

# Morgan Lewis

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Partner



May 5, 2019

The Honorable Jay Clayton  
Chairman  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549

Re: Precidian ETFs Trust, et al.; Investment Company Act Rel. No. 33440 (April 8, 2019)

Dear Chairman Clayton:

On behalf of our client, Precidian Funds LLC ("Precidian"), we are responding to a letter from Eaton Vance to the Commission (the "Letter"), dated May 3, 2019, regarding the recently published Notice of Application cited above ("Notice"). In the Letter, Eaton Vance argues that the ActiveShares structure would violate Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder. As the Commission is aware, this is not an issue of first impression, and we believe this issue was fully considered by the Commission and its staff prior to the issuance of the Notice. Eaton Vance should itself be aware that this issue was raised, as the company participated in the drafting of two different letters from Gary Gastineau to the Commission, dated March 10, 2016 and May 24, 2017, respectively, that specifically raised this issue (see File Nos. SR-NYSEArca-2016-08 and SR-NYSEArca-2017-36). We believe that the arguments made by Eaton Vance are misguided and both legally and factually incorrect.

The Letter does not accurately describe the ActiveShares structure. The Letter indicates that "trading" will be carried out through the confidential account overseen by the AP Representative, which is not the case. As stated in footnote 22 of Precidian's application, "the AP Representative will not trade securities in the confidential account on behalf of an Authorized Participant other than buying or selling the securities included in a Creation Basket to be delivered to or received from, respectively, an ETF." Contrary to statements made in the Eaton Vance Letter, Authorized Participants have no ongoing ability to trade in a Fund's underlying holdings, including for hedging purposes. In short, the Letter provides an incorrect factual basis for its arguments. The purchases and sales made by the AP Representative through the confidential account for an Authorized Participant will

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occur solely in connection with execution of an Authorized Participant's creation or redemption order.

Eaton Vance suggests that execution of an order by a broker-dealer for a customer would constitute insider trading because the composition of the order itself would be material non-public information. The composition of the creation basket and the redemption basket provided by an ActiveShares ETF to an AP Representative would be non-public information and may be material, but use of that information by the AP Representative in facilitation of an in-kind creation order or in-kind redemption order is clearly lawful and consistent with ordinary brokerage practice. As the Commission knows from its consideration of Precidian's request for exemptive relief, the non-public basket information received by an AP Representative under the ActiveShares structure would, and may only, be used for purposes of executing purchases and sales of portfolio securities in connection with creations and redemptions orders submitted by an Authorized Participant. Section 10(b) and Rule 10b-5 do not prohibit a broker from using material non-public information received in connection with a customer order from executing the order; instead, those provisions prohibit a broker from using the information for its own benefit, such as by trading ahead of the order for the broker's proprietary account or recommending to other customers that they sell ahead of the order.<sup>1</sup> In order to protect against such misuse, Section 15(g) of the Exchange Act requires broker-dealers to establish policies and procedures to prevent disclosure to others of material non-public information of which they come into possession as part of their business of receiving and executing customer orders and advising institutional customers.<sup>2</sup> These requirements are satisfied by the ActiveShares structure. The AP Representative receives material non-public information through the disclosure of the creation basket and the redemption basket and is allowed to execute that order for the benefit of its customer, the Authorized Participant, but must have policies and procedures in place to ensure that neither the AP Representative nor the Authorized Participant can misuse the material non-public information, such as by trading ahead of the order.

Similarly, execution by a broker-dealer of an order containing material non-public information in this context does not meet the definition of "insider trading." As noted by the SEC on its website, "illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, non-public information about the security." In the case of the AP Representative, execution of the purchase order or sale order is not a misuse of the material non-public information because the AP Representative is not breaching a

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<sup>1</sup> SEC Staff Summary Report on Examinations of Information Barriers (Sept. 27, 2012) (Noting that broker-dealers receive confidential information from institutional investors through taking orders for execution in the secondary markets which would not be captured by the staff's review of insider trading).

<sup>2</sup> ABA, Keeping Current: SEC Charges Broker-Dealer for Failure to Protect Against Insider Trading by Employees (June 29, 2017).

fiduciary duty or other relationship of trust and confidence. The AP Representative has an agreement with the issuer under which it is required to purchase and sell these baskets on behalf of the Authorized Participant, but without disclosing identity of the securities to the Authorized Participant. The AP Representative is acting consistently with its agreement with the issuer (as well as its agreement with the Authorized Participant customer) by executing the orders in a non-transparent manner. Insider trading would be a concern if the AP Representative were using the basket information for its proprietary trading desk to front-run the execution of the purchase of the creation basket or sale of the redemption basket. That concern is not present under the structure approved in the Notice, which expressly requires that the AP Representative have robust policies and procedures in place to prevent just such misuse of the portfolio holdings information.

The creation and redemption process used by the ActiveShares ETFs not only complies with the requirements of Section 10(b) and Rule 10b-5, but it is also consistent with Rule 10b5-1(c) which recognizes that a person will not be liable for insider trading when it is clear that the person did not use material non-public information in making his or her decision to trade. Execution by an AP Representative of an order from an Authorized Participant to purchase a creation basket or sell a redemption basket does not involve an investment decision by the AP Representative. The investment decision to purchase or redeem a creation basket is made by the Authorized Participant, an entity that does not have access to the non-public basket information. Thus, the material non-public information at issue is not a factor in the investment decision.

Even if the material non-public information known by the AP Representative were to be attributed to the Authorized Participant, as the Letter suggests it might be, the ActiveShares creation and redemption process would qualify for an affirmative defense under Rule 10b5-1(c)(i). Rule 10b5-1 generally provides a defense to insider trading to a person who trades a security at a time when the person is aware of material non-public information if the person enters into a binding contract to trade the security prior to coming into possession of material non-public information. As contemplated by the rule, the Authorized Participant enters into a binding contract to purchase or sell the basket of securities at a time when the Authorized Participant is not aware of material non-public information. In connection with becoming an Authorized Participant, a firm must agree to submit creation and redemption orders without knowing the identity of the basket and, in connection with those orders, to direct the AP Representative to purchase the creation basket or sell the redemption basket (whatever the identity of the basket may be), without the exercise of discretion by the Authorized Participant or the AP Representative. As provided in Rule 10b5-1, the Authorized Participant provides in its order (without knowing the composition of the ETF basket) directions that specify the amount of securities to be purchased or sold (*i.e.*, an amount equal to the net asset value of the creation unit) and the price at which and the date on which the securities were to be purchased or sold (*i.e.*, execution instructions, such as execution at the closing price or at the volume weighted price). The date on which the basket securities are purchased and sold is fixed by the AP Agreement as the date on which the orders are accepted by the

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ActiveShares ETF. Finally, as required by Rule 10b5-1(c), the AP Representative is required to effect the purchases or sales pursuant to the Authorized Participant's binding order and the execution instructions.<sup>3</sup> As a result, even if the basket information known by the AP Representative were attributed to the Authorized Participant, the ActiveShares creation and redemption process would not be insider trading pursuant to the affirmative defense under Rule 10b5-1.

The ActiveShares structure contemplates an information flow that is similar to that embodied in the processes used today by U.S. mutual funds to carry out in-kind redemptions, consistent with SEC regulation and guidance. Mutual fund boards often adopt procedures that allow a fund to deliver portfolio securities instead of cash to redeeming shareholders when doing so is in the best interests of the fund and its other shareholders. In connection with those redemptions, the fund will typically discuss with the redeeming shareholder the securities that are intended to be distributed in-kind. Upon receipt of the redemption securities, the investor may elect to sell the securities into the market. Eaton Vance's own mutual funds follow this practice, as described in the funds' prospectus and SAIs.<sup>4</sup>

For all of the reasons stated above, we believe that the assertions made by Eaton Vance in the Letter should not preclude or delay the Commission from approving the requested exemptive order. In light of the above, Precidian asks the Commission to grant the requested order on Monday May 6, 2019. Please contact me at [REDACTED], or Barry Barbash, at [REDACTED], or Georgia Bullitt, at [REDACTED], of Willkie Farr & Gallagher, if you have any questions regarding this letter.

Sincerely,



W. John McGuire

cc: Robert J. Jackson Jr., Commissioner  
Hester M. Peirce, Commissioner  
Elad L. Roisman, Commissioner

Dalia Blass, Director, Division of Investment Management  
Barry P. Barbash, Willkie Farr & Gallagher LLP  
P. Georgia Bullitt, Willkie Farr & Gallagher LLP

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<sup>3</sup> Selective Disclosure and Insider Trading, Investment Company Act Rel. No. 24599 (August 15, 2000) ("taken as a whole, the revised defense is designed to cover situation in which a person can demonstrate that the material non-public information was not a factor in the trading decision.")

<sup>4</sup> See <https://funds.eatonvance.com/includes/loadDocument.php?fn=480.pdf&dt=fundspdfs%27> at p. 48 and <https://funds.eatonvance.com/includes/loadDocument.php?fn=13211.pdf&dt=fundpdfs %27> at 27.