Comment on the Proposed Rule “Conflicts and Affiliations” (RIN 3038-AF76, 91 FR 50926)

Date: October 2026

To: Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission

Re: Conflicts and Affiliations, RIN 3038-AF76, Docket No. CFTC-2026-1686, 91 FR 50926 (Aug. 6, 2026)

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Responds to: the request for alternatives to an end-of-period net-position (“flat”) limit (91 FR 50951); Questions 44, 46, 47 and 50; and the data and implementation aspects of Question 55(iv)

Summary

The Proposal confines an affiliate market maker to bona fide market making, but it does not say what analysis the independent regulatory service provider (RSP) should use to support its annual certification. This comment proposes one input to that analysis: an attribution of the affiliate’s gross trading profit and loss on settled binary event contracts into spread capture and inventory profit and loss, each measured against the midpoint at the time of the trade. Because these contracts settle at a value fixed by their resolution source, the two parts add up exactly to realized gross trading profit with no mark-to-model. Much of the input data overlaps with data the Proposal already expects the RSP to receive.

The attribution identifies patterns that warrant further examination. It does not by itself establish a violation or compliance. Positive inventory profit can arise from legitimate market making and inventory management, and negative or statistically insignificant results do not show that the affiliate stayed within its obligations.

Recommendations:

1. Do not add an end-of-period net-position limit as a condition. Instead, specify that the “written documentation and analysis” supporting the certification under proposed § 38.852(c)(2)(iii) include the attribution described in Section II for binary event contracts.
2. Have the RSP apply the three screens in Section III and evaluate their results alongside quoting obligations, contemporaneous inventory and hedge records, and evidence about access and information advantages.
3. Require the market maker or incentive program to classify the affiliate’s fills against contemporaneous positions and exposure records, and to fix thresholds and classification rules before results are observed, subject to part 40 review.
4. Adopt the method as an acceptable practice in Appendix B to part 38. Proposed text is in Section VI; Section VII raises public reporting as a separate question.

I commented on the prediction-markets ANPRM on April 13, 2026 (Comment No. 114899), proposing a test of whether an operator’s fee revenue is statistically independent of event outcomes. The Commission’s proposed prediction-markets rule cited that comment among those suggesting that

"gaming" be defined by elements associated with gambling, and preliminarily found such definitions overbroad (91 FR 35806, 35825 & n.198 (June 12, 2026)). This comment does not revisit that question. It applies a related measurement where this Proposal locates the conflict: the affiliate's trading profits, which the exchange and its affiliate "may ultimately share" (91 FR 50949).

I. The Proposal names the conflict but not the analysis

The Proposal already identifies what the certification must examine. It leaves open how the RSP should examine it.

- **The harm.** "The harms identified above turn on the affiliate's ability to convert operational and information advantages into proprietary profit, and on the exchange's stake in the affiliate's directional gains" (91 FR 50949).
- **The condition.** Proposed § 38.852(c)(1)(ii)(D) requires the market maker or incentive program to ensure that the affiliate's trading is reasonably calculated to contribute to a fair and orderly market, and that the affiliate does not make bids or offers, or enter into transactions, inconsistent with that purpose, "including by taking directional proprietary positions other than in connection with its obligation to maintain two-sided quotations" (91 FR 50951, 50992). The Commission acknowledges that the program specifications in clauses (A) through (D) "are not defined in detail in the rule" (91 FR 50980).
- **The open request.** The Commission preliminarily declined an end-of-period "flat" requirement because it "could vary across products" and because "a firm may be engaging in market making activity—rather than directional trading—even if it holds a net directional position under some circumstances." It asked for "any alternatives that could help to ensure that affiliate market makers only engage in bona fide market making activities" (91 FR 50951).
- **The certification.** The RSP must certify annually that the affiliate meets the conditions, supported by "appropriate written documentation and analysis" (91 FR 50952). The Proposal does not specify that analysis. It asks whether the Commission "should further specify standards with respect to the certification requirement" (id.; Question 50).
- **The data.** The Commission expects certification to require "message and transaction data at a high-frequency from every market in which an affiliate market maker is active," identifying the affiliate's bids and offers with price levels and timestamps (91 FR 50981).

Two further statements in the Proposal suggest what to look for in that data. The market-maker definition the Proposal relies on describes firms that are "compensated for the risk involved in allowing their inventory of securities to act as a buffer against temporary order imbalances" (91 FR 50950 n.195). The cost analysis adds that order-priority subordination could cause the affiliate "to trade against informed market participants," an adverse-selection cost it proxies with Kyle's lambda (91 FR 50980). Together they point to one question: whether the affiliate's profit comes mainly from supplying liquidity, or from inventory that persistently gains in value. Neither statement makes inventory gains improper. Market makers can earn them legitimately through inventory management, compensation for bearing risk, or better pricing.

The Commission also states that it "does not have information about the trading motives of affiliate principal trading firms" (91 FR 50980). Where the affiliate is the sole source of liquidity, subordination has no effect and the remaining conditions "are the operative protections" (91 FR 50951; Question 46).

There, condition (D) carries much of the weight, and it is the condition hardest to observe. The attribution below gives the RSP a structured view of how the affiliate earns its trading profit; Section V sets out what it cannot show.

II. The measurement: an attribution for settled binary contracts

For each binary event contract that settles in the reporting quarter, the attribution covers every fill of the affiliate in that contract over the contract's life, including fills in earlier periods. Positions opened before the rule's effective date, or transferred between accounts, need a documented reconciliation. The result is gross trading profit and loss for a cohort of settled contracts, with fees and incentives allocated consistently; it is not the affiliate's quarterly accounting profit. Open positions in contracts not yet settled should be reported separately, by volume and net exposure, so that the annual certification does not overlook them.

Let B be the fixed payout of a winning contract, with prices and settlement values expressed in the same currency units. For each fill, let q be the signed quantity (positive when the affiliate buys the "yes" side; a purchase of "no" at price c counts as a sale of "yes" at B − c), p the fill price, m the midpoint of the best bid and offer immediately before the fill, and S the settlement value per "yes" contract (normally 0 or B). Summing over the affiliate's fills in a contract:

$$\Pi = \Sigma\, q\cdot(S - p) = \Sigma\, q\cdot(m - p) + \Sigma\, q\cdot(S - m)$$

The first sum on the right is spread capture. The second is inventory profit and loss, measured against the trade-time midpoint. For inventory held to settlement it is realized at the settlement value. For inventory closed earlier it equals the change in the midpoint while the position was held, whatever the outcome. For example, with B = 1, buying at 0.45 when the midpoint is 0.50 and selling at 0.65 when the midpoint is 0.60 yields 0.10 of spread capture and 0.10 of inventory profit, whether the contract later settles at 0 or 1. For fills of the affiliate's resting quotes, spread capture equals the counterparty's effective half-spread and inventory profit equals the negative of its price impact measured at settlement; for the affiliate's own liquidity-taking fills, the signs reverse.

Three properties make the attribution administrable:

1. **It is additive by fill.** Each fill carries its own spread and inventory terms, so no lot-matching convention is needed.
2. **It is exact at settlement.** S comes from the resolution source, so there is no mark-to-model and no residual. Only the split between the two terms depends on the reference price; the total does not.
3. **It partitions by provenance.** Each fill, or portion of a fill, is either passive (a resting quote of the affiliate was hit) or affiliate-initiated (an order of the affiliate removed liquidity). Against the affiliate's contemporaneous position, it is also inventory-reducing, hedging or other. A single order can reduce a position and then open the opposite one, so classification applies to fill portions, not orders.

Component	Measured as	What a bona fide market maker might show	A persistent departure may warrant reviewing
Spread capture	q(m − p), summed over all fills	Positive, and normally a principal source of trading profit	Liquidity-removing activity outweighing quoting, if negative (fills of resting quotes cannot make it negative)
Inventory P&L on passive fills	q(S − m) on fills of resting quotes	Near zero or negative where takers are informed; positive where customer flow is biased, where risk-bearing is compensated, or where the affiliate prices better	Quotes shaded by nonpublic information or a directional view (Screen 2)
Inventory P&L on affiliate-initiated fills	q(S − m) on liquidity-removing fill portions, split into inventory-reducing, hedging and other	Volume and returns require assessment against documented quoting needs and the validity of the benchmark	Directional position-taking, or use of an information or speed advantage (Screen 1)
Fees, rebates, incentives	Amounts paid or received, allocated consistently	Terms no better than those available to unaffiliated members (§ 38.852(b)(2), (c)(1)(ii))	Incentive terms more favorable to the affiliate

III. Three screens for the certification

The screens are proposed diagnostics. This comment does not present empirical validation of their false-positive rates, detection performance or operating thresholds, which would need calibration on each DCM's data. A flag prompts further examination by the RSP and the regulatory oversight committee. It does not by itself establish a violation, and the absence of a flag does not establish compliance.

The screens rest on different assumptions, none of which the accounting identity supplies. A zero-mean inventory-profit benchmark requires the reference midpoint to be unbiased conditional on the trade direction, size and selection underlying the tested fills; where it is not, for example because customer flow is systematically biased, positive inventory profit can arise without directional intent. Peer comparisons depend on the comparability of the matched fills. Composition measures are descriptive.

Screen 1: affiliate-initiated inventory. Liquidity-removing fill portions that increase inventory and are not supported as hedges merit particular examination for their connection to the affiliate's two-sided quoting obligations. Positions built through shaded quotes are the subject of Screen 2. The RSP should estimate, with a confidence interval, the mean inventory profit per event cluster on liquidity-removing fill portions classified as other, and report their share of the affiliate's volume. It should report the same statistic for inventory-reducing and hedging portions without treating a positive value as a flag, since cutting adversely selected inventory before the price fully adjusts can be profitable. A persistently positive result for portions classified as other warrants examination of whether those positions were connected to the affiliate's quoting obligations, using its quoting records and documented quoting needs, contemporaneous inventory and hedge records, and access and information arrangements.

Screen 2: passive inventory against a benchmark. Inventory profit on resting quotes can be positive without directional intent. Transaction-level evidence from one prediction-market DCM shows that "low-price contracts win far less often than required to break even" (Bürgi, Deng & Whelan 2026). The RSP should therefore compare the affiliate's passive inventory profit per contract traded with that of comparable passive fills of unaffiliated members participating in a market maker or incentive program, matched on contract, side, price range, size and time to resolution. Subordination may leave the affiliate with the more adversely selected orders (91 FR 50980), which would bias the comparison against finding an excess. Other differences in side, timing, price level, size and stage before resolution can bias it either way, and the RSP should describe those that remain. A persistent excess for the affiliate warrants review for quotes shaded by nonpublic information, the Proposal's second concern (91 FR 50949), or by a directional view; better pricing models and faster quote updating are the legitimate explanations the review must consider. Where no comparable unaffiliated fills exist (Question 46), the RSP should say so and report a calibration table of the affiliate's quote midpoints against realized outcomes. An unavailable benchmark yields limited evidence, not a clean result.

Screen 3: composition. The RSP should report spread capture, both inventory components, and fees and incentives in dollars and per contract traded, by product category and quarter, including negative components. Shares of total profit should be reported only where the total is positive and material, because shares of a small denominator are unstable. A rising inventory share is a reason for review, not a breach.

Four design rules keep the screens disciplined:

- **Unit of inference.** The unit is the underlying event, not the contract. Strike ladders, multi-outcome markets and combinations on one event settle together, so standard errors should be clustered by event. Where events share a driver, such as one data release or one election night, or a combination spans several events, clustering should be at that coarser level, and results should also be reported with the largest events excluded.
- **Estimates, not verdicts.** Inferential results, such as means, differences and calibration estimates, should be reported as effect sizes with confidence intervals, not significance alone. Observed dollar totals are accounting quantities and need no sampling interval.
- **Pre-specification.** Thresholds, classification rules and matching criteria should be fixed in the market maker or incentive program before results are observed, and reviewed independently.
- **Sample size and repeated testing.** The RSP should state minimum-sample rules and how it accounts for repeated testing across products, quarters and screens. Power depends on the

number and distribution of sufficiently independent event clusters, not on the number of contracts. Prediction markets list "a large and continually refreshed population of individual small, short-lived, and idiosyncratic contracts" (91 FR 50949), which may supply many such clusters in a year. Where they do not, a test that cannot reject provides limited evidence.

IV. Fit with the Proposal and with the Volcker precedent

The attribution responds to the reasons the Commission gave for preliminarily declining a "flat" requirement, and it draws on what the Volcker rulemaking learned about revenue-source tests.

- **Net positions are allowed.** The screens do not ask whether the affiliate holds positions at settlement. They ask whether its inventory gains persist in ways that warrant examination. That tracks the distinction the Commission drew in preliminarily declining a flat limit (91 FR 50951).
- **Products differ in thresholds, not method.** The attribution is the same for every binary event contract. Product-specific thresholds belong in the market maker or incentive program under part 40 review, as the Proposal provides for quoting hours and spreads (91 FR 50951; Question 44).
- **Data overlap, and the work that remains.** The inputs are the affiliate's fills, the top of book at each fill, settlement values, contemporaneous position and exposure records and, for Screen 2, comparable fills of unaffiliated program market makers. They come from the DCM's audit trail and the affiliate's records, and they overlap with the high-frequency data the Commission already expects certification to require (91 FR 50981). The remaining work includes historical reconciliation, peer identification, reference-price reconstruction, event grouping, hedge validation, statistical implementation and investigation of flags. On Question 55(iv), this comment describes requirements and possible efficiencies; it does not estimate their cost or the capacity of potential providers.
- **No volume cap.** The method imposes no volume or value cap, so the affiliate can still quote the long tail (Question 47). Its compliance costs could still bear on the bootstrapping rationale and should be weighed with the Proposal's other costs.

The Volcker precedent. The 2011–2012 Volcker proposals, including the Commission's, would have required market making to be "designed to generate revenues primarily from fees, commissions, bid/ask spreads or other income not attributable to appreciation in the value of covered financial positions" (77 FR 8332, 8358 (Feb. 14, 2012)). They also proposed a Spread Profit and Loss metric that measured spreads against "the mid-market price," as the spread-capture term here does (id. at 8438). The 2014 final rule dropped the requirement and did not retain the Spread Profit and Loss metric. It kept "only a modified version" of the proposed Comprehensive Profit and Loss Attribution metric (79 FR 5808, 6040 (Jan. 31, 2014)), which focuses on "when revenues are generated, rather than the specific sources of revenue" (id. at 6041) and whose patterns "may warrant further review of the desk's activities" (id. at 5896). That metric remains in appendix A to part 75, under "Source-of-Revenue Measurements."

The agencies noted, as the proposal had, that spreads may not be "reasonably ascertainable in certain asset classes," and recognized that requiring spread revenue to be identifiable "on a close-to-real-time basis" and distinguishable from price appreciation over the holding period "would be unduly burdensome" (79 FR at 5896 n.1107). They also confirmed that the market-making exemption was not

meant “to preclude a trading desk from generating any revenue from price appreciation” (id.). Standardized terminal payouts and recorded order-book data may reduce some of the valuation and reconstruction difficulties identified then. They do not remove benchmark uncertainty, and they do not establish whether trading is bona fide. The attribution is therefore proposed as an input to supervisory review, consistent with the 2014 treatment of how a desk generates profit as “not a dispositive factor” (id.). Spread limits under proposed § 38.852(c)(1)(ii)(C) constrain, but do not eliminate, incentives to widen spreads within the permitted range or to move the reference midpoint.

V. Limits

The attribution has five limits. The design above addresses them only in part.

1. **Reference price.** In thin books the midpoint can be wide, one-sided, stale or set by the affiliate’s own quotes. Where a credible alternative exists, results should also be reported under a reference the affiliate does not set, such as the midpoint of the best unaffiliated bid and offer or a recent unaffiliated trade, with a large divergence treated as a data-quality flag. Where none exists, the analysis should say so and disclose the share of volume affected. Where no usable reference price exists at all, as for fills against a one-sided book, the affected volume and gross trading profit and loss should be reported separately, with the spread and inventory attribution identified as unavailable and the coverage limitation explained. Request-for-quote and combination trades should be reported separately, and short-horizon markouts (the midpoint change one and five minutes after each fill) can serve as a lower-noise check. Where the affiliate alone sets the best bid and offer, the attribution measures its gains against its own prices, and the calibration table cannot separate pricing against biased customer flow from quote shading based on information.
2. **Benchmark assumption.** A zero-mean benchmark for inventory profit assumes the reference midpoint is unbiased conditional on the direction, size and selection of the trades examined. Customer-flow bias, compensation for bearing risk and better pricing can each produce positive inventory profit in legitimate market making.
3. **Correlated outcomes and sample size.** Contracts on one event, or events with a shared driver, settle together. Inference should treat that cluster as the unit, and a small number of clusters limits what any test can show.
4. **Not a test of intent.** Inventory profit measures gains relative to the trade-time midpoint, not intent or the connection between a position and quoting obligations. Impermissible trading can lose money, and legitimate trading can gain.
5. **Scope.** The attribution covers trading on the DCM. It does not reach information advantages exploited on other venues, the price-priority and repricing concerns raised in comment CFTC-2026-1686-0005, or the access restrictions described in comment CFTC-2026-1686-0008. It cannot by itself separate gains from preferential access or latency from gains from information. Access also matters for this method: where unaffiliated market makers are absent, the Screen 2 benchmark is unavailable.

VI. Proposed text

The Commission could add one sentence to proposed § 38.852(c)(2)(iii) and describe the method as an acceptable practice under Core Principle 16 in Appendix B to part 38. Because acceptable practices are illustrative rather than exclusive, the rule text states only what the attribution must separate. Commission staff have since advised that DCMs designing incentive programs should consider Core Principle 16, and that "[t]his obligation is particularly important when a market-maker is a subsidiary or affiliate of the DCM" (CFTC Letter No. 26-23 (Aug. 12, 2026)). That advisory is staff guidance that "does not create new obligations" (id.).

Proposed addition to § 38.852(c)(2)(iii):

> *For event contracts that settle at either a fixed amount or zero, the written documentation and analysis shall include an attribution of the affiliate market maker's gross trading profit and loss that separately states spread capture, inventory profit and loss, and fees and incentive payments, together with the limitations of that attribution. Appendix B to this part describes an acceptable practice for this attribution.*

Proposed new element of the Core Principle 16 acceptable practices, following proposed element (1):

> ***Attribution of affiliate market maker trading.*** *(i) Scope. The written documentation and analysis supporting a certification under § 38.852(c)(2)(iii) should include, for each product category and each quarter of the certification period, an attribution of the affiliate market maker's gross trading profit and loss on the designated contract market for event contracts that settle at either a fixed amount or zero. The attribution should cover every fill of the affiliate market maker over the life of each such contract that settled in the quarter, including fills in earlier periods, with a documented reconciliation of positions opened before the effective date or transferred between accounts. Open positions in contracts not yet settled should be reported separately by volume and net exposure.*
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> *(ii) Definitions. Prices and settlement values are expressed in the same currency units, and the fixed payout is the amount paid on a winning contract. For each fill, the signed quantity is positive for a purchase of the "yes" side and negative for a sale, a purchase of the "no" side at price c being treated as a sale of the "yes" side at the fixed payout minus c; the reference price is the midpoint of the best bid and offer immediately before the fill; and the settlement value is the amount paid per "yes" contract at settlement, normally either the fixed payout or zero. Each fill, or portion of a fill, should be classified as passive or liquidity-removing and, against the affiliate market maker's contemporaneous position, as inventory-reducing, hedging or other. A hedging classification should be supported by records of the exposure hedged across related contracts and venues; an order flag alone is not sufficient.*
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> *(iii) Components. The attribution should separately state: (A) spread capture, measured for each fill as the signed quantity multiplied by the difference between the reference price and the fill price; (B) inventory profit and loss on passive fills, measured for each fill as the signed quantity multiplied by the difference between the settlement value and the*

> *reference price; (C) inventory profit and loss on liquidity-removing fill portions, measured in the same way and stated separately for inventory-reducing, hedging and other portions; (D) fees, rebates, and incentive payments, allocated on a consistent basis; and (E) results for request-for-quote trades, combination trades and fills against a one-sided book, stated separately. Where a credible alternative reference price that the affiliate market maker does not set exists, results should also be stated under it; where none exists, the analysis should say so and disclose the share of volume affected. Where no usable reference price exists for a fill, the affected volume and gross trading profit and loss should be reported separately, the spread and inventory attribution should be identified as unavailable, and the resulting coverage limitation should be explained.*
>
> *(iv) Analysis. The analysis should state the means, differences and calibration estimates in (A) and (B) with confidence intervals, using standard errors clustered by underlying event or, where events share a driver or a combination spans several events, by that coarser cluster, and should report the observed amounts in (C) as accounting quantities: (A) the mean inventory profit and loss per cluster on liquidity-removing fill portions classified as other, the same statistic for inventory-reducing and hedging portions, and the share of the affiliate market maker's traded volume classified as other; (B) the difference between the affiliate market maker's inventory profit and loss per contract traded on passive fills and that of comparable passive fills of unaffiliated members participating in a market maker or incentive program, matched on contract, side, price range, size and time to resolution, with remaining differences described, or, where no comparable fills exist, a statement to that effect and the calibration of the affiliate market maker's quotation midpoints against realized outcomes; and (C) each component in paragraph (iii) in dollars and per contract traded, including negative components, and, where total profit and loss including fees is positive and material, as a share of that total. The analysis should state minimum-sample rules and how repeated testing across products, quarters and screens is addressed.*
>
> *(v) Use. The market maker or incentive program should fix thresholds, classification rules and matching criteria before results are observed, subject to independent review by the regulatory service provider. A result beyond a threshold should prompt further examination of the affiliate market maker's quoting records, contemporaneous inventory and hedge records, and access and information arrangements, and does not by itself establish a failure to satisfy § 38.852(c)(1)(ii)(D). A result within thresholds, an unavailable benchmark or an underpowered test does not by itself establish compliance.*

VII. A separate question: public reporting

Separately from the supervisory attribution, the Commission could consider whether DCMs should publish, annually and with a delay, the aggregate dollar amounts of the components listed in paragraph (iii) of the proposed acceptable practice, by product category. Such reporting would give customers who receive the per-session notice under proposed § 38.852(c)(3) a factual measure of how the affiliate earns its profit. It has different costs and disclosure consequences from the supervisory analysis and should be assessed on its own.

Respectfully submitted,

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References

- CFTC, Conflicts and Affiliations, 91 FR 50926 (Aug. 6, 2026) (proposed rule, RIN 3038-AF76)
- CFTC, Prediction Markets; Public Interest Determinations, 91 FR 35806 (June 12, 2026) (proposed rule, RIN 3038-AF65)
- CFTC Division of Market Oversight, Staff Advisory on Self-Certification of Incentive Programs for Prediction Markets, CFTC Letter No. 26-23 (Aug. 12, 2026)
- CFTC, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Covered Funds, 77 FR 8332 (Feb. 14, 2012) (proposed rule)
- CFTC, Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds, 79 FR 5808 (Jan. 31, 2014) (final rule)
- 17 CFR part 75, appendix A (eCFR, accessed Oct. 3, 2026)
- Constantin Bürgi, Wanying Deng & Karl Whelan, Makers and Takers: The Economics of the Kalshi Prediction Market, CESifo Working Paper No. 12122 (2026)
- Amadeus Brandes, Comment No. 114899 on RIN 3038-AF65 (Apr. 13, 2026)
- Comments CFTC-2026-1686-0005 (Brubaker Public Relations, Inc.) and CFTC-2026-1686-0008 (REAKT Solutions LLC)