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Via Regulations.gov Comments Portal

Mr. Christopher Kirkpatrick
Secretary
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

Re: RIN 3038–AF76 — Conflicts and Affiliations

Dear Mr. Kirkpatrick:

ProphetX LLC ("ProphetX") respectfully submits this letter in response to the Commodity Futures Trading Commission's (the "Commission" or "CFTC") notice of proposed rulemaking, Conflicts and Affiliations.[1] ProphetX is a recently registered Designated Contract Market ("DCM") and Derivatives Clearing Organization ("DCO") operating a participant-first, sports-native prediction market exchange, and it offers the perspective of a newly regulated market operator for which the neutrality of the venue toward the participants trading on it is a defining commitment. ProphetX has previously commented on the Commission's prediction markets rulemakings and its request for information on fintech innovation, and has submitted comments to the Commission's Innovation Advisory Committee.[2]

[1]Conflicts and Affiliations, 91 Fed. Reg. 50926 (Aug. 6, 2026) (the "Proposal"). Unless otherwise defined in this letter, capitalized terms and abbreviations have the meanings given to them in the Proposal.

[2]*See* Letter from ProphetX LLC to Christopher Kirkpatrick, Secretary, CFTC, re: RIN 3038–AF65, Prediction Markets (Advance Notice of Proposed Rulemaking) (Apr. 20, 2026) (the "ANPR Letter"); Letter from ProphetX LLC to Christopher Kirkpatrick, Secretary, CFTC, re: RIN 3038–ZA24, Request for Information: Identifying Regulations to Facilitate Innovation and Competition to Financial Products and Services for Fintech Firms (July 9, 2026) (the "RFI Letter"); Letter from ProphetX LLC to Christopher Kirkpatrick, Secretary, CFTC, re: RIN 3038–AF65, Prediction Markets; Public Interest Determinations (July 27, 2026); Letter from Dean Sisun, Co-Founder and Chief Executive Officer, ProphetX LLC, to Michael Passalacqua, Designated Federal Officer, Innovation Advisory Committee, CFTC (Aug. 20, 2026) (the "IAC Letter").

I. The Importance of Open, Competitive Markets That Match Two Sides

ProphetX was built on a single structural conviction, one it has advanced in each of its submissions to the Commission: a genuine exchange matches two sides. On an open, competitive exchange, independent buyers and sellers meet on equal terms, prices are formed through competition among them, and the venue earns its revenue by facilitating transactions rather than by taking the other side of them.[3] Congress made this a core obligation of every DCM under the Commodity Exchange Act (the "CEA"), requiring each to provide a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process.[4] That neutrality is what allows an exchange to deliver the benefits the CEA associates with organized markets, competitive price discovery, reliable risk transfer, and the dissemination of accurate pricing information, and it is what distinguishes a federally regulated exchange from the house-banked sportsbook model, in which the operator sets the price and stands as every customer's counterparty.

Exchange form, however, can be layered on top of different economic substance. A venue can present customers with an order book, a matching engine, and the vocabulary of an exchange while, in practice, a single affiliated market maker supplies most customer liquidity. In that structure, independent price formation may be limited: prices may reflect primarily one firm's models and risk parameters rather than competition among multiple independent participants, and the exchange's common parent may share in the affiliate's trading results. The structure can therefore resemble a single dealer market more than an open, competitive exchange in which independent participants meaningfully compete to set price.

The concern is not affiliation as such. Affiliated liquidity can play a legitimate and valuable role, particularly in launching new venues and new products, where independent liquidity providers are often unwilling to commit capital until a market has proven itself. The concern is displacement: a structure in which the affiliate does not bridge the venue to an open, competitive market, but instead becomes the market. The harms of that structure compound. When an exchange's commercial success depends on the trading profits of its affiliated market maker, the exchange exercises its discretion over matching priority, market-data and connectivity arrangements, fee and incentive programs, product listings, and surveillance and discipline under a standing incentive to favor its affiliate. Independent market makers, perceiving that they would be competing against a structurally advantaged affiliate on the venue's terms, may be less willing to commit capital to the venue, which leaves the affiliate dominant and deepens the exchange's dependence on it. The Commission has recognized precisely this dynamic, observing that the conflict presented by an affiliate principal trading firm inheres in the exchange's economic position and is most acute where

[3] *See* IAC Letter at 1–2 (describing ProphetX's peer-to-peer exchange model, in which participants set prices and trade against one another, the platform earns a commission rather than a betting margin, and the venue holds no directional position in the outcome); ANPR Letter at 1 (describing ProphetX's founding premise that analytics-based trading operates best in open, market-based systems rather than in closed, operator-driven systems in which outcomes are priced by the house).

[4] CEA Section 5(d)(9), 7 U.S.C. 7(d)(9) (DCM Core Principle 9); *see also* CEA Section 3(a), 7 U.S.C. 5(a) (describing the national public interest served by transactions subject to the CEA as providing a means for managing and assuming price risks, discovering prices, or disseminating pricing information through trading in liquid, fair, and financially secure trading facilities).

the affiliate is the exchange's dominant or sole source of liquidity.[5] Left unchecked, the result is a market in which customers may pay a dealer's margin while believing they are receiving an exchange's competitive price, and in which the public legitimacy of the regulated event-contract market, on which every DCM depends, is placed at risk.

ProphetX commends the Commission for confronting these questions directly, and for doing so through notice-and-comment rulemaking that would replace an uneven patchwork of voluntary practices with a consistent and durable regulatory baseline.[6] In its prior submissions, ProphetX urged the Commission to provide categorical regulatory certainty for sports event contracts through its exemptive authority under Section 4(c) of the CEA, while emphasizing that exchange status must also carry market-structure content: Section 4(c) can define what may trade, but the Commission's market-structure and conflicts rules will determine whether those products trade through neutral, competitive price formation.[7] The Proposal takes up that second question, and it does so thoughtfully.

The Proposal reflects a careful and, in ProphetX's view, fundamentally sound understanding of affiliated market structures. In particular, ProphetX commends the Commission for distinguishing an affiliated intermediary that acts as agent for customers from an affiliate that trades as principal against them, and for calibrating its response to the different conflicts each presents; for drawing the line on affiliate principal trading between bona fide market making and directional proprietary trading, rather than either prohibiting affiliated liquidity outright or permitting it without meaningful conditions; for requiring bona fide market-making obligations and incentive parity, which help protect the ability of independent participants to compete; and for recognizing that new venues, and the broad and continually refreshed contract universes characteristic of prediction markets, present a genuine coordination problem that affiliated liquidity can help solve. As ProphetX urged in its IAC Letter, the Proposal does not mandate any single business model; it reflects the sound market-structure principle that affiliated liquidity may help support or bootstrap a market, but should supplement rather than displace independent price formation.[8] ProphetX also welcomes the Commission's evident commitment to principles-based regulation and to administering what Chairman Selig has called the "minimum effective dose" of regulation.[9]

ProphetX's responses to the Commission's specific requests for comment, set out in Part II, are organized around a single objective: the final rules should reliably distinguish an exchange whose affiliated liquidity supplements open, competitive, two-sided price formation from a venue in which affiliated liquidity effectively displaces independent price formation, permitting the former under proportionate safeguards while preventing the latter. Two themes run through those responses. First, the rules should preserve the ability of new entrants to bootstrap liquidity. The Commission should not prohibit affiliate market making, impose a capital-independence

[5] *See* Proposal, Section III.B.ii.

[6] *See* Proposal, Section I.F (describing existing voluntary practices as uneven and explaining the benefits of a consistent, durable regulatory baseline).

[7] *See* ANPR Letter at 2–3; IAC Letter at 1, 3–4.

[8] IAC Letter at 2.

[9] *See* Proposal, Section III.A.iii (citing Statement of Chairman Michael Selig (Apr. 1, 2026)).

condition, or administer the bona fide market-making standard through mechanical, position-by-position tests; it should instead require exchanges that rely materially on affiliated liquidity to cultivate independent liquidity actively. Second, compliance obligations should be proportionate. Mandated third-party services should be available from a sufficiently broad and competitive pool of qualified providers, and their scope and cost should scale with the size and risk of the activity supervised, so that the cost of compliance does not become a regulatory moat that only the largest incumbents can cross.

II. Responses to the Commission's Requests for Comment

ProphetX's responses to certain of the Commission's requests for comment follow, organized by the section of the Proposal in which each request appears. Each question is reproduced verbatim from the Proposal and is followed by ProphetX's response. Where ProphetX addresses related questions together, those questions are set out in sequence and followed by a single response. References to a "Regulation" are to the Commission's regulations in 17 CFR chapter I, and references to a "proposed" Regulation are to that Regulation as it would be adopted or amended by the Proposal.

A. Proposal Section II.B — Commission Regulations 38.604 and 38.606 (DCM Financial Surveillance of Members and Third-Party Regulatory Service Providers)

Question 28. The nature and estimated incremental cost of any change to existing arrangements that would be required to comply with Commission Regulation 38.606 as proposed; and

Question 29. The nature and estimated incremental cost of complying with the mandatory independent third-party RSP alternative described above, including any market-capacity considerations that would arise if additional DCMs were required to engage NFA or another RSP for Commission Regulation 38.604 surveillance of affiliate FCMs.

ProphetX Response to Questions 28 and 29: ProphetX supports the flexibility that proposed Regulation 38.606 would preserve. To the extent the Commission's regulations contemplate reliance on an RSP, however, the Commission should broaden the pool of entities qualified for that role and calibrate the required scope of services to the scale and risk of the activity.

Under existing Regulation 38.606, a DCM may rely only on a registered futures association or a registered entity to serve as its RSP.[10] Given that NFA is the only registered futures association, the eligible pool consists of NFA and other registered entities, many of which operate trading or clearing businesses that may compete with the DCM whose affiliate would be surveilled. A narrow pool of eligible providers creates capacity constraints as additional DCMs require these services, concentrates pricing power in the providers that do exist, and may leave a DCM with no meaningful alternatives to NFA other than an RSP that is itself a competitor.

Without measures to broaden eligibility and contain cost, a requirement intended to mitigate conflicts could instead harden into a regulatory moat: a fixed cost of entry that established venues

[10] 17 CFR 38.606(a); *see also* Proposal, Section II.A.i (noting that NFA is the sole registered futures association).

can readily absorb but that newer and smaller DCMs cannot, to the detriment of the fair competition and responsible innovation the CEA directs the Commission to promote.[11] The Commission should therefore permit qualified independent firms that are not registered entities to serve as RSPs, subject to objective standards for independence, expertise, systems, and capacity and to appropriate Commission access and oversight, as described further in response to Question 51.

In assessing acceptable compliance costs, the Commission should also account materially for the scale of a DCM's operations. An expense that is immaterial to a large, established exchange may be a significant barrier to a new entrant.

B. Proposal Section III.A — Commission Regulations 38.852 and 37.1201 (Conflicts of Interest Involving an Affiliate Market Participant)

Question 32. Whether the principles-based formulation in proposed Commission Regulations 38.852(b)(1) and 37.1201(b) is appropriately calibrated, or whether the rule text should instead enumerate additional specific procedures an exchange must adopt. If applicable, please specify which Acceptable Practices should be moved to regulation text.

ProphetX Response: ProphetX supports the principles-based formulation of proposed Regulations 38.852(b)(1) and 37.1201(b). The requirements should remain principles-based, and the Acceptable Practices should remain in guidance to the extent possible rather than being moved into rule text. The separations appropriate for an exchange with an affiliate market participant will vary with the exchange's structure, size, and products and with the nature of the affiliate's activity, and, as the Commission has recognized, a prescriptive mandate could impose costs without corresponding benefit and deter entry and competition in an evolving industry with unique market structures.[12] This is particularly true where, as here, the Commission is establishing a new regulatory framework. A principles-based framework, informed by Acceptable Practices and tested through the Commission's ongoing compliance monitoring and examinations, will give the Commission the opportunity to determine whether its approach is working in practice and to identify, on the basis of that experience, any areas in which more specific requirements prove necessary.

Question 34. Whether DCMs and SEFs should be able to share legal and compliance staff with an affiliate market participant.

ProphetX Response: Yes. The Commission should permit DCMs and SEFs to share legal and compliance staff, as well as other general corporate functions, with an affiliate market participant, subject to appropriate conflicts-of-interest controls. Certainly, shared personnel should be functionally separated or recused from surveillance, investigations, discipline, rule enforcement, and other regulatory decisions specifically involving the affiliate. Yet requiring full duplication of legal and compliance functions across an affiliated group would impose costs that fall most heavily

[11] *See* CEA Section 3(b), 7 U.S.C. 5(b) (identifying among the purposes of the CEA the promotion of responsible innovation and fair competition among boards of trade, other markets, and market participants).

[12] *See* Proposal, Section III.A.vi.1.

on newer and smaller exchanges. Further, legal and compliance professionals are well positioned to adhere to, and to demonstrate adherence to, strict conflicts-of-interest guidelines. Rather than prohibiting such sharing, the Commission should permit it subject to safeguards such as written information-barrier policies governing the handling of the exchange's non-public information, recusal of shared personnel from matters in which the exchange's self-regulatory responsibilities and the affiliate's interests conflict, and documentation of conflicts and their resolution consistent with proposed Regulation 38.852(b)(1). Where an affiliate market maker trades on a DCM, the independent monitoring of the DCM's conflicts procedures required by proposed Regulation 38.852(c)(2)(ii) would provide an additional external check.

Question 38. Are there benefits of affiliations between exchanges and market participants, such as enhanced liquidity, broader market options for customers, resource efficiencies, and increased competition and innovation that the Commission has not described in this Proposal? If so, please describe.

ProphetX Response: Yes. ProphetX agrees with the Commission's description of the benefits of affiliation, including the coordination problem that new venues face in attracting liquidity.[13] ProphetX offers two further observations drawn from its experience operating a market-based sports platform since 2019.

First, the benefit of affiliated liquidity extends beyond the viability of markets to the needs of the individual participants who trade in them. Liquidity is exceptionally hard to come by. It is, as ProphetX has previously explained, the essential input that makes the price signals of event contract markets meaningful,[14] and in its absence traders can remain underserved with respect to both the exposures they intend to take and their risk-management needs. A participant seeking to hedge an exposure, or to express a considered view about an event outcome, derives no value from a listed contract in which no counterparty is present. Affiliated liquidity can meet those needs in the period before independent liquidity providers find it worthwhile to participate.

Second, affiliation can be a necessary tool of competition among venues, and not only a source of liquidity within them. Established trading firms and other traditional financial institutions typically require substantial expected returns before committing capital and resources to a new venture, and they are often constrained by internal approval processes that are not designed to support early-stage innovation. A new exchange that cannot supply its own initial liquidity therefore depends on the willingness of the same incumbent firms that already serve established venues. Vertical integration allows a non-incumbent venue to overcome that barrier and to compete on the merits of its market structure, products, and technology. That is a pro-competitive benefit, distinct from the coordination problem the Commission describes, and it advances the CEA's purpose of promoting fair competition among boards of trade.

These benefits are realized, however, only when affiliated liquidity serves as a bridge to an open, competitive market rather than as a permanent substitute for one. That is why ProphetX supports

[13] *See* Proposal, Section III.B.ii.

[14] *See* ANPR Letter at 10; *see also* Proposal, Section VII.C (recognizing the challenges DCMs would face in attracting unaffiliated principal trading firms willing to provide liquidity in at least certain markets).

the Commission's conditioned approach, as well as the additional measures described in ProphetX's response to Question 47.

C. Proposal Section III.B — Commission Regulations 38.852(b) and (c) (Prohibition on Affiliate Principal Trading Firms and Conditional Affiliate Market Maker Exception)

Question 40. Whether the Commission should instead prohibit affiliate principal trading altogether with no market-maker exception.

ProphetX Response: No. ProphetX agrees with the Commission's preliminary determination not to prohibit affiliate principal trading altogether. There are bona fide reasons for a vertically integrated structure, and, as described in ProphetX's response to Question 38, affiliated liquidity can be a necessary component of financial innovation and fair competition, particularly for non-incumbent venues that cannot rely on established liquidity providers to support new ventures. A flat prohibition would fall most heavily on new entrants, would entrench incumbent venues whose liquidity networks are already established, and, as the Commission recognizes, would leave much of the broad and continually refreshed contract universe characteristic of prediction markets without liquidity at all.[15] The concern that animates calls for a prohibition, that affiliated liquidity may displace independent price formation, is legitimate. It is better addressed, however, through conditions that protect the competitive position of independent participants, such as incentive parity, impartial access, conflicts controls, and independent oversight, together with the additional measures ProphetX recommends in response to Question 47, than by eliminating affiliated liquidity altogether.

Question 41. Whether the requirements should apply uniformly to all affiliate principal trading activity or be limited—for example, by market access (for example, to markets accessible to customers who are not ECPs), by a measure of the affiliate's significance in a product, or by other criteria—and how any such threshold should be defined and monitored.

ProphetX Response: The requirements should be limited by reference to the nature and purpose of the affiliate's trading. It is important not to apply conditions designed for active liquidity providers and market makers to activity that does not require the same oversight. As proposed, the requirements would reach an affiliate FCM's house trading that is incidental to its operations as an intermediary for customer positions, such as trading for risk-management purposes, and would subject that activity to the same prohibition and conditions designed for active liquidity providers and market makers. The Commission should provide a clear exemption for affiliate FCMs with limited house trading activity, defined by reference to the incidental purpose and limited scale of that activity and subject to the principles-based conflicts framework of proposed Regulation 38.852(b)(1).

[15] *See* Proposal, Section III.B.v.2.

Question 44. Whether quantitative parameters—for example, a minimum percentage of trading hours quoted, a maximum spread, a minimum size, and an end-of-day net-position limit—should be fixed in Commission rule text rather than established in the market maker or incentive agreement subject to Commission review, as proposed, and what values or standards are appropriate across prediction-market products with differing characteristics.

ProphetX Response: ProphetX supports the Commission's proposed approach of establishing quantitative parameters in the market maker or incentive agreement, subject to Commission review through the part 40 process, rather than fixing them in rule text. Appropriate parameters will differ materially across prediction-market products. A contract on a marquee sporting event with deep two-sided interest bears little resemblance, in its liquidity profile, trading horizon, and risk characteristics, to a thinly traded contract on a less prominent event that may be listed for only a short period. Values fixed in rule text would inevitably prove too permissive for the former or too onerous for the latter, and would be most likely to deter affiliated liquidity in precisely the long-tail contracts in which, as the Commission recognizes, it is most needed.

More fundamentally, the Commission should avoid treating directional positions, viewed in isolation, as inconsistent with bona fide market making or requiring each transaction or position to map mechanically to contemporaneous two-sided quotations. ProphetX supports the Proposal's core requirement that an affiliate market maker maintain continuous two-sided quotations on the affiliated DCM. But market makers manage inventory and risk across products, venues, and time horizons, including through trading on affiliated and unaffiliated platforms. As a result, bona fide liquidity provision may produce a directional position on a particular DCM or in a particular contract even where the firm's overall activity is market making rather than speculative proprietary trading. A position that appears directional when viewed solely on the affiliated DCM may reflect inventory management, hedging, or liquidity provision when the firm's activity across correlated products or other trading venues is considered. The Commission itself recognizes this principle in declining to propose an end-of-day flat-position requirement, explaining that a firm may be engaged in market making, rather than directional trading, even if it holds a net directional position under some circumstances. ProphetX agrees and recommends that the Commission not adopt an end-of-day net-position limit in rule text.

Accordingly, the appropriate inquiry under proposed Regulation 38.852(c)(1)(ii)(D) should be whether the firm's overall activity in connection with its market-making function is reasonably designed to provide liquidity and maintain fair and orderly markets, rather than whether individual positions or transactions can be matched mechanically to contemporaneous two-sided quotations. ProphetX recommends that the Commission confirm, in the final rule or accompanying guidance, that positions arising from inventory management and from the hedging of market-making risk, including hedging conducted in correlated contracts or on other venues, are taken "in connection with" the affiliate market maker's obligation to maintain two-sided quotations. Nothing in this recommendation would permit an affiliate to operate an unrelated speculative proprietary book. The affiliate would remain obligated to maintain bona fide two-sided quotations on the DCM, and its trading activity should remain reasonably related to that market-making function. This approach would preserve the line the Commission has drawn between bona fide market making and directional proprietary trading while administering it in a manner consistent with how market making is conducted in practice.

Question 45. Whether order-priority subordination is technically and operationally feasible across the matching systems in use, and whether it should be required, replaced by a volume- or value-based cap, or supplemented by such a cap, including a phased or sunset cap. Could an exchange or market maker circumvent the spirit of the requirement by switching to pro rata caps?

ProphetX Response: Order-priority subordination should not be required. A neutral matching algorithm that applies ordinary price/time or other generally applicable priority rules to all participants does not favor an affiliate merely because the affiliate receives the same priority as an unaffiliated participant. Requiring the affiliate to trade behind every unaffiliated order at the same price would instead affirmatively disadvantage the affiliate and could reduce its willingness and ability to supply liquidity, particularly in thin or rapidly moving markets.

The Commission's objective can be achieved through less distortive safeguards. An affiliate market maker would still be required to maintain bona fide two-sided quotations, comply with market-making performance standards and incentive parity, contribute to fair and orderly markets, remain subject to conflicts controls and independent third-party oversight, and trade on a venue open to unaffiliated liquidity on non-discriminatory terms. The Commission should therefore require neutral, consistently applied matching rules and prohibit preferential treatment for the affiliate, rather than mandate categorical last priority. ProphetX likewise does not support replacing subordination with a mechanical volume- or value-based cap, which, like subordination, could reduce liquidity without regard to whether independent liquidity is actually available.

Question 46. Where an affiliate is the sole source of liquidity in a product and the affiliate's orders face no competing orders against which to be subordinated, whether the remaining conditions adequately protect customers or whether additional protections should apply.

ProphetX Response: The remaining conditions are adequate in this circumstance. Where there is no alternative liquidity in a product, affiliated market makers should be permitted to trade without additional restrictions, provided that this dynamic has emerged organically and not as a result of artificial constraints on independent participation. Markets in which an affiliate is the only liquidity provider will be common at the inception of new products and across the long tail of thinly traded contracts. Permitting the affiliate to provide liquidity in those markets is critical to product innovation and to allowing traders to take on deliberate exposures or establish risk-management positions that would otherwise be unavailable. Additional restrictions in this circumstance, such as a volume- or value-based cap,[16] would not redirect liquidity to independent participants, because none is present; they would simply leave customers without a counterparty.

The proviso, however, is essential, and it is where the Commission's attention should be focused. A sole-liquidity market presents the structural concern described in Part I when the affiliate's position is maintained by design rather than by circumstance, for example through access requirements, fees, incentive terms, connectivity or market-data arrangements, or other features of the venue that discourage independent liquidity providers from participating. The Commission

[16] *See* Proposal, Section III.B.v.3 (requesting comment on whether a volume- or value-based cap should be adopted, particularly where the affiliate is the sole source of liquidity).

should therefore make clear that a DCM whose affiliate is the sole source of liquidity in a product must ensure that the market remains genuinely open to independent liquidity providers on terms no less favorable than those available to the affiliate, consistent with the DCM's impartial access obligations and the incentive-parity requirement of proposed Regulation 38.852(b)(2), and should pair that obligation with the affirmative efforts described in ProphetX's response to Question 47.

Question 47. What other conditions the Commission could set to mitigate the potential conflicts present with an affiliate market maker trading on exchange while preserving the ability for exchanges to use affiliate market makers for bootstrapping purposes.

ProphetX Response: Rather than imposing additional restrictions on the trading activity of an affiliate market maker, the Commission could require a DCM that relies materially on an affiliate market maker to undertake reasonable efforts to attract unaffiliated market makers and liquidity providers. Building on the incentive-parity requirement of proposed Regulation 38.852(b)(2), such efforts could include offering market-making or liquidity-incentive programs on terms no less favorable than those available to the affiliate, conducting outreach to potential unaffiliated liquidity providers, and periodically assessing whether additional unaffiliated liquidity can reasonably be developed in the products in which the DCM relies on its affiliate. This approach would directly address the Commission's concern regarding prolonged dependence on affiliated liquidity[17] while preserving the affiliate market maker's ability to provide liquidity where independent firms are unwilling or unable to do so.

Such an obligation would also align the exchange's incentives with the Commission's objective. Unlike a volume cap or sunset provision, which would operate mechanically whether or not independent liquidity is in fact available, a reasonable-efforts obligation targets the conduct that distinguishes a venue using affiliated liquidity to bootstrap an open, two-sided market from a venue using it to foreclose one.

Question 48. Whether a capital-independence condition should be applied and, if so, how it can be implemented and verified where a common parent funds both the exchange and the affiliate. Is it possible for the DCM to determine whether the trading affiliate is independently funded? How would it do so? Is it possible for any trading affiliate to actually be financially independent from an affiliated exchange?

ProphetX Response: No. ProphetX supports the Commission's preliminary decision not to propose a capital-independence condition. The rise of vertically integrated structures among new market participants is not accidental. These structures go hand in hand with growth and innovation in markets where incumbents are unwilling or unable to adjust to emerging market demands, and a new venue and its affiliated liquidity provider will, in the ordinary course, be funded by the same founders and investors. As the Commission recognizes, a parent entity is likely to supply capital to both the DCM and the affiliate market maker.[18] Where that is the case, ProphetX does not believe a DCM could meaningfully determine that the trading affiliate is independently funded,

[17] *See* Proposal, Sections III.B.ii, III.B.v.3 (considering whether the exception should be time-limited or subject to a cap that tightens as unaffiliated liquidity develops).

[18] *See* Proposal, Section III.B.iii.

and it is doubtful that any trading affiliate funded by a common parent could be genuinely financially independent of its affiliated exchange. A capital-independence condition would therefore be either formalistic, satisfied by intercompany arrangements that do not change the economic reality that capital is fungible within a corporate group, or prohibitive, operating in practice as the flat prohibition the Commission has preliminarily declined to adopt and falling most heavily on new entrants.

Nor would such a condition address the conflict at its source. The conflicts the Commission has identified arise from the exchange's control over the terms on which participants trade, its access to non-public information, and its ultimate economic interest in the affiliate's trading results, none of which depends on the source of the affiliate's capital. Those conflicts are addressed directly by the Proposal's other conditions, including bona fide market-making obligations, incentive parity, information barriers, independent verification, and disclosure, together with the financial resources requirements of DCM Core Principle 21.

Question 51. How "independent" should be defined for the third-party RSP, and whether the framework in Commission Regulation 38.606 affords sufficient capacity for this function.

ProphetX Response: The Commission should ensure that the independent third-party RSP requirement does not create unnecessary capacity constraints or barriers to entry. ProphetX recommends that "independent" be defined by reference to objective criteria focused on the absence of conflicting interests, rather than by narrowing the categories of entities eligible to perform the function. Such criteria could include, for example, that the RSP is not under common control with, and has no material financial interest in, the DCM or the affiliate market maker; that its compensation is not contingent on the results of its reviews or certifications; and that it maintains safeguards preventing the use of information obtained in performing the RSP function for any other commercial purpose.

ProphetX does not believe that the existing Regulation 38.606 framework affords sufficient capacity for this function. Under that framework, an RSP must be a registered futures association or a registered entity, a pool that consists of NFA and other registered entities, many of which operate trading venues or clearinghouses that may compete with the DCM whose affiliate would be surveilled. Moreover, the function contemplated by proposed Regulation 38.852(c)(2), which combines financial surveillance of a principal trading firm that carries no customer funds, monitoring of an exchange's conflicts procedures, and data-intensive annual certification of order-priority subordination and market-making performance, differs substantially from the FCM-focused financial surveillance for which Regulation 38.606 was designed.[19] To support competition and innovation, the Commission should broaden the universe of entities qualified to perform these functions, subject to objective standards for independence, expertise, systems, and regulatory capability. A sufficiently competitive pool of qualified providers would reduce

[19] *See* Proposal, Section III.B.iii (noting that Regulation 38.604 is directed to a DCM's financial surveillance of member FCMs and the protection of customer funds, whereas an affiliate market maker trades for its own account and carries no customer funds).

concentration risk and help ensure that the cost of obtaining required regulatory services does not disproportionately impact the ability of newer or smaller DCMs to compete.

The stakes are significant. Although the Commission notes that it lacks direct cost estimates for the data-intensive certification process, Commission staff preliminarily expects annual costs of approximately $500,000 for implementation, $1 million for software, and $700,000 for cloud services; the Proposal separately contemplates fees for the RSP's financial-surveillance and conflicts-monitoring functions.[20] Costs of that magnitude may be readily absorbed by a large incumbent exchange, but for a newer or smaller DCM they could outweigh the benefits of affiliated market making altogether, effectively converting the Commission's conditioned exception into a prohibition for new entrants while leaving it available to the largest venues. The framework should therefore permit the scope and cost of RSP services to be calibrated to the size, complexity, trading activity, and risk presented by the relevant affiliate market maker.

Question 52. Whether the interruptive, affirmatively acknowledged per-trading-session notice in proposed Commission Regulation 38.852(c)(3) is warranted, or whether a lighter regime—public disclosure together with a one-time disclosure at account opening or before a customer first trades—would adequately protect customers at lower cost, and whether the two approaches should be combined.

ProphetX Response: ProphetX shares the Commission's view that customers should know when a venue's affiliate may be the counterparty to their trades, and it supports clear and prominent disclosure of affiliate market-making relationships. Even so, the interruptive, affirmatively acknowledged per-trading-session notice in proposed Regulation 38.852(c)(3) is an overly prescriptive requirement that may not be workable in practice. The Commission should instead permit a principles-based approach to the delivery of disclosure on an ongoing and continuous basis.

Several features of the proposed requirement would make it difficult to administer. The concept of a discrete trading "session" is not well defined for markets that may trade on an extended or near-continuous basis and that customers access predominantly through mobile applications. The requirement would also apply, through DCM rules, to intermediaries and to any other operator of an electronic interface through which customers enter orders, including the third-party technology providers through which customers increasingly access DCM-listed contracts,[21] even though, as the Commission acknowledges, a DCM can reach non-member interface operators only indirectly.[22] Most importantly, a notice that must be acknowledged before every session risks becoming a reflexive click-through. Customers presented repeatedly with the same interruptive notice are likely to dismiss it without reading it, diminishing rather than enhancing the salience of the information the Commission seeks to convey.

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[20] *See* Proposal, Section VII.C (Consideration of Costs and Benefits).

[21] *See* RFI Letter at 2–4 (describing the third-party technology service vendors that provide the front-end interfaces through which customers access sports event contracts listed on DCMs).

[22] *See* Proposal, Section III.B.iii (noting that a DCM can require delivery of the notice by its members through its rules but reaches non-member interface operators only indirectly).

A principles-based standard would better serve the Commission's objective and would combine the two approaches the Commission describes. Such a standard could require a DCM to disclose the affiliate relationship and the conditions imposed on the affiliate, including the applicable market-making and conflicts conditions, publicly and to each customer at account opening or before the customer's first trade, and to keep that disclosure continuously and conspicuously available at the point of trading (for example, through a persistent indicator identifying the products in which an affiliate market maker is active), while leaving the specific means of delivery to the DCM's reasonable discretion, subject to Commission review. ProphetX believes this approach would keep the affiliate relationship in front of customers at the moment it matters, as the Commission intends, more effectively and at lower cost than the highly prescriptive proposed notice.

Question 55. The Commission requests that DCMs on which an affiliate market maker trades, and any other market participant with relevant information describe:

i. **The number and identity of DCMs on which an affiliate currently trades for its own account, the products involved, and the affiliate's share of liquidity or volume in those products.**

ii. **The terms on which any such affiliate currently trades, including any market maker or liquidity provider agreement, quoting obligations, position limits, and the source of the affiliate's capital.**

iii. **The nature and estimated cost of modifying trade-matching systems to implement order-priority subordination.**

iv. **The nature and estimated cost of engaging an independent third-party RSP to perform the surveillance, monitoring, and certification required by proposed Commission Regulation 38.852(c)(2), including any market-capacity considerations. Please identify who are the most likely entities to perform this independent third-party RSP role. Would it most likely be NFA? Would other entities enter the market in this capacity?**

v. **The nature and estimated cost of implementing the per-trading-session disclosure across members and non-member order-entry interfaces, and of any lighter disclosure alternatives.**

vi. **The Commission requests comment on the time DCMs, SEFs and applicable affiliates would need to comply, and on whether the rule should provide a transition period for affiliate trading arrangements in existence on the effective date.**

ProphetX Response (Item iv): ProphetX refers the Commission to its response to Question 51. The cost of mandatory independent third-party oversight should be proportionate to the scope and risk of the activity being supervised. A fixed-cost model designed for a large or complex market participant could create a significant barrier to entry for smaller or developing venues—the very venues for which, as the Commission recognizes, affiliated liquidity matters most. With respect to the Commission's questions regarding the most likely providers, the existing eligibility framework would leave many DCMs with few practical alternatives to NFA, and reliance on a single principal

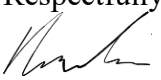
provider would concentrate the function, constrain capacity as additional DCMs require these services, and limit competitive pressure on cost and quality. Other qualified entities would be more likely to enter the market in this capacity if the Commission broadens eligibility as described in ProphetX's response to Question 51. The Commission should therefore preserve flexibility for RSP arrangements and fees to scale with the nature and volume of the activity subject to surveillance, and should encourage a sufficiently broad pool of qualified providers to promote competition in the provision of these services.

III. Conclusion

ProphetX again commends the Commission for undertaking this rulemaking and for the care with which it has approached the questions that affiliated market structures present. The distinction at the heart of the Proposal, between affiliated liquidity that supports genuine two-sided price formation and affiliated trading that displaces it, is sound, and the Commission's proposed framework takes important steps to preserve it. In finalizing the Proposal, ProphetX respectfully urges the Commission (i) to preserve the ability of new entrants to bootstrap liquidity by allowing affiliate market makers to operate under bona fide two-sided quoting obligations, neutral matching rules, incentive parity, and proportionate safeguards, while requiring exchanges that rely materially on affiliated liquidity to cultivate independent liquidity; and (ii) to ensure that mandated third-party services and other compliance obligations are proportionate and available from a competitive pool of qualified providers, so that the cost of compliance does not itself become a barrier to the fair competition the Proposal seeks to promote. ProphetX stands ready to work with the Commission and its staff as the Commission develops a final rule.

If there are any questions, or if ProphetX can provide additional information relating to the foregoing comments, please do not hesitate to contact the undersigned at dean.sisun@prophetexchange.com or Bruce Fekrat, Chief Legal Officer, at bruce.fekrat@prophetexchange.com.

Respectfully submitted,



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