

The Hedger's Gap: What Institutional Risk Transfer on Prediction Markets Needs to Scale

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Businesses have traditionally hedged in two markets, and both leave gaps

Companies have traditionally managed operating risk across two risk transfer markets. Futures markets let them lock in the price of an input cost, such as fuel, grain, interest rates or currencies. Insurance markets transfer a potential loss to an insurer for a premium.

Both work well for the risks they were built for, but many of the risks that impact a business fall outside of them. Futures track broad benchmarks. A grower can lock in the price of its crop, but that price hedge pays nothing if a late frost destroys its harvest. A retailer can hedge the dollar, but not a new tariff squeezing its margins. Insurance covers property, liability and a list of named perils, but many operating risks aren't covered at all: a policy decision, a rainy weekend, a spike in shipping rates.

Parametric insurance was designed for this gap. It pays a fixed amount when a measured trigger is hit, with no claims process. In practice it covers a narrow set of perils, mostly natural catastrophe and weather.¹ Each policy is custom-built, takes weeks to underwrite, is priced for large buyers, and the reinsurance capacity behind it is limited. As such, it isn't accessible or affordable to many businesses.

Event contracts are a newer third option. They are contracts traded on an exchange (in the US, on exchanges regulated by the CFTC) that pay \$1 if a specific event happens and nothing if it doesn't. A business can buy enough of them to offset, partially or fully, the loss it would incur if that event occurred.



	Event contracts	Futures	Parametric insurance
Hedge reference	A specific event, defined contract by contract	A broad benchmark (a commodity, index or rate)	A trigger negotiated policy by policy
Expiry	Time-based or custom	Set by the exchange's listing calendar, often monthly or quarterly	The policy term
Speed	Fast; days for a custom contract	Fast	Weeks of underwriting
Minimum size	Contracts from \$1	A fixed size set by the exchange (e.g. one corn future covers 5,000 bushels)	Priced for large buyers
Exit option	Sell at the market price	Sell at the market price	Can't be sold or transferred
Upfront cost to the hedger	The contract price, which is the market's estimate of the probability of a payout	A margin deposit, typically 3 to 12% of the contract's value ²	The premium
Counterparty	A clearinghouse; every position fully prefunded	A clearinghouse; margin plus a default fund	The insurer's balance sheet

One of the main appeals of event contracts is fit. A festival worried about rain on a specific weekend can buy protection for that time period in that city, and sell it back if the date moves. A company exposed to a tariff decision can hedge that decision directly instead of a loosely related benchmark. And a small business can buy a few hundred dollars of protection without an underwriter.

Hedgers are already using them

This is not theoretical. Businesses and insurers are already moving real risk onto prediction markets, often for less than the alternatives cost, and sometimes where no alternative exists.

- **Sports bonus insurance.** In August an insurer placed about \$660,000 of block trades on Kalshi that pay up to \$3 million as LSU's football team advances through the playoff, matching the bonus ladder in its head coach's contract. Game Point Capital, which insures



coaching bonuses and is widely reported to be the buyer, has said its Kalshi hedges on NBA bonuses cost roughly half what comparable reinsurance would.³

- **Event disruption.** NEXTPredict, which is hosting a conference in New York this month, stood to lose money if a storm or strike grounded flights and many of its attendees couldn't get there. Event insurance wouldn't cover it, because the venue would remain open. For \$12,000, it bought contracts that pay out \$3 million if more than half the flights into JFK are cancelled on the main travel day.⁴
- **Tariffs and freight.** Zest Tea, a Maryland company that imports its tea, hedges the risk that tariffs and container shipping rates rise and squeeze its margins.⁵
- **Weather.** 28Wishes, a Los Angeles ice cream shop, loses about 20% of its sales when the temperature drops below 70°F or it rains. It spends about \$20 a day on weather contracts that pay out in those conditions. In cold or rainy stretches, the payouts have covered up to \$1,500 a month, roughly 43% of its rent.⁵

The trading data points the same way. An analysis of 1,265 Kalshi markets settled between August 2025 and August 2026 found that more than half of weather positions were held through settlement, against 1 to 3% for sports contracts.⁶ That is consistent with hedging: speculators trade in and out, while a hedger holds until the risk resolves.

The exchanges are building for this demand. Kalshi, the largest regulated US venue, said in May that its institutional trading volume had grown 800% over the preceding six months.⁷ It lists custom contracts within days when no existing market fits a client's risk (assuming the contract fits specifications certified by the CFTC).⁸ It also lets two parties negotiate a large trade privately and then book it on the exchange as a block trade. That works around thin order books in many markets and keeps a large trade from swinging the public price.

What stands between early adoption and scale

Most hedges today are arranged one trade at a time, rather than run as a standing program the way a company hedges fuel or currency every quarter. Most corporate treasurers have yet to look at an event contract at all. Four gaps explain why, and each one is solvable. Several are already being worked on.

1. **Capital.** Every contract ties up its full payout in cash until it settles, which makes some hedges expensive to carry.
2. **Liquidity at size.** Real capacity exists, but specialist risk capital and a steady flow of hedging demand are still thin, and the firms taking the other side need somewhere to lay the risk off.



3. **Settlement rules.** Event contracts can cut basis risk, the gap between what a hedge pays and what the business actually loses, well below what futures or broad insurance triggers allow. How far depends on the fine print: which data source, measurement method and time window a contract settles on. Those rules differ from venue to venue.
4. **Regulatory clarity.** The Supreme Court has been asked to decide whether states can apply their gambling laws to sports event contracts traded on a CFTC-regulated exchange. Institutions want that answer, along with clearer tax, accounting and insurance capital treatment, before they commit at scale.

Gap 1: Capital that hedgers can afford to tie up

A Kalshi event contract is fully collateralized today: it ties up its full payout in cash until it settles (Kalshi's perpetual futures already trade on margin). That makes it less capital efficient than futures, and the gap is widest in two cases: protection against likely events, and protection that runs for a long time.

The mechanics are simple. Every contract pays \$1 or nothing, and the clearinghouse holds that \$1 from the moment the trade is made. The price decides who puts it up. Buy protection at 10 cents and you post 10 cents while the seller posts 90. Buy at 75 cents and you post 75.

Event contracts lock up the full payout, futures a fraction of it

Collateral posted per \$1M of protection





Likely events. When the protected event is likely, the hedger carries the cost directly. \$1 million of protection on a 75% event ties up \$750,000 of the hedger's own cash until settlement. A futures hedge of similar size might only need about \$80,000 of initial margin, though the futures hedger also faces daily margin calls with no cap on losses.²

Long-dated protection. When the event is unlikely, the seller posts most of the collateral. A market maker selling \$1 million of protection against a low-snowfall ski season at 10 cents posts \$900,000. Assume its capital costs 12% a year and the cash earns the 3.25% Kalshi pays eligible accounts on deposits.⁹ The difference, 8.75% a year, is the real cost of tying the money up: about \$39,000 over six months, or \$79,000 over a full year. Market makers generally price the cost of the capital they tie up into their quotes, so the hedger ends up paying for it. The longer the protection runs, the bigger that cost can get.

Three changes would narrow the gap.

Risk-based margin. On September 22, Kalshi's clearinghouse filed with the CFTC to let institutions post far less than the full payout.¹⁰ Collateral would instead be sized to how far the price could reasonably move in a single day, recalculated daily and topped up as prices change. It rises as expiry nears and never exceeds the maximum loss. Sports, culture and mention markets will be excluded. A decision is due by the end of the year. Kalshi already has the broker side in place: its affiliate Kinetic Markets was registered as a futures commission merchant (FCM), a broker that can hold customer funds and offer margin, in March.¹¹ Polymarket is moving the same way: in July it applied to register a related company as an FCM.¹²

The hard part is gap risk: a contract's price can jump from 30 cents to zero in an instant, with no trading in between. How collateral should work depends on how the outcome unfolds:

- **Outcomes that build up gradually**, like a season's snowfall or a month's rainfall, move prices step by step. The clearinghouse has time to collect more collateral as prices drift, so this is the natural place to start.
- **Outcomes decided on a known date**, like a court ruling or an inflation report, can jump on that day. Collateral can rise toward the full payout as the date approaches.
- **Outcomes that can arrive without warning**, like a tariff announced with no notice, can jump at any time. These need collateral close to the full payout throughout.

Netting across markets. Kalshi already reduces the collateral required when two positions in the same event offset each other, for example buying one interest-rate level and selling another on the same Fed decision.¹³ Based on its published rules, that relief is granted event by event. A business that hedges with related contracts in different markets, say a Fed decision and an



inflation report, has to fully fund each position even when one partly offsets the other. Portfolio-wide netting, which futures clearinghouses have used since CME introduced SPAN margining in 1988, would reward exactly the structured positions hedgers build.

Collateral that keeps earning. Kalshi and Polymarket both pay 3.25% on collateral (Kalshi on all cash and open positions, Polymarket on selected long-dated markets), below the Fed's current 3.75% to 4.00% range.^{9 14} Futures clearinghouses offer a better model. CME accepts Treasuries, money market funds, stocks, corporate bonds and even gold as collateral, with haircuts (a stock is counted at 70% of its value).¹⁵ An institution can keep its capital in the assets it already holds, earning its normal return, while that capital also backs its hedges. The CFTC's December 2025 guidance on tokenized Treasuries and money market funds as margin opens the door for prediction market venues to do the same.¹⁶

Gap 2: Liquidity at the size hedgers need

The public order book understates capacity. What's actually scarce is specialist risk capital and a steady flow of hedging demand to attract it.

Professional market makers are already in place. Susquehanna became Kalshi's first institutional market maker in 2024.¹⁷ Jump Trading and Wintermute are among the firms providing liquidity on both Kalshi and Polymarket.^{18 19}

To a hedger with \$5 million of exposure, a thin order book on a weather or policy contract looks like a dead end. It isn't. Susquehanna has said it could quote tens of millions of dollars of risk on a contract that has seen only about \$100,000 of trading.²⁰ Galaxy launched an OTC desk for event contracts in June with a \$10 million bilateral trade, taking the other side as principal and documenting it as a swap under an ISDA master agreement (the standard contract the swaps industry uses), so the fund booked the risk in the framework it already has.^{21 22} That is becoming the standard institutional route: many of the same market makers already run swap businesses, sell-side firms are offering hedge funds event exposure through swaps that pay out on a listed contract's price or settlement value, and some desks now offer bilateral block trades that clear through the exchange's clearinghouse.²³ Size is there for institutions, through negotiated blocks and bilateral trades.²⁴ In markets other than sports, that is where the depth sits, not the public order book. That route also needs dealer relationships a hedge fund has and most corporate treasurers don't.

The tighter constraint is what market makers can hold. A quant firm can quote a contract quickly. Pricing a hurricane, a tariff decision or a coaching bonus well, and carrying it for months, is what specialists do: reinsurers, energy and commodity merchants, sports-risk underwriters. Most of them aren't active in prediction markets yet, and most of the firms that



are don't run specialist books. Specialists can bring that capital in two ways: by quoting as market makers on the exchanges, or by trading bilaterally, taking the other side of large trades directly the way Galaxy's desk does.

The other part is flow. Market makers commit capital where they see repeat business. Hedging demand today arrives one bespoke trade at a time, which is expensive to price and hard to lay off. Aggregation changes that. When many businesses' exposures are standardized onto the same contracts and brought to market together, some offset each other. An importer that loses if a tariff is imposed and a domestic producer that loses if it's dropped sit on opposite sides of the same contract. The market maker only has to hold the imbalance, spreads tighten, and tighter spreads bring more hedgers. Grain futures grew this way, with farmers on one side, millers on the other and speculators in between.

Two incentives would speed this up:

- **Fee rebates for hedging volume.** Kalshi already runs one for members hedging sportsbook risk: once qualifying hedging volume passes 300,000 contracts in a month, it rebates the taker and Request-for-Quote (RFQ) fees on that volume. It filed a second program in January for insurers hedging policies written on sporting events, with a 5,000-contract monthly threshold. The same logic can extend to any category of hedger.²⁵
- **Market-maker programs for each new hedging category.** Kalshi already runs a market maker program across more than 80 product series, from economic data and stock indices to crypto and sports. Participating firms get reduced fees and adjusted position limits in exchange for keeping quotes live almost all of the time.²⁶ Extending similar terms to each new hedging category as it launches would give specialists a reason to commit capital before the volume arrives.

Gap 3: Settlement rules a treasury manager can rely on

A hedge is only as good as the rules it settles on. Today those settlement rules vary by venue, sit in individual rulebooks, and aren't written with hedgers in mind.

Temperature shows the problem. Kalshi and Polymarket's US exchange settle daily high-temperature contracts on the National Weather Service's daily climate report. Polymarket's international markets, and ForecastEx (the exchange behind contracts sold through Interactive Brokers) settle on hourly weather station readings, either directly or through Weather Underground.²⁷ Because the daily climate report also captures readings between the hours, it



can show a high 1°F or more above the hourly-based sources for the same station and day. During daylight saving time, the two groups also measure the day over windows an hour apart. Same city, same day, same measurement, and the results can differ.

That isn't a flaw in any one contract. Each is well defined. The problem is that a treasury team has to read each rulebook to find out, and can't compare contracts across venues on equal terms.

Swaps had the same problem in the early 1980s, when every trade was negotiated from scratch. Standard definitions from ISDA, the swaps industry body, let dealers price, hedge and net positions consistently, and the market grew on top of them. Event contracts need the same thing. The data source (e.g. which weather station, which release of a government statistic), the location (where relevant), the measurement window, rounding, what happens if the source is revised or late, and the fallback should all be described consistently across venues.

The market can get there on its own, in two ways:

1. **A shared data layer.** Companies such as Kelvon are building normalization layers that map what contracts mean and how they settle across venues.²⁸ Wider adoption by venues, brokers and data providers is the next step.
2. **An industry standard.** The Coalition for Prediction Markets exists but focuses on policy.²⁹ It or another industry body could publish a definitions standard, the way ISDA did for swaps.

Exchanges have little reason to standardize on their own, because unique contracts keep liquidity at home. In swaps, it was a group of dealer banks, not an exchange, that formed ISDA in 1985 and set the common terms.

Settlement itself is the other half. Venues already publish how each contract settles, including how they handle revised data and disputes. What hedgers also need is independent verification: a trusted data provider confirming the settlement value before money moves. Built into an automated data feed, it adds a check without slowing payouts. Kalshi has shown what this looks like for weather. In September it amended seven weather rulebooks so that it can delay expiration when a source report contains a material error, wait for corrected data, and if reliable data never appears, settle at the 'last fair price' it determines.³⁰ Its partnership with The Weather Company makes TWC's data the settlement source for its hourly temperature markets and, in Kalshi's words, a trusted source for verifying weather outcomes.³¹ That model can extend to other categories as well.



Gap 4: Regulatory clarity

Many institutions are waiting for regulatory clarity before they commit. The biggest open question is now heading to the Supreme Court.

In August the Ninth Circuit held that Kalshi's sports contracts are likely not swaps and that federal law likely does not stop Nevada applying its gaming laws to them, splitting with the Third Circuit, which sided with Kalshi against New Jersey.³² New Jersey, Robinhood and Crypto.com have all asked the Supreme Court to settle it.^{33 34} If the Court takes the case, a ruling could come by mid-2027.

The case is about sports contracts, but the answer will shape how all event contracts are treated: as federally regulated derivatives or as state-regulated wagers. Either outcome is arguably better for institutional adoption than today's uncertainty. A ruling for the CFTC gives hedgers one national rulebook. A ruling for the states would likely draw a line between sports contracts and the weather, economic and financial contracts businesses use to hedge, though it would also invite states to test where that line sits. Either way, compliance teams get an answer they can plan around.

The CFTC is also writing its own rules. On June 10 it proposed a framework for deciding when an event contract is against the public interest, with a three-step test that weighs, among other factors, a contract's usefulness for hedging. A final rule would give exchanges a written standard for what they can list.³⁵

Clarity on that question would also help settle two others.

1. **Tax and accounting.** A Bipartisan Policy Center brief in August set out three ways event contract gains could be taxed: as gambling winnings (ordinary income, with withholding), as Section 1256 contracts (60% long-term capital gain, 40% ordinary income), or as capital gains.³⁶ Which one applies to event contracts generally will depend partly on how the court fight ends. Accounting has a related gap. Accounting rules generally require contracts like these to be valued at their market price at every reporting date, and without hedge accounting the change goes straight into that period's earnings. Say a ski resort pays \$100,000 in October for protection against a poor season, planning to hold the contracts until the season ends in March. By its December year-end, a weak start to the snow season has lifted the contracts' value to \$600,000. The resort must report a \$500,000 gain that year, even though it hasn't sold the contracts. The lost ticket revenue they protect against shows up from January to March, in the following year. One year looks unusually good and the next unusually bad, even though over the full season the hedge did its job. Hedge accounting fixes this by recording the gain in the same period as the loss it offsets. It was



built mainly for price, interest-rate and currency risk: under current US GAAP a hedge on snowfall, a tariff decision or a cancelled event would generally not qualify. Guidance from the large audit firms would help clear up the confusion, and a few early adopters willing to document their approach would help provide further clarity.

2. **Capital credit for insurers.** Insurers get capital relief when they pass risk to a reinsurer that regulators recognize, usually one that is licensed, rated, or fully collateralized. Aon's head of parametric, Cole Mayer, told Insurance Journal in May that regulators are unlikely to grant capital credit to an insurer using the platforms 'at their current stage of development'; the exchanges, unlike reinsurers, also carry no financial-strength rating.³⁷ The workaround already exists: the insurer buys reinsurance from a reinsurer, and the reinsurer hedges its own exposure on the exchange. The insurer gets its capital credit, and the exchange still absorbs the risk. Over time, the case for direct recognition is strong. Today every position is fully collateralized, and once margin arrives, positions will still sit with a CFTC-regulated clearinghouse backed by a default fund and member assessments, the same structure regulators already recognize for futures. A rating measures a risk the exchange structure already addresses.

Four signals to watch over the next 12 months

1. **The Supreme Court.** First, whether it agrees to hear the case; then, how it rules. A clear answer is the single biggest unlock for institutional participation.
2. **The CFTC's final rule on event contracts.** A final version of the June proposal would set the first written standard for what exchanges can list, and would show whether hedging utility carries weight in that test.
3. **The CFTC's decision on Kalshi's margin filing, due by the end of the year.** Approval with meaningful relief on non-sports contracts, such as weather, economic and financial markets, would be the biggest single cut to the cost of hedging.
4. **Polymarket's FCM application.** Approval would give institutions a second major US venue they can reach through a regulated broker, with margin, and would push both venues to compete on the terms hedgers care about.

Where Hedgestead fits

Each of these gaps has people working on it. Exchanges are building margin and listing new contracts on request, market makers are adding capacity, and the courts are moving toward the needed clarity on regulating the space. One piece remains on the hedger's side of the table:



structuring the hedge. A treasury team needs to know which of its risks can be hedged, which contracts to use, how much to buy, and what the hedge will and won't cover.

That is the work Hedgestead is being built to do: structuring and executing hedges for businesses on regulated prediction market exchanges. This includes sourcing the contracts that match a business's risk exposure, evaluating hedge effectiveness, routing each trade to the order book or an OTC block, and documenting the basis risk that remains. As more businesses hedge this way, that steady flow of demand will also help draw in the additional liquidity the market needs.

If you run a business with a risk no policy covers, provide liquidity and want steady hedging flow, or operate a venue building for institutions, we'd like to hear from you.



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