What Killed Intrade?

by JOHN CASSIDY • MARCH 11, 2013

On Sunday night, Intrade, the online-prediction exchange that became famous during last year’s Presidential election, said that it was closing down forthwith following the discovery of “financial irregularities.” But what were these irregularities? Intrade didn’t say. But citing Irish law—Intrade is legally domiciled in the Emerald Isle—it said that it had been obliged to halt trading on its Web site, close out its customers’ accounts, and “cease all banking transactions for all existing Company accounts immediately.”

Obviously, the big story would be if Intrade, or the authorities, had uncovered efforts to corner one or more of the prediction markets on the electronic exchange, which allowed people to bet on everything from the weather to the Oscars to politics. During the Presidential contest, there were rumors about efforts to manipulate Intrade’s election market, which many journalists, myself included, monitored closely to see how investors and bettors were viewing the chances of Barack Obama and Mitt Romney. For example, after the first debate, in which President Obama did badly, the estimated probability of him being reëlected fell sharply on Intrade—more sharply than could easily be justified on the basis of one off night—prompting some dark mutterings that Romney supporters might have been trying to ramp the market.

This was just speculation, of course. Quite possibly, the irregularities that Intrade mentioned in the statement it posted on its home page on Sunday evening have little or nothing to do with the actual prediction markets. Intrade’s reference to having to cease banking activities could theoretically suggest that it had been operating without sufficient capital, or while it was otherwise in financial trouble. Last November, the Commodity Trade Futures Commission sued Intrade to stop Americans from using the site, saying that it was illegally selling futures contracts, which can only be traded in the United States on a registered exchange or by special exemption. Since then, the number of people using the site has plummeted. Last year, more than a million trades took place on the site, according to Intrade’s own figures. So far this year, there had been just 52,166 trades. This decline must have affected Intrade’s finances adversely.

Whatever was at the bottom of Intrade’s sudden demise, most non-speculators will forever associate it with the 2012 Presidential election. (The company has actually existed, in various guises, since 1999. Its founder, John Delaney, an Irish accountant and entrepreneur, died in May, 2011, while climbing Mount Everest.) While Intrade’s election market correctly predicted that Obama was likely to win, the puzzling aspects of its operation weren’t confined to what happened immediately after the first debate. From that point, right up until the eve of the election, Intrade consistently showed Obama with a lower chance of winning, and Romney with a bigger chance of winning, than other betting sides did, particularly those operated by professional bookmakers. Intrade generally put the probability of Obama winning at somewhere between sixty and seventy per cent. By contrast, the bookies’ odds implied that Obama’s odds of winning were eighty per
In an efficient financial market, such discrepancies shouldn’t persist, because they create arbitrage opportunities. At least in theory, a speculator could have made money by betting on Obama at Intrade and hedging his position by betting on Romney at the bookmakers. The fact that the gap remained raised questions about how Intrade operated, and whether it was really, as it claimed, a deep and liquid market. And if it wasn’t very deep or very liquid, then there were some legitimate questions about whether it could manipulated by somebody willing to expend not very much money.

It wasn’t just the fact that Intrade showed Romney with a higher probability of winning than other markets that excited curiosity. Even on days when there wasn’t very much news affecting the election, the odds on Intrade moved around quite a bit. On October 23rd, just two weeks before the election, Brad Plumer, of the Washington Post’s Wonkblog, pointed to some Romney trades, valued at just $17,800, which pushed the implied odds of the G.O.P. candidate winning from forty per cent to forty-nine per cent. The Atlantic’s Derek Thompson also covered the story. In response to his post, Carl Wolfenden, the exchange-operations manager for Intrade, posted a comment saying that the firm had reviewed the trades and found nothing suspicious: “During the period you reference above 40 individuals bought Romney shares and no individual bought more than 15% of the shares traded during that period.... So we don’t believe this was manipulation but more a run on Romney when the market was unusually thin.”

Given this sort of thing, it’s inevitable that people will speculate (pun intended) about what was really going on. Thompson quoted the University of Michigan economist Justin Wolfers, who has long been a student (and defender) of prediction markets. Wolfers said: “There are several scholars right now looking at manipulation of political prediction markets. They tell me that they have some circumstantial evidence that InTrade has been the subject of several manipulation attempts, but I’m yet to see their work, so I’m not sure how seriously to take it.” Now that Intrade is no more, perhaps these studies will see the light of day.

As of now, there simply isn’t enough information to reach any conclusions. About all we really know is that Intrade has shut down, quite possibly for good. After the C.F.T.C. forced Americans off the site at the end of last year, betting on U.S. politics fell off sharply. Recently, one of the most popular activities on the site had been speculating about the identity of the next Pope. As of yesterday, the market had been saying that the election of an Italian pontiff was the single most-likely outcome, with an implied probability of forty-seven per cent. The clear favorite was Cardinal Angelo Scola, the archbishop of Milan, whose chances of victory the market participants estimated at twenty-five per cent. The second favorite was Cardinal Peter Turkson, of Ghana (nineteen per cent). We’ll see sometime soon whether Intrade (or, rather, the gamblers who used it) called the papal election correctly.

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