

May 3, 2019

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Boston, MA 02110

*By Email and Hand Delivery*

Jay Clayton, Chairman  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20850

Robert J. Jackson, Jr., Commissioner  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20850

Hester M. Peirce, Commissioner  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20850

Elad L. Roisman, Commissioner  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20850

Re: Precidian ETFs Trust, et. al.; Notice of Application

Dear Chairman Clayton and Commissioners Jackson, Peirce and Roisman:

I am writing to address the recently noticed application by Precidian ETFs Trust and related parties to operate actively managed exchange-traded funds (“ETFs”) that, different from existing active ETFs, would not publicly disclose their portfolio holdings on a daily basis (“Precidian ETFs” or “Funds”).<sup>1</sup> While not requesting a hearing on the application, I seek to bring to your attention that the operation of the Precidian ETFs would violate Section 10(b) and Rule 10b-5 under the Securities Exchange Act of 1934 (the “1934 Act”).<sup>2</sup>

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<sup>1</sup> Precidian ETFs Trust, et. al., Notice of Application, Investment Company Act Release No. 33440 (April 8, 2019) (the “Notice”).

<sup>2</sup> The application referenced in the Notice does not seek exemptive relief pursuant to the Commission’s general exemptive authority under Section 36 of the 1934 Act from Section 10(b) or Rule 10b-5. Nor does the Notice itself discuss, or offer any analysis regarding, how the operation of the Precidian ETFs might otherwise comply with these provisions.

The application contemplates that Precidian ETFs would issue and redeem their shares in creation unit transactions with authorized participants (“APs”), primarily on an in-kind basis. For in-kind creation unit transactions, APs would purchase and sell the associated basket instruments by trading through broker-dealers acting on an agency basis (“AP Representatives”). The Funds would provide AP Representatives with daily disclosure of their current portfolio holdings, which constitutes material non-public information. Using the selectively disclosed portfolio holdings information, an AP Representative would, at the direction of its AP customer, execute trades (including shorting transactions) in the Fund’s basket instruments on behalf of the AP in connection with the AP’s purchases and redemptions of creation units of Fund shares.

The case law that has developed around Section 10(b) and Rule 10b-5 stands for the proposition that possession of material non-public information while trading in affected securities creates a presumption that the trading was in fact made on the basis of the information, and is thus illegal, even when done while a confidentiality agreement with the source of the information is in place.<sup>3</sup> Rule 10b5-1 under the 1934 Act goes even further, stating that such possession is in fact considered use of the information,<sup>4</sup> subject to a limited set of affirmative defenses (which, as a practical matter, cannot be exercised by the AP Representatives). In short, to comply with the law, a person in possession of material non-public information may not trade on the basis of that information.

Positions taken by the U.S. Securities and Exchange Commission (the “Commission”) have consistently supported this interpretation.

- In the adopting release to Regulation Fair Disclosure, the Commission noted: “If a person receives material nonpublic information subject to such a confidentiality agreement, the use or disclosure of the information for securities trading purposes will lead to insider trading liability under Rule 10b-5.”<sup>5</sup>
- In a corresponding Investment Company Release addressing the selective disclosure of material nonpublic information by open-end funds, the Commission noted that “[d]ivulging nonpublic portfolio holdings to selected third parties is permissible only when the fund has legitimate business purposes for doing so and the recipients are subject to a duty of confidentiality, including a duty not to trade on the nonpublic information.”<sup>6</sup>

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<sup>3</sup> See *SEC v. Adler*, 137 F.3d 1325, 1337 (11th Cir. 1998) (“[W]hen an insider trades while in possession of material, nonpublic information, a strong inference arises that such information was used by the insider in trading.”).

<sup>4</sup> See Exchange Act Rule 10b5-1(b), 17 CFR § 240.10b5-1(b) (“[A] purchase or sale of a security of an issuer is ‘on the basis of’ material non-public information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale.”).

<sup>5</sup> Final Rule, Selective Disclosure and Insider Trading, Securities Act Rel. No. 33-7881, 64 Fed. Reg. 72590, 72595 at n. 38 (August 15, 2000).

<sup>6</sup> Investment Company Act Release No. 26287 (Dec. 1, 2003), 68 FR 70402 (Dec. 17, 2003).

- Even in the Precidian Notice itself, the Commission reiterates that “[t]he federal securities laws and an investment adviser’s fiduciary duties permit the disclosure of an ETF’s nonpublic portfolio information to selected third parties only when the ETF has legitimate business purposes for doing so and the recipients are subject to a duty of confidentiality, including a duty not to trade on the nonpublic information.”<sup>7</sup>

The proposed operation of the Precidian ETFs provides that AP Representatives would buy and sell the securities held in a Fund’s portfolio (and shorting transactions thereof) on behalf of their AP customers in connection with the APs’ purchases and redemptions of creation units of Fund shares. When an AP wants to purchase one or more creation units, it will instruct its AP Representative to buy the underlying securities held by the Precidian ETF on its behalf. When an AP wants to redeem creation units, it will instruct its AP Representative to sell the underlying Fund securities on its behalf. In each of these transactions, the AP Representative would trade in the underlying Fund securities while in possession of – and based on – material non-public information. While Section 10(b) and Rule 10b-5 might ordinarily be thought to apply to an issuer’s securities (i.e., the Fund’s shares), in the case of a pooled investment vehicle, it must also apply to the trading of the pooled vehicle’s underlying holdings. If not, Section 10(b) and Rule 10b-5 would have little meaning when applied to registered investment companies, which is clearly not the intent of the Commission.<sup>8</sup>

Section 10(b) and Rule 10b-5 do not provide an express exemption for agents, applicable here to the extent an AP Representative is treated as an agent for its AP customer. Accordingly, an AP Representative would violate Section 10(b) and Rule 10b-5 whenever it trades in a Fund’s underlying holdings. Commission approval of the Precidian ETFs would not cleanse that violation, because the order issued in connection with the Notice would not include an exemption from Section 10(b) and Rule 10b-5.

Further, the APs themselves would also fall under the Section 10(b) and Rule 10b-5 prohibitions. Under the proposal, APs would have an ongoing ability to trade (including shorting transactions for hedging purposes), through their AP Representatives, in a Fund’s underlying holdings using the selectively disclosed portfolio holdings information. But for its ability to trade on the basis of material non-public information held by its AP Representative, an AP would be unable to effect the in-kind creation and redemption transactions that are an essential component of the AP’s profitable arbitrage trading. While APs would be able to effect trades in a Fund’s underlying securities on the basis on material non-public information, other market participants could not.

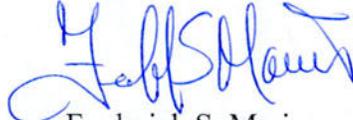
I believe this disparate treatment is antithetical to the protections outlined in the case law and Commission positions interpreting Section 10(b) and Rule 10b-5 as applied to the trading on the basis of material non-public information. Accordingly, I respectfully ask that you reconsider whether it is appropriate and in the public interest to issue an order approving an exemptive application that would authorize the operation of ETFs that violate the federal securities laws.

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<sup>7</sup> See Notice at footnote 36.

<sup>8</sup> See *supra* footnote 6 and accompanying text.

Very truly yours,



Frederick S. Marius  
Chief Legal Officer

cc: Dalia Blass, Director, Division of Investment