

# Prediction Market Fund

## Legal Framework and Registration Analysis

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### I. Threshold Characterization: What Are Prediction Market Contracts?

The answer to almost every question here turns on one foundational issue: prediction market contracts — binary event contracts of the type traded on Kalshi and similar CFTC-designated contract markets (DCMs) — are commodity interests regulated under the Commodity Exchange Act (CEA), 7 U.S.C. § 1 et seq. They fall within the CEA's definition of "swap" in CEA § 1a(47)(A)(ii), which includes any agreement, contract, or transaction that provides for payment dependent on the occurrence, nonoccurrence, or the extent of the occurrence of an event or contingency associated with a potential financial, economic, or commercial consequence. The CFTC has exclusive jurisdiction over these instruments.

This means the fund is a commodity pool under CEA § 1a(10) and 17 C.F.R. § 4.10(d): a pooled investment vehicle in which participants contribute funds that are used to trade commodity interests. From that single characterization, the entire regulatory structure follows.

### II. The CFTC Framework

#### A. Commodity Pool Operator (CPO) Registration

The person or entity that forms and operates the fund — soliciting investors, managing the pool, and controlling the trading — is a commodity pool operator under CEA § 1a(11) and must register with the CFTC through the National Futures Association (NFA) pursuant to CEA § 4m(1) and 17 C.F.R. Part 4, unless an exemption applies.

#### Key Exemptions to Analyze

##### 1. Rule 4.13(a)(3) — The "De Minimis" Exemption

This exemption is available to operators of pools where: (a) interests are exempt from Securities Act registration and offered without public marketing; (b) interests are sold solely to "qualified eligible persons" (QEPs) or "accredited investors"; AND (c) commodity interest positions are used solely for bona fide hedging OR the aggregate initial margin and premiums do not exceed 5% of the liquidation value of the pool, OR the aggregate net notional value does not exceed 100% of liquidation value. For a fund primarily trading prediction market contracts, this de minimis trading threshold almost certainly cannot be met. The fund's raison d'être is to trade these contracts, so Rule 4.13(a)(3) is unavailable.

##### 2. Rule 4.13(a)(4) — QEP Exemption (Reinstated December 19, 2025)

On December 19, 2025, CFTC staff issued no-action relief that effectively reinstates an exemption from CPO registration previously available under Regulation 4.13(a)(4) prior to its repeal in 2012, and also clarifies that CTA registration relief is available to these newly-exempt CPOs. This is potentially significant. However, the relief is only available to investment advisers registered with the SEC as investment advisers who also file Form PF, and requires that each investor meet the QEP definition under CFTC Regulation 4.7(a)(6).

The conditions for the reinstated QEP exemption are:

- The operator is currently required (or would be required) to register as a CPO, or relies on other Rule 4.13 relief;
- The operator is registered with the SEC as an investment adviser (RIA registration);
- Interests are exempt from Securities Act registration and not publicly marketed (subject to Rule 506(c) exception);
- Each investor qualifies as a QEP under 17 C.F.R. § 4.7(a)(6); and
- The operator files Form PF.

"Accredited investor" is a lower threshold than QEP. QEP includes, among others, persons with at least \$2 million under management with investment advisers, or \$200,000 in initial margin and premiums on deposit. If your client intends to accept accredited investors who are not QEPs, this exemption is unavailable.

### **3. No Applicable Exemption → CPO Registration Required**

If neither Rule 4.13(a)(3) nor the reinstated QEP exemption applies (e.g., because investors are not all QEPs, or the operator is not an SEC-registered RIA), the operator must register as a CPO with the CFTC through the NFA. Registration requires:

- Application through NFA's ORS system;
- Submission of a Disclosure Document meeting 17 C.F.R. Part 4, Subpart B requirements; and
- Compliance with reporting, recordkeeping, and financial requirements under 17 C.F.R. §§ 4.20–4.27.

Even registered CPOs may seek relief from certain disclosure and reporting requirements under Rule 4.7 if all participants are QEPs.

## **B. Commodity Trading Adviser (CTA) Registration**

If the manager separately advises the fund on trading (as opposed to operating the pool), it may also be a commodity trading adviser under CEA § 1a(12) subject to registration under CEA § 4m(1). However, for a fund manager who is both the CPO and the trading decision-maker, this typically does not result in a separate CTA registration obligation. The same exemptions under 17 C.F.R. § 4.14 (and the reinstated QEP no-action relief for CTAs) apply in parallel.

## **C. Associated Persons (APs)**

Any person who solicits investors for the fund or supervises persons doing so must register as an Associated Person of the CPO under CEA § 4k(2) and 17 C.F.R. § 3.12. This is a personal registration, not an entity registration.

#### **D. NFA Membership**

Both the CPO and any registered APs must be members of the National Futures Association (NFA), a registered futures association under CEA § 17.

### **III. The Securities Law Framework**

#### **A. The Fund Interests Are Securities**

LLC membership interests sold to investors to raise \$3M are securities — investment contracts under *SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), and potentially notes under *Reves v. Ernst & Young*, 494 U.S. 56 (1990). This is entirely independent of the CFTC framework. The CEA's exclusive jurisdiction over the underlying contracts does not displace securities regulation of the fund interests themselves.

#### **B. Securities Act of 1933 — Offering Exemption**

The fund must rely on an exemption from registration under the Securities Act. The standard vehicle is Regulation D, Rule 506(b) (17 C.F.R. § 230.506(b)):

- Sales only to accredited investors (and up to 35 sophisticated non-accredited investors, though in practice none);
- No general solicitation or advertising; and
- Form D filed with the SEC within 15 days of first sale.

Alternatively, Rule 506(c) permits general solicitation if all purchasers are verified accredited investors — but note that using Rule 506(c) affects the availability of the reinstated CFTC QEP exemption (it is permitted under that relief, but with conditions).

State "blue sky" preemption applies to Rule 506 offerings under § 18(b)(4) of the Securities Act; only notice filings (and fees) are required in most states.

#### **C. Investment Company Act of 1940 — Fund Registration Exemption**

The fund must avoid being a registered investment company. Two exemptions are available:

- § 3(c)(1): no more than 100 beneficial owners and no public offering. Works for this fund at \$3M, assuming a relatively small investor count.
- § 3(c)(7): unlimited investors, but all must be qualified purchasers (generally \$5M in investments for individuals). More flexible but requires a higher investor threshold.

#### **D. Investment Advisers Act of 1940**

The fund manager will be an investment adviser under the Advisers Act. At \$3M AUM, the manager falls well below the \$110M threshold for SEC registration and would be a state-registered investment adviser (in New Jersey and/or the states where it operates). However, if the manager pursues the reinstated CFTC QEP CPO exemption, SEC RIA registration becomes a condition of that exemption — creating a significant tension: the manager would need to register with the SEC (normally unavailable below \$110M AUM) as a precondition for the CFTC exemption. This may be possible under the "mid-sized adviser" rules or may require the manager to simply register as a CPO instead.

## IV. Current Regulatory Environment: Important Caveats

The prediction market regulatory landscape is in genuine flux as of March 2026:

**CFTC Rulemaking Pending:** The CFTC issued an Advance Notice of Proposed Rulemaking on March 12, 2026, seeking public comment on event contract derivatives, the types that may be prohibited as contrary to the public interest, and other regulatory questions, with comments due April 30, 2026.

**CFTC-SEC Coordination:** CFTC Chairman Selig has announced a joint "Project Crypto" initiative with the SEC to end jurisdictional disputes and coordinate oversight, and has directed the CFTC to issue guidance clarifying how prediction markets and event contracts can be listed and traded under U.S. law.

**Withdrawal of Prior Rule Proposals:** Chairman Selig directed staff to withdraw the 2024 proposed event contracts rule that would have prohibited political and sports-related event contracts, and withdrew the 2025 staff advisory cautioning registrants about sports-related event contracts.

**State Gaming Law Preemption — Circuit Split:** Federal district courts in Nevada and New Jersey sided with Kalshi and found the CEA preempted state gaming laws, but the Maryland federal district court reached the opposite conclusion — a circuit split that has not yet been resolved. This is particularly relevant for sports-related event contracts.

## V. Summary

Issue	Analysis
Nature of prediction market contracts	Commodity interests (swaps) under CEA § 1a(47); CFTC exclusive jurisdiction
Fund structure	Commodity pool under CEA § 1a(10)
CPO registration	Required unless 4.13(a)(3) de minimis or reinstated QEP exemption available
CTA registration	Generally same analysis as CPO; relief available in parallel

AP registration	Required for persons soliciting investors
NFA membership	Required for CPO and APs
Securities Act	Rule 506(b) or 506(c) offering exemption; Form D filing
Investment Company Act	§ 3(c)(1) or § 3(c)(7) exemption
Investment Advisers Act	State RIA registration (NJ); federal RIA registration if pursuing QEP CPO exemption
State gaming laws	Unresolved preemption issue; circuit split; monitor closely

## VI. Key Open Questions for Your Client

The following facts will be determinative for the analysis:

- Compensation structure: Is the manager receiving a performance allocation/carried interest, or just a management fee? A performance allocation is a hallmark of "operating for compensation" that forecloses some exemptions.
- Investor qualifications: Will all investors be QEPs, or merely accredited investors? This determines whether the reinstated Rule 4.13(a)(4) exemption is even on the table.
- Which prediction markets: Kalshi only, or others? Sports-related contracts carry additional legal exposure given the state gaming law preemption litigation.
- Marketing approach: General solicitation (Rule 506(c)) vs. private placement (Rule 506(b)) affects both the securities offering and the CFTC exemption analysis.
- AUM trajectory: If the fund scales, SEC registration thresholds shift and the analysis changes.

## VII. Bottom Line

At \$3M trading primarily in prediction market contracts, CPO registration is the most likely outcome unless all investors are QEPs and the manager can satisfy the conditions of the December 2025 no-action relief (including SEC RIA registration). The securities law requirements apply independently and are relatively straightforward for a small private fund with accredited investors.

Given the rapidly evolving regulatory environment — including the pending CFTC Advance NPRM, the CFTC-SEC Project Crypto coordination, and the unresolved state gaming law preemption litigation — this analysis should be revisited as those proceedings develop.

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