficiency is less essential to the hedging function of event contracts, and that users transacting for this purpose may value liquidity over informational efficiency. However, hedging is unlikely to concern more than a small subset of prediction market users, whereas the benefits of information revelation are reaped by anyone observing event contract prices to mitigate uncertainty. Furthermore, users relying on prediction markets for hedging purposes are themselves likely to be interested in how informative those contracts are about the very event against which they hedge. The facilitation of hedging thus provides a weak case for preventing informed trading.

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[76] Thierry Foucault, Marco Pagano and Ailsa Röell, *Market Liquidity: Theory, Evidence, and Policy* (2nd edn, Oxford University Press 2024) 93-94; Lawrence R Glosten and Lawrence E Harris, 'Estimating the Components of the Bid/Ask Spread' (1988) 21 Journal of Financial Economics 123.

[77] For instance, a 'yes' contract for a given event might price at $0.52 and a 'no' contract at $0.53, approximately reflecting an expected bid-ask spread of five cents for each contract.

[78] Fox, Glosten and Rauterberg (n 71) 892.

[79] For a similar argument, see Robin Hanson, 'Insider Trading and Prediction Markets' (George Mason University, Department of Economics 2007) Working Paper <https://mason.gmu.edu/~rhanson/insiderbet.pdf> accessed 19 May 2026.

[80] A related argument is made by Sanford J Grossman and Joseph E Stiglitz, 'On the Impossibility of Informationally Efficient Markets' (1980) 70 The American Economic Review 393.

Prediction market platforms have a strong incentive to spontaneously regulate informed trading in a way that maximises liquidity. Both Kalshi and Polymarket monetise their services through trading fees and other commissions related to trading volume,[81] and both implement liquidity reward programmes aiming to encourage the provision of liquidity.[82] Liquidity thus directly drives their revenues, whereas informational efficiency does not. Put differently, because these platforms do not internalise the social benefits of information revelation, they have no reason to weigh informational efficiency against liquidity in a way that maximises social welfare. Finally, platforms have a strong incentive to signal their willingness to prevent and sanction insider trading to reassure their retail users,[83] who likely account for far more trading volume than informed users.[84]

These incentives may well lead prediction market platforms to over-sanction exogenous informed trading. Kalshi's Rulebook provides that 'if a Trader is an Insider that has access to material non-public information that is the subject of an Underlying of any Contract […], that Trader is prohibited from attempting to enter into any trade or entering into any trade, either directly or indirectly, on the market in such Contracts. An "Insider" means any person who has access to or is in a position to have access to material nonpublic information before such information is made publicly available'.[85] Breaches expose users to a battery of sanctions, including 'a fine or penalty fee […] sufficient to deter recidivism' (with no cap specified),[86] the disgorgement of profits,[87] and the suspension or revocation of trading access and membership benefits.[88]

The Rulebook does not define or restrict the concept of material nonpublic information in any way, nor does it say anything about the source from which the information has

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[81] Kalshi, 'Fees' <https://help.kalshi.com/en/articles/13823805-fees> accessed 19 May 2026; Polymarket, 'Fees' <https://docs.polymarket.com/trading/fees> accessed 19 May 2026.

[82] Polymarket, 'Liquidity Rewards' <https://docs.polymarket.com/market-makers/liquidity-rewards> accessed 18 May 2026; Kalshi, 'Liquidity Incentive Program' <https://help.kalshi.com/en/articles/13823851-liquidity-incentive-program> accessed 18 May 2026.

[83] See the discussion of investor confidence in Fox, Glosten and Rauterberg (n 67) 102-103.

[84] The converse would mean that many users hold superior information about the event's outcome, which is intuitively extremely unlikely given the nature of events to which event contracts relate (political elections, geopolitical events, sports outcomes, etc.).

[85] KalshiEX LLC Rulebook, version 1.28 (Kalshi's Rulebook), rule 5.17(y). See also rule 2.11 and 5.17(cc) (implicitly referring to 17 CFR § 180.1).

[86] Kalshi's Rulebook, rule 9.5(c).

[87] Kalshi's Rulebook, rule 9.5(d).

[88] Kalshi's Rulebook, rule 9.5(e), (f).

been obtained. As a result, anyone with knowledge of a fact suggesting that an event contract is mispriced, irrespective of the nature or source of the information, falls within the ban. The rule is broader than is socially optimal in that it prevents exogenous users from exploiting their informational advantage, even though trading by these users would significantly contribute to the information revelation process at the heart of prediction markets' social function.

A case for mandatory insider trading rules covering exogenous trading would nonetheless hold if liquidity losses on prediction markets generated negative externalities. On traditional financial markets, a significant fall in liquidity in one market can propagate to others, ultimately producing a macroeconomic liquidity shock that no single company or its shareholders fully internalises[89] and which, therefore, warrants public regulation.[90]

Such contagion is unlikely to materialise on prediction markets. Prediction markets are not interconnected with other markets in the way securities markets or major commodities markets are. In particular, companies and financial institutions, let alone banks, are unlikely to have large leveraged positions on event contracts or to use them as collateral.[91] Furthermore, contrary to the collapse of a company's security price and liquidity, which can cause financial trouble to that company and its own creditors and shareholders, event contracts serve no comparable allocative function in the economy. The contagion risk from a fall in an event contract's liquidity is therefore likely to be limited.

As a final note, the information revelation benefits of prediction market trading counterintuitively make a weak case for any single state to authorise trading on its territory. Because the resulting forecasts are a public good consultable by anyone and from anywhere, a state that permits its informed citizens and firms to trade captures only a small fraction of the global benefit their trading generates while bearing the full domestic cost, discussed in Section 3 below, of hosting that market. This might result in a cross-border externality whereby each state, reasoning unilaterally, under-provides the activity relative to the global optimum.[92] The problem is compounded in jurisdictions with a thin financial market culture and few participants able to 'beat the

[89] See eg Markus K Brunnermeier and Lasse Heje Pedersen, 'Market Liquidity and Funding Liquidity' (2009) 22 Review of Financial Studies 2201.

[90] Paul Oudin, *European Insider Dealing Law* (forthcoming, Oxford University Press) manuscript on file with the author.

[91] Brunnermeier and Pedersen (n 85).

[92] For a theorization of the under-provision of global public goods, see Todd Sandler, *Global Collective Action* (Cambridge University Press 2004) 69.

market' through informed trading, where the domestic information dividend is slim to begin with. This may help explain why many jurisdictions forbid prediction market trading outright.

3 The Social Costs of Prediction Markets and their Regulation

Three concerns counterbalance the positive social function of prediction markets. The first is the feedback effects associated with some event contracts:[93] bets on future events can incentivise whoever is able to influence these events to do so in a way that allows them to secure a profit. A candidate in an election might for instance decide to withdraw from their campaign after taking bets on the success of their opponents. The article labels as 'endogenous users' those market participants who can affect the outcome of the underlying of the event contract they trade. Section 3.1 argues that, although regulations prohibiting endogenous trading can be useful in certain contexts, prediction market platforms have strong incentives to (and do) self-regulate by prohibiting them. Second, prediction markets expose retail users to systematic losses in a way that is closer to gambling markets than securities markets, which justifies the application of gambling rules whenever prediction markets are deemed too harmful to retail users (Section 3.2). Finally, several areas of the law can be mobilised whenever event contracts are deemed worthy of prohibition on moral grounds (Section 3.3).

3.1 Endogenous Trading

Nearly three decades after the Marine Insurance Act discussed in the introduction, the British Parliament passed the Life Assurance Act, which confined life insurance to persons holding an insurable interest in the insured life, voiding any policy taken out 'by way of gaming or wagering'.[94] The concern was twofold: such policies were gambles dressed as insurance and, more troublingly, they gave the policyholder a financial interest in the insured's death, potentially creating the wrong kind of incentives.[95] The Life Assurance Act echoed the Marine Insurance Act, whose

[93] The term is borrowed from the financial economics literature, where 'feedback effect' denotes the influence of secondary-market prices on the real economy through their informational role: Bond, Edmans and Goldstein (n 36). See also Alex Edmans, Itay Goldstein and Wei Jiang, 'The Real Effects of Financial Markets: The Impact of Prices on Takeovers' (2012) 67 The Journal of Finance 933. Such effects likely exist on prediction markets too, as our discussion of market manipulation in Section 2.2 suggests. However, this article uses this term to refer to the pecuniary incentive an event contract creates for those who can influence its outcome, rather than the feeding of price information into real decisions.

[94] Life Assurance Act 1774 (14 Geo 3, c 48).

[95] Jacob Loshin, 'Insurance Law's Hapless Busybody: A Case against the Insurable Interest Requirement' (2007) 117 The Yale Law Journal 474, 480.

preamble lamented that what 'was intended for the Encouragement of Trade and Navigation, has, in many Instances, become hurtful of, and destructive to the same'.[96] In each case, the law aimed to withdraw the wagering instrument from those positioned to bring about the event insured.[97]

Prediction markets can raise moral hazard problems similar to those of insurance markets.[98] Endogenous prediction market users, who are able to influence the outcome of an event contract, might be tempted to invest in it before acting in a way that determines the contract's outcome. In this sense, endogenous trading is the modern analogue of the death-wager the 1774 Act was passed to suppress. The 'Death Bets Act' bills now before the US Congress,[99] which aim to forbid event contracts based on an individual's death, are direct conceptual inheritors of the 1774 Act.

Endogenous trading on prediction markets can have feedback effects well beyond life and death. American investor Bill Ackman suggested that Eric Adams, a candidate in the New York City mayoral race, should bet on the success of his opponent Andrew Cuomo before withdrawing from the race.[100] Polymarket, for its part, listed a contract on whether 'Little Joe', a gorilla once notorious for escaping Boston's Franklin Park Zoo, would escape again following his transfer to Pittsburgh. Anticipating that Polymarket users might engineer his escape, the market's resolution terms reserved Polymarket's right to 'void any market if there is credible evidence of coordinated manipulation or external interference with the gorilla or its enclosure', with Polymarket pledging to 'cooperate fully with law enforcement in any investigation of interference'.[101] Both examples illustrate how prediction markets can invite 'event manipulation', thereby triggering feedback effects on the very events they purport to forecast.

In this sense, prediction markets can become 'bounty markets': by openly pricing the occurrence of an event, they reward whoever is in a position to trigger it, including in

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[96] Marine Insurance Act 1745, preamble.

[97] For a brief discussion of both acts, see Geoffrey Clark, *Betting on Lives: The Culture of Life Insurance in England 1695–1775* (Manchester University Press 1999) 22-27.

[98] For a conceptual framing of moral hazard in the context of insurance, see Tom Baker, 'On the Genealogy of Moral Hazard' (1996) 75 Texas Law Review 237, 251-252.

[99] supra n 29.

[100] Andrew Gelman, 'Uh oh prediction markets' *Columbia Statistical Modeling, Causal Inference, and Social Science* (7 January 2026) <https://statmodeling.stat.columbia.edu/2026/01/07/uh-oh-prediction-markets/> accessed 18 May 2026.

[101] Polymarket, 'Will Little Joe escape again?' <https://polymarket.com/event/will-little-joe-escape-again> accessed 25 June 2026.

contexts where the event is not to be wished for. In turn, the harm caused by the feedback effect of prediction market trading depends on the underlying event. Obviously, prediction market bets should not determine elections' outcomes, trigger geopolitical events, or reward criminal conduct. On the other hand, Taylor Swift changing her wedding date to cash in on related contracts can safely be considered not particularly harmful,[102] setting aside the losses incurred by other market participants as a result of her trading[103] and the potential emotional distress inflicted on the Swifties.[104]

Platforms do not directly bear the harm caused by endogenous trading. Nevertheless, they have a strong incentive to spontaneously prohibit it, for reasons parallel to those set out in the previous section: stringent enforcement might reassure retail users and, at any rate, platforms have every reason to favour liquidity over informed trading. The example of Kalshi shows again that stringent prevention rules can be proactively implemented by prediction markets in the context of endogenous trading. Indeed, Kalshi's Rulebook provides that 'if a Trader is an Insider that […] has the ability to exert any influence on the subject of an Underlying of any Contract, that Trader is prohibited from attempting to enter into any trade or entering into any trade, either directly or indirectly, on the market in such Contracts'.[105] Likewise, 'if a Trader is a decision maker, either directly or indirectly, or has any influence, either directly or indirectly, no matter the scale and importance of the influence, on the outcome of the Underlying (event) of any Contract, that Trader is prohibited from [trading]'.[106]

Insider trading rules are not the only relevant instrument. Rules governing specific professions or public functions are in fact often better tailored to the specific objective at stake. For instance, trading by public officials or political candidates ahead of an election is objectionable for reasons of democratic integrity and public morality specific to that context, not because endogenous trading is everywhere problematic.[107] While insider trading rules do not offer the same granularity, they do have a comparative advantage of their own: financial regulators and prosecutors who enforce them are the public authorities best equipped to detect and prosecute trades concealed within ordinary market activity. Finally, prediction markets on which the

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[102] Polymarket, 'Taylor Swift x Travis Kelce get married by...?' <https://polymarket.com/event/taylor-swift-x-travis-kelce-get-married-by> accessed 18 May 2026.

[103] The redistributive aspects of prediction markets are further discussed in Sections 3.2 and 3.3.

[104] 'Swifties', *Taylor Swift Wiki* <https://taylorswift.fandom.com/wiki/Swifties> accessed 19 May 2026.

[105] Kalshi's Rulebook, rule 5.17(y).

[106] Kalshi's Rulebook, rule 5.17(z).

[107] This argument is further discussed in Section 3.3.

risks posed by endogenous trading and feedback effects are too high relative to their information revelation and hedging benefits could simply be banned outright.[108]

Useful as it is, the distinction between endogenous and exogenous trading is not always clear-cut. For instance, following the capture of former Venezuelan President Nicolás Maduro, the US Justice Department announced the indictment of a US Army service member who allegedly used classified information about Maduro's imminent capture to secure profits by trading on prediction markets.[109] Polymarket advertised several event contracts answering questions such as 'Maduro out by...?'[110] and 'US forces enter Venezuela again by...?',[111] with contracts resolving to 'Yes' if the underlying event occurred by the date specified in the event contract. Based on our classification, this user does not squarely qualify as either exogenous (because he participated in Maduro's capture) or endogenous (because he likely did not have a say over when the operations would be launched).

Where to draw the line is ultimately a definitional and policy question, informed by the empirical magnitude of feedback risk and a preference as to how feedback risk and informational efficiency should be balanced. A broad definition of unlawful endogenous trading, capturing anyone who might in any way participate in the underlying event, for instance privileges the suppression of feedback effects over the (possibly short-lived) gain in informational efficiency from trading, whereas a narrow definition reverses that priority.

In conclusion, the choice whether to prohibit endogenous trading should be left to prediction market platforms whenever endogenous trading does not cause any specific harm (aside from a wealth transfer to the endogenous trader). These platforms already have sufficient incentives to prevent this form of trading. They might even over-sanction it, given their interest in maximising liquidity and trading volume at the expense of informational efficiency. At a minimum, this means a platform's decision not to prohibit a particular category of endogenous trading should not be second-guessed, so long as it generates no harmful feedback. On the other hand, public

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[108] In this sense, see eg CFTC Notice on Prediction Market Rulemaking 19-20, 89-91, 152.

[109] US Department of Justice, 'U.S. Soldier Charged With Using Classified Information To Profit From Prediction Market Bets' (23 April 2026) <https://www.justice.gov/opa/pr/us-soldier-charged-using-classified-information-profit-prediction-market-bets> accessed 18 May 2026.

[110] Polymarket, 'Maduro out by...?' <https://polymarket.com/event/maduro-out-in-2025> accessed 18 May 2026.

[111] Polymarket, 'US forces enter Venezuela again by...?' <https://polymarket.com/event/us-forces-in-venezuela-again-by> accessed 18 May 2026.

regulators should intervene and prohibit specific trading practices whenever the legality of endogenous trading is likely to cause harmful feedback effects.

3.2 Retail User Protection

Normatively, considerations relating to the protection of retail users on prediction markets occupy the contested ground between securities regulation and gambling regulation. Gambling poses well-documented public health risks,[112] such as addiction, excessive indebtedness, and crime committed to repay gambling debts, and prediction markets are no exception.[113] Aside from these pathologies, prediction market users exhibit the same biases as those observed in financial and betting markets, by overvaluing extreme profits and undervaluing average outcomes. This phenomenon has been dubbed the 'favorite-long shot bias' in the context of horse races.[114]

Unlike gambling, which serves no function other than occasionally providing gamblers with short-term enjoyment and enriching the house in the long run, prediction market trading serves a useful economic function by supplying liquidity and, at times, contributing to informational efficiency on these markets in a similar way to securities trading. Unlike securities markets, however, prediction markets offer no growing pie: aggregate equity market capitalisation can rise over time so that buy-and-hold retail investors enjoy substantial long-run returns,[115] whereas prediction markets are zero-sum and consistent profit requires being meaningfully better than the average user.[116] In fact, once trading and liquidity costs are taken into account, *all* uninformed strategies have a negative expected return. One recent working paper documents that the top 1% of profitable Polymarket users—predominantly liquidity providers—capture 76.5% of all gains, with 68.8% of users losing money,[117] meaning that retail users recurrently incur significant losses by trading with a small group of

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[112] May CI van Schalkwyk, Mark Petticrew and Martin McKee, 'A Public Health Approach to Gambling Regulation: Countering Powerful Influences' (2021) 6 The Lancet Public Health e614.

[113] Hahn and Tetlock (n 68) 269 and literature cited.

[114] Wolfers and Zitzewitz (n 6) 117-118 and literature cited; Richard H Thaler and William T Ziemba, 'Anomalies—Parimutuel Betting Markets: Racetracks and Lotteries' (1988) 2 Journal of Economic Perspectives 161, 163.

[115] See eg Dmitry Kuvshinov and Kaspar Zimmermann, 'The Big Bang: Stock Market Capitalization in the Long Run' (2022) 145 Journal of Financial Economics 527.

[116] Traders' performance needs to be sufficiently good to cover the cost incurred on each trade as a result of the bid-ask spread and the trading fees charged by the platform.

[117] Pat Akey and others, 'Who Wins and Who Loses in Prediction Markets? Evidence from Polymarket' (2026) Working Paper <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=6443103> accessed 18 May 2026.

consistently profitable counterparties. This suggests that prediction markets are structurally harmful to unskilled traders in a way securities markets are not. Furthermore, prediction market platforms have little incentive to account for the harm incurred by retail investors as a result of prediction market trading, as these uninformed investors both contribute to market liquidity and represent a potentially important source of transaction fees.

Does it follow that retail users should be barred from trading on prediction markets or otherwise protected? Not necessarily. The answer depends on how each society at a given time balances individual freedom, market efficiency, and consumer protection. In an ideal world, protective rules should apply exclusively to those in need of protection while permitting those best able to cater for their own interests to trade freely. This is the logic of the distinction between retail and professional investors familiar from financial regulation.[118]

Unfortunately, this distinction translates poorly to prediction markets. On financial markets, an investor's professional status can be inferred from trading experience, employment history, and financial knowledge.[119] By contrast, a prediction market user with no financial knowledge might well be an expert on some issues but not others. A seismologist might, for instance, be able to predict with remarkable precision the future occurrence of earthquakes in a given part of the globe, and thus to secure meaningful profits, without any financial knowledge or past involvement with prediction markets. Barring such specialists from trading on protective grounds is both self-defeating (their interests may be better served by trading than by abstaining) and counterproductive (such trades might contribute substantially to the informational efficiency of prediction markets). In this sense, classification as 'retail' or 'professional' depends on the market in which prediction market users trade, rather than on whether they possess an objective minimum level of skill.

Gambling laws are not particularly well-suited to such nuances either. Aside from pure prohibition, gambling laws usually include measures such as age and

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[118] This distinction has been relied on by the European Securities and Markets Authority (ESMA), and subsequently European national market authorities, to prohibit the marketing, distribution or sale of so-called binary options to retail clients: ESMA Decision (EU) 2018/795 of 22 May 2018 [2018] OJ L136/31. In the UK, see FCA, 'Product Intervention Measures for Retail Binary Options' (Policy Statement PS19/11, March 2019. See also ESMA's recent position that event contracts might under certain circumstances qualify as binary options at n 21.

[119] In the context of the MiFID II directive, for instance, a 'professional client is a client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs' and meets several additional criteria listed by the directive, whereas anyone else is a retail client: MiFID II, art 4(1)(10), (11) and Annex II.

advertising restrictions, limits on credit-funded bets, and affordability checks. Distinctions between retail and professional gamblers also exist in some jurisdictions in the area of tax law, where they are mostly based on the recurrence of winnings for taxation purposes.[120] While some of these measures could be applied to prediction markets, they bring little nuance in terms of users' capacity to hedge their risk or secure a profit based on the information they hold.

Disclosure requirements could be imposed on prediction market platforms to inform retail users of the risks and structural losses that bets on prediction markets entail. However, even in ordinary consumer settings, mandated disclosure 'chronically fails to accomplish its purpose': disclosees do not read, do not understand, and do not act upon the information disclosed to them.[121] Prediction markets are a peculiarly unpromising setting for disclosure: not only is there little hidden information to disclose, but the zero-sum structure of event contracts—every gain is some other user's loss—is apparent from the product itself. The fact that buying 'yes' and 'no' contracts for the same event systematically costs more than one dollar also makes it rather obvious that the expected return of prediction market trading is structurally negative. Users who trade despite these signals are no more likely to be deterred by an additional risk warning than a gambler would be by being told, before entering a casino, that they are likely to lose money.

Position and stake limits are perhaps the most credible intermediate instrument. Caps on speculative positions are standard in the US Commodity Futures Trading Commission's regime,[122] and limits on the size of wagers are an equally familiar tool of gambling regulation.[123] Aside from protecting retail users against excessive loss, position limits might incidentally forestall endogenous traders' incentive to bring about the underlying event while preserving the aggregation of information dispersed across many small stakes, thereby speaking both to the feedback concerns of Section

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[120] In France, for instance, regular and significant gains derived from gambling where skills play a role in the probability of winning can be taxed under the regime of non-commercial profits: Code général des impôts, art 92; CE, 21 June 2018, n° 412124; CE, 5 July 2023, n° 470936. In Germany, sustained gambling gains in games involving a mix of luck and skill, such as poker, can be taxed differently than pure games of chance and occasional gambling: Bundesfinanzhof, 16 September 2015, X R 43/12 (see esp para 36).

[121] Omri Ben-Shahar and Carl E Schneider, 'The Failure of Mandated Disclosure' (2011) 159 University of Pennsylvania Law Review 647, 651.

[122] 7 USC § 7(d)(5).

[123] William Eadington, 'Gambling Policy in the European Union: Monopolies, Market Access, Economic Rents, and Competitive Pressures among Gaming Sectors in the Member States' in Tom Coryn, Cyrille JCF Fijnaut and Alan Littler (eds), *Economic Aspects of Gambling Regulation: EU and US Perspectives* (Brill | Nijhoff 2008) 84.

3.1 and to the protective concerns of the present Section.[124] Nevertheless, position limits ration harm rather than sort users, as they neither distinguish the expert seismologist from the compulsive gambler nor alter the negative expected return that makes uninformed trading structurally loss-making.

The existing regulatory toolkit thus offers little more nuance than outright authorisation or prohibition. The difficulty of distinguishing effectively between retail and professional users means that creating a retail user protection regime tailored to the specific context of prediction markets is especially delicate. As a result, the question of whether to regulate prediction markets essentially reduces to a binary choice between wholesale authorisation and prohibition. This may help explain why prediction markets tend to be either broadly permitted or entirely prohibited in any given jurisdiction.

3.3 Moral Considerations

Different jurisdictions might consider prediction markets immoral for different reasons, whether because of event contracts' subject matter (for instance, political events, life and death, or criminal actions) or because of broader objections to gambling. A distinct objection targets not the subject matter but the distributive consequences of trading: prediction markets, in general or through particular practices such as endogenous trading, redistribute wealth in ways some may find morally objectionable, in line with the observations made in Section 3.2.[125] Prediction market platforms may of course fail to align with such considerations, meaning that self-regulation is an especially poor fit for these concerns.

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[124] To illustrate this idea, a cap of a few hundred dollars on bets placed in prediction markets would likely discourage candidates in an election from withdrawing from the race in order to profit from such bets.

[125] The redistributive effect is real but diffuse. Informed and endogenous traders' gains are not borne by their immediate counterparties alone but by the whole pool of users, against whom liquidity providers widen the bid-ask spread and shallow the order book in anticipation of trading with informed counterparties, as explained in Section 2.2. Whether redistribution warrants intervention is a question of distributive justice analytically distinct from economic efficiency: a set of rules may maximise aggregate wealth (put differently, be Kaldor-Hicks efficient) while leaving some users far worse off. On the efficiency/distribution distinction and trade-offs between both, see Guido Calabresi and Douglas Melamed, 'Property Rules, Liability Rules, and Inalienability: One View of the Cathedral' (1972) 85 Harvard Law Review 1089, 1093-1105; Louis Kaplow and Steven Shavell, 'Notions of Fairness versus the Pareto Principle: On the Role of Logical Consistency' (2000) 110 The Yale Law Journal 237; Louis Kaplow and Steven Shavell, 'The Conflict between Notions of Fairness and the Pareto Principle' (1999) 1 American Law and Economics Review 63; Daniel Kahneman, Jack L Knetsch and Richard H Thaler, 'Fairness and the Assumptions of Economics' (1986) 59 The Journal of Business S285.

Whether such views are warranted is a political and philosophical question beyond this article's scope.[126] What matters here is which legal instrument fits which concern. Gambling laws are well suited to wholesale prohibitions of prediction markets or to bans on betting on specified subjects, whereas insider trading laws are better suited to concerns about how a trader came by the information they used.

Returning to the example of the US Army service member who allegedly traded on classified information ahead of Maduro's capture, the objection was not that someone from the Army participated in event contracts in the abstract, but that the information was obtained and exploited improperly. Because insider trading rules are concerned with the misuse of information, they are best suited to addressing this category of cases. On the other hand, restrictions based on the contract's subject matter—for instance, the interdiction of betting on politics or sports—or of prediction markets writ large are best enacted through gambling rules.[127] Indeed, these rules apply uniformly across betting platforms regardless of whether the wager takes the form of an event contract. Sector-specific regimes can also complement both where the prohibition is justified for a particular industry or class of persons, such as public officials trading on political events.

Conclusion

This article has shown that, because event contracts sit between gambling and financial instruments, each regulatory concern should be matched to the instrument best suited to it. Assuming prediction markets are authorised, market manipulation should be prohibited through financial regulation, as it directly destroys the information revelation that makes these markets socially valuable. Exogenous informed trading, by contrast, is the very engine of that information revelation, and should remain lawful for this reason. Prediction market platforms, whose revenues are derived from trading volume rather than informational efficiency, may even need to be prevented from implementing over-reaching insider trading rules that prohibit such trading too comprehensively. On the other hand, endogenous trading should be unlawful to the extent that it produces harmful feedback effects on the underlying events. Absent such harm, the choice whether to prohibit it can be left to platforms, which already have ample incentive to do so. Everything else should remain within

[126] For a discussion of the political aspects of gambling regulation in the US, see Raymond D Sauer, 'The Political Economy of Gambling Regulation' (2001) 22 Managerial and Decision Economics 5.

[127] This is for instance the approach retained in France by Code de la sécurité intérieure, art L320-1-L320-6 (general interdiction of gambling with category exceptions) and Loi n° 2010-476 of 12 May 2010 (restriction of online betting to sports, horse races and poker) and in Germany by Glücksspielstaatsvertrag 2021, §21 (regulation of sports betting).

the ambit of platform self-regulation, complemented where appropriate by professional or sector-specific rules, as for public officials.

Two considerations may nonetheless justify a more restrictive regime. Because any uninformed trading strategy on prediction markets has a negative expected return, prediction markets are structurally harmful to unskilled retail users in a way securities markets are not. However, the familiar retail/professional distinction translates poorly to prediction markets, where expertise is event-specific. Because no tailored protective regime appears workable, the question whether prediction market law should protect retail users collapses into a near-binary choice between wholesale authorisation complemented with financial regulation and prohibition through gambling law. Finally, moral considerations may justify the prohibition of some or all prediction markets through various regulatory instruments depending on the scope of the prohibition.

Ultimately, the choice between authorising prediction markets and forbidding them is a political one. The benefits of prediction markets in terms of information revelation and hedging are extremely difficult to quantify, and so too are the harms that might justify their prohibition. This difficulty is compounded by the fact that prediction markets' informational benefits largely accrue beyond the borders of any state that hosts the market. Finally, whether the benefits of prediction markets justify their costs turns on a trade-off between efficiency, redistribution and morality, whose resolution is inherently subjective and jurisdiction-dependent. Rather than solving these intractable questions, this article offers a framework for analysing the implications of each approach and the instruments available to implement it.