Regulating Prediction Markets

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Introduction

Modern governance and corporate strategy demand real-time expectation tracking, although traditional surveys and financial derivatives are limited by infrequent, slow updates. Prediction markets have stepped into this gap as a high-frequency alternative, hosting an incredibly wide range of wagers, from policy decisions to everyday sports games. By capturing such a wide range of human behavior, these platforms introduce a compelling mix of usefulness and vulnerabilities into the world of forecasting.

While a prediction market's ability to aggregate data offers massive analytical value, its rapid scaling has exposed severe liabilities, notably the risk of government insiders exploiting material non-public information (MNPI) for personal financial gain. This whitepaper breaks down prediction market mechanics, analyzes key platforms, and evaluates the emerging U.S. regulatory and legislative guardrails designed to prevent public officials from trading on confidential data.

Understanding Prediction Markets

A prediction market is an online platform that allows participants to trade event-based contracts whose payoffs are tied directly to the occurrence or nonoccurrence of a specific, unknown future event. Often structured as binary options questions, like "Yes/No", these markets allow traders to take positions on a wide range of topics, including political election results, macroeconomic data releases, and sporting outcomes. Because contract prices fluctuate with supply and demand, they serve as a unique tool for real-time forecasting, mapping the market's shared consensus on a probabilistic scale. For instance, a trader who buys a "Yes" contract receives a fixed payout (typically $1) if the underlying event occurs before expiration and

receives nothing ($0) if it does not. Conversely, a “No” contract returns $1 if the event does not happen, and $0 if it does. In a liquid market, the trading price of a contract directly represents the crowd’s estimated probability of the event. A “Yes” contract trading at $0.60 indicates a market-implied 60% probability that the event will happen.

Platforms generally make these contracts using the following models:

Continuous Double Auction	A stock-market-style order book that directly matches buyers to sellers, adjusting prices instantly as trades execute.
Automated Market Makers	Algorithms that dynamically quote buy and sell prices based on the volume of bets already placed on each option.
Blockchain/Smart Contracts	Decentralized architectures that automate betting and distributions without a centralized operator.

While a variety of platforms utilize these underlying operational models, the current prediction market industry is largely defined by two leading exchanges: Kalshi and Polymarket.

Kalshi

In 2020, Kalshi became the first federally regulated prediction market in the United States, operating as a “Designated Contract Market” overseen by the Commodity Futures Trading Commission (CFTC).

Insider Trading Enforcement: Kalshi applies strict platform-specific rules that ban individuals from trading if they have access to MNPI or possess direct/indirect influence over the underlying event’s outcome. The platform actively enforces these policies via account suspensions and financial penalties.

Macro Markets Expansion: In 2020, Kalshi opened “Macro Markets,” allowing users to trade distributions on core economic variables such as CPI inflation readings, Nonfarm Payrolls, GDP

growth, and Federal funds rate target decisions, meeting by meeting. These contracts are supported by major market makers such as Susquehanna and are available through popular retail brokerages such as Robinhood.

Polymarket

Launched in 2020, Polymarket is a decentralized prediction marketplace built entirely on blockchain technology.

Decentralized Execution: Polymarket uses self-executing smart contracts on the blockchain to facilitate wagers and distribute payouts, enabling it to operate globally without relying on a single centralized market operator. It operates in a legal gray area relative to U.S. regulatory frameworks, with an exchange model tailored primarily for offshore participants.

Geopolitical Volatility: Polymarket features heavy trading volume on geopolitical events. Highly publicized trades on the platform have attracted scrutiny over potential insider trading, ending in prosecutions of military personnel using classified intelligence.

In 2025, Polymarket launched its distinct domestic arm, Polymarket US, to expand into the United States through a compliant, regulated framework. To achieve this, the platform acquired the CFTC-registered Designated Contract Market, QCEX, which operates as a registered exchange under the Commodity Exchange Act. In short, buying a fully licensed exchange—QCEX in this case—gave Polymarket US a legal shortcut to launch in the American market without waiting years for regulatory approval. Unlike Polymarket's decentralized offshore platform, which uses blockchain-based smart contracts, the U.S. entity operates as a centralized exchange that enforces strict user verification. While its parent platform operates

globally, this domestic entity ensures full compliance with federal oversight requirements and meets the regulatory standards of other major U.S. derivatives exchanges.

The Current Regulatory Landscape

Understanding the current regulatory landscape is important when evaluating existing laws and how they address the risks involved in prediction markets. In the United States, prediction markets are generally regulated as derivative markets because their contracts derive their value from the outcome of a future event. A derivative is a contract that may be tied to a physical commodity, interest rate, stock index, or any asset, otherwise known as futures, options, and swaps. As a result, prediction markets are supervised within the broader framework that governs derivative markets.

This regulatory framework is managed primarily by the CFTC. The CFTC administers the Commodity Exchange Act (CEA) and oversees futures, options, and event contracts that involve financial risk. The CFTC plays a crucial role in promoting integrity, resilience, and vibrancy in U.S. derivative markets through its regulatory oversight. Their overall goal is to help protect participants and reduce systemic risk. As part of this oversight, platforms that offer prediction contracts must obtain approval before doing so. An important provision of the Commodity Exchange Act (CEA), known as the "Special Rule", gives the CFTC authority to determine whether an event contract should be prohibited. Under this rule, the CFTC applies a two-step review process. First, it evaluates whether the contract involves unlawful activity under federal or state law, or whether it relates to activities such as assassination, terrorism, war, or gaming. Second, the CFTC determines whether the contract is contrary to public interest. If either condition is met, the agency may prohibit the contract from being offered. These

protections were developed in response to growing concerns about market oversight and financial risk.

To understand why these safeguards exist today, it is helpful to consider the changes introduced by the Dodd-Frank Act in 2010. During this time, most swaps were traded "over the counter" (OTC), meaning they were not regulated, centrally reported, or cleared by a clearinghouse. OTC markets, which were unmonitored at the time, led to many large financial losses with no reporting trail. These shortcomings demonstrated the need for stronger governance and greater market transparency.

This historical push for improved oversight continues to shape current debates surrounding prediction markets. One of the most significant regulatory questions is whether prediction markets should be treated as a financial instrument or as gambling. Critics argue that prediction markets resemble gambling because participants wager on future events. However, supporters argue that prediction markets provide useful forecasting information and therefore serve a financial purpose. This distinction remains a central point of regulatory debate. Platforms like Kalshi and Polymarket contend that peer-to-peer event contracts differ fundamentally from traditional sportsbooks because there is no "house". They say prediction markets are structured like traditional futures markets by connecting participants. Furthermore, no wager would exist unless a person on one side is willing to do business with the other side. States like Washington and New Jersey believe prediction markets are stretching the law as the CEA regulates financial contracts, currency prices, interest rate contracts, and commercial contracts, not sports betting platforms. As a result, states think platforms found a loophole to run an unregulated sportsbook, not a modern financial market.

However, the legal classification of prediction markets is not the only issue under debate. Another important question is whether government officials should be allowed to participate in prediction markets, particularly when they may have access to non-public information. As prediction markets continue to evolve, concerns about government ethics and the use of insider information have become increasingly relevant.

Government Ethics and Insider Information

Nonpublic information is a critical issue in prediction markets because it refers to information that government employees possess but the public does not. According to the U.S. Code of Federal Regulations, an employee may not use their public office for personal financial gain. In addition, employees may not engage in financial transactions using nonpublic information, nor may they use that information for their own private interests or the interests of others.

To address these risks, Congress has enacted formal ethics legislation to prevent public service from being used for personal financial gain. Two important pieces of legislation are the Ethics in Government Act (EIGA) and the Stop Trading on Congressional Knowledge (STOCK) Act. The EIGA requires members of Congress and other government employees to publicly disclose their financial interests each year to promote transparency and help identify potential conflicts of interest. In addition to these requirements, the STOCK Act strengthened transparency requirements by requiring members of Congress and other federal employees to report significant financial transactions within 45 days and reaffirmed that they are subject to federal insider trading laws.

Despite these laws, allegations of insider trading involving members of Congress have continued to arise. For example, dozens of Congressional members executed trades in sectors expected to appreciate during COVID-19. Such as remote work technologies and telehealth companies are likely to be positively impacted by shutdowns. An example of this is Senator Richard Burr, who sold between $628,000 and $1.7 million in personal stocks on February 13, 2020. Prior to these transactions, he had been briefed on the potential global impact of COVID-19. The Department of Justice and the Securities and Exchange Commission (SEC) investigated Burr for potential insider trading, but the investigation later ended without charges.

Cases such as this highlight the concerns regarding how effective the existing enforcement mechanisms are. This creates a tension between elected officials acting on behalf of their constituents and their personal financial incentives. However, these cases are difficult to prosecute because distinguishing between harmless and illegal trading is challenging. Additionally, institutional incentives may limit legislators' willingness to pass laws against themselves.

In response to these concerns, on September 3, 2025, the Restore Trust in Congress Act was introduced in the House, with over 80 cosponsors. This bill would prohibit lawmakers from owning or trading individual-company stocks. The Restore Trust in Congress Act was created because existing rules, such as the STOCK Act, have not fully prevented conflicts of interest. If enacted, the bill would reflect a shift toward more stringent restrictions on financial conflicts of interest within Congress. As prediction markets expand, the challenge will be to ensure that government officials cannot use nonpublic information to gain an unfair advantage in forecasting markets.

Risks of Government Officials Participating in Prediction Markets

Geopolitical and National Security Vulnerabilities

In traditional financial markets, asset prices fluctuate in response to public information such as corporate earnings, supply chain metrics, and macroeconomic data. Geopolitical event-contacts, however, operate differently. The data driving these markets, such as upcoming troop movements, missile strikes, or covert diplomatic maneuvers, is entirely isolated within closed government and defense channels. This creates an information asymmetry, where the public is entirely unaware of the true probability of an event, while a select group of institutional insiders has absolute certainty.

The following table shows critical vulnerabilities created by geopolitical event-based contracts:

Leakage Risks	Abnormal spikes in trade volume can serve as leading indicators of classified information. For example, offshore prediction marketplaces experienced highly unusual contract purchases tracking potential U.S. military strikes on Iran immediately prior to those actions occurring in February 2026.
Tactical Moves for Profit	To protect market positions, personal financial incentives can encourage individuals to alter the pacing, secrecy, or execution of state actions.

While proxy trading in traditional stock markets allows politicians to gain a premium from the public, insiders are still subject to risk—a friction layer. An official can buy defense or pharmaceutical equities based on nonpublic information, but external variables such as corporate mismanagement can still dilute their financial returns.

Prediction markets eliminate this friction layer. By tokenizing the literal event baseline into a pure, mathematical binary contract ($1 or $0), prediction platforms allow public officials

to bypass trading proxies and monetize state secrets with zero exposure to external market variables.

Case Study: *United States v. Gannon Ken Van Dyke*

The criminal indictment of active-duty U.S. Army soldier Gannon Ken Van Dyke stands as the first federal prosecution for insider trading within prediction markets. The case shows how classified military intelligence can be directly commercialized through binary-event contracts.

In December 2025, Van Dyke was involved in the tactical planning and execution of "Operation Absolute Resolve," a classified military mission to capture Venezuelan President Nicolas Maduro.

Between December 27 and January 26, Van Dyke made thirteen wages, turning $33,034 to $409,881. The following are a few of the trades executed:

U.S. Forces in Venezuela… by January 31, 2026	Yes
Maduro out by… January 31, 2026	Yes
Will the U.S. invade Venezuela by… January 31	Yes
Trump invokes War Powers against Venezuela by… January 31	Yes

Immediately following the operation, sharp spikes in Polymarket's trading volume triggered intense media scrutiny, prompting Van Dyke to cover his digital tracks. He quickly withdrew the bulk of his proceeds, transferring them to a foreign cryptocurrency vault before channeling them into a newly opened domestic brokerage account. Additionally, he contacted Polymarket on January 6, 2026, requesting the permanent deletion of his trading account, claiming he had lost access to his registered email address. That same day, he redirected his

primary cryptocurrency exchange email to an anonymous address he had proactively created under a pseudonym back on December 14, 2025.

Following his actions, Van Dyke was hit with a federal indictment assigned to the Southern District of New York, charging him with three counts of violating the Commodity Exchange Act, one count of wire fraud, and one count of an unlawful monetary transaction. This prosecution, handled jointly by the Securities and Commodities Fraud Task Force and the National Security and International Narcotics Unit, marked a definitive effort by federal law enforcement to establish that prediction marketplaces cannot be exploited to profit from national security secrets. The systemic fallout from this incident served as a major catalyst for the 119th Congress, prompting a surge of legislative proposals (such as the PREDICT Act and the STOP Corrupt Bets Act of 2026) designed to permanently ban senior government officials and military members from trading event contracts or to prohibit exchanges from listing sensitive government and military outcomes entirely.

Analysis of Current Regulatory Gaps

Current Weaknesses

To understand why it is so difficult to prosecute insider trading in prediction markets, it helps to look at how traditional securities laws work.

Under standard securities laws, insider trading is not just about having a secret advantage. It is illegal because a corporate insider breaks a specific duty of trust owed to the company's shareholders. But event contracts are fundamentally different. Like derivatives, they operate purely on peer-to-peer execution. You are not buying a fractional piece of a company. You are simply entering a zero-sum contract with a stranger on the other side of the trade.

Because you do not owe that stranger any loyalty or fiduciary duty, the traditional rules of insider trading fall flat. Prediction markets operate outside this shareholder framework, leaving classical insider trading theory dead in the water. To fight this, federal prosecutors are forced to pursue a different legal route, the misappropriation theory under CFTC Rule 180.1. Instead of arguing that the trader cheated the person on the other side of the bet, prosecutors must prove the trader deceptively stole the confidential data from the source, which, in cases Van Dyke's, is the U.S. government itself.

Anonymous and Offshore Prediction Markets

If you move off regulated exchanges, decentralized and offshore prediction markets completely break the compliance safety net. By tokenizing event contracts on a blockchain using stablecoins like USDC, these platforms bypass identity checks (KYC), anti-money laundering controls, and domestic position limits entirely. Traditional banking surveillance is built to flag massive, sudden liquidations in investment portfolios, but blockchain networks completely squash that barrier. A corrupt insider can execute a contract wager, secure a high-leverage payout, and instantly route hundreds of thousands of dollars into an anonymous offshore crypto account before any traditional compliance net can react.

The unchecked design of decentralized markets opens the door to radical tail risks. Platforms like Augur have historically faced intense public backlash for hosting peer-to-peer pools tracking the deaths of public figures, essentially running live, high-leverage "assassination markets" that operate entirely out of the reach of centralized regulators.

Domestic Proposals

While regulatory enforcement can only control so much—especially when dealing with decentralized, offshore networks—the federal government still maintains direct leverage within its own borders. To close the domestic loopholes exploited by traditional and event-driven markets, the proposed Ending Trading and Holdings in Congressional Stocks (ETHICS) Act introduces the following statutory provisions:

Provision	Core Text	Impact
§ 13161(2)(A)	Restricts securities, commodities, futures, and "any economic interest comparable... acquired through synthetic means, such as the use of a derivative, including an option, warrant, or other similar means."	By targeting "derivatives" and "options," this language prevents binary-event contracts from serving as a workaround.
§ 13161(7)	Defines futures to include security futures and "any other contract for the sale of a commodity for future delivery."	Aligns with commodities law by capturing platforms regulated as futures or commodities markets.
§ 13161(3)	Defines a covered person as "a Member of Congress, and a spouse or dependent child of a Member of Congress."	Prevents proxy trading through spouses, dependents, or household members.
§ 13162(a)	"A Member of Congress shall not purchase any covered investment" and must divest within 90 days.	Moves from disclosure to outright trading prohibition.
§ 13163(g)(1)(B)	Sets recurring penalties at the greater of monthly salary or "an amount equal to 10 percent of the value of each covered investment" out of compliance.	Adds scaled penalties tied to the value of illegal holdings.

Benefits of Prediction Markets Worth Preserving

Prediction markets have become an increasingly important tool for forecasting future events. Monthly trading volume in prediction markets has increased from around $100 million in early 2024 to more than $13 billion by the end of 2025. This sharp increase in trading volume suggests that prediction markets are becoming a more widely used tool for information aggregation and speculation. Additionally, prediction markets generate forecasts by allowing participants to trade on the outcomes of future events. Through this process, the market can consolidate diverse opinions into a single price that reflects the public's collective expectations about future outcomes, providing a continuously updated probability estimate. Moreover, prediction markets go beyond mere forecasting tools; they also uncover dispersed or hidden information that may not be easily captured from data sources. Therefore, prediction markets often provide more dynamic forecasts than polls or surveys.

Beyond forecasting, prediction markets can help businesses, researchers, and policymakers improve decision-making. The probabilities generated by these markets reflect both expected outcomes and market participants' confidence, providing valuable information in uncertain conditions. For instance, prediction markets can support forecasting economic events by providing estimates for inflation, recession risk, business performance milestones, and policy changes. Furthermore, they can complement tools like formal reports or surveys. Prediction markets also benefit economic research by revealing how incentives shape judgment. Researchers can use them to examine questions such as whether experts consistently outperform non-experts, how accuracy changes with participation, and how information diffuses through markets. Overall, prediction markets link incentives, beliefs, and pricing mechanisms, producing a powerful tool useful for research strategies and informed decision-making.

Prediction markets are increasingly being used as financial tools rather than simply forecasting platforms. In recent years, they have become integrated into financial and institutional decision-making frameworks. They act as tools for hedging, risk management, and real-time probability assessment. Institutional participants use event contracts to hedge against policy risks, regulatory changes, and other uncertainties that are not easily captured by traditional financial instruments. This reflects the ability of prediction markets to provide continuous, real-time updates on expectations. As a result, prediction markets function alongside traditional financial instruments by offering a distinct, event-based measure of expected future outcomes. Given their expanding role in finance, prediction markets have become increasingly relevant to regulators and policymakers.

Policy Recommendations and Proposed Reforms

The STOCK Act has increased transparency regarding congressional stock trading; however, several of its policies are weak and limit its effectiveness. One of the major shortcomings is the delayed disclosure requirement, which requires members of Congress and other government officials to disclose stock transactions exceeding $1000 within 45 days of the transaction. While this improves transparency, disclosure is not immediate. As a result, officials can complete trades and potentially benefit from nonpublic information long before the public becomes aware of the transaction. This delayed reporting reduces the law's ability to deter questionable trading and weakens public oversight.

One reform that could address this lack of effectiveness is the introduction of pre-clearance requirements for government officials and their immediate family members. Officials and relatives should be required to obtain approval before conducting trades involving companies, industries, or contracts that may be affected by government policy, legislation, or

regulatory actions. This proposal is modeled after practices in the financial services industry. For example, FINRA Rule 3210 requires many securities industry employees to obtain written authorization before holding personal trading accounts. In addition, broker-dealers often enforce internal ethics codes that require employees to pre-clear certain trades before executing them. These procedures serve as an important protection against insider trading and conflicts of interest.

A similar framework for public officials would prevent trades that create actual or apparent conflicts of interest, increase accountability, protect citizen trust in government decision-making, and allow officials to continue investing in assets. Under this system, officials could maintain diversified investments while facing greater scrutiny when trading in industries directly affected by their official responsibilities.

Another major concern regarding oversight of insider trading is the role of self-regulation by Congress. Congress oversees its own ethics enforcement, which can create conflicts of interest and weaken public confidence in the integrity of investigations. Furthermore, allegations of congressional insider trading periodically capture public attention, but criminal prosecutions remain rare. According to *"Congress Members Caught Breaking Trading Rules: A Complete Timeline,"* former Representative Chris Collins remains the only member of Congress convicted of insider trading charges, and he was later pardoned. In addition, the Department of Justice has investigated several members but has declined to prosecute in almost every case. Many members of Congress fail to report their stock trades by the deadline required under the STOCK Act, yet the consequences for doing so are minimal.

To address these concerns, Congress should establish an independent congressional ethics and financial oversight commission. This commission would have the authority to monitor

financial statements, review trading activity, and investigate potential violations. Unlike the current oversight structures, this group would operate separately from Congress. It would be staffed by ethics experts, security professionals, and investigators.

Its responsibilities could include monitoring financial disclosures in real time; auditing transactions for potential conflicts of interest; investigating allegations of insider trading and ethics violations; issuing public reports on compliance and enforcement actions; and recommending civil penalties for criminal enforcement.

An independent commission would help address concerns about congressional self-regulation and likely enhance public confidence in the fairness and credibility of enforcement. By strengthening oversight and improving accountability, these reforms would help close the gaps left by the STOCK Act and restore public trust in the government.

Conclusion

Prediction markets continue to prove their value as innovative tools for forecasting future events, decision-making, and aggregating information from public opinion. Their ability to generate predictions has attracted the attention of businesses, researchers, and policymakers alike. However, the growth of these markets has also raised concerns regarding regulation, ethics, and the potential misuse of insider or nonpublic information. As prediction markets become more influential, ensuring their integrity will require stronger oversight, clear legal standards, and safeguards against conflicts of interest.

Recent controversies involving government officials and the broader debate surrounding insider trading highlight the importance of maintaining public trust in markets that influence public and private decision-making. By implementing thoughtful regulations, increasing

transparency, and promoting accountability, policymakers can help prediction markets achieve their full potential while protecting market participants and the public interest. Ultimately, a balanced approach that encourages innovation while addressing ethical and legal risks will keep prediction markets valuable tools for understanding and preparing for the future.

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