

Underlying Index).<sup>4</sup> The representative sampling techniques that will be used by the Advisor to manage the New Funds do not differ from the representative sampling techniques it uses to manage the Funds that were the subject of the Commission's June 25, 2002 order under the 1940 Act relating to other series of the iShares Trust indexes of fixed income securities.<sup>5</sup>

When using a representative sampling strategy, the Advisor attempts to match the risk and return characteristics of a New Fund's portfolio to the risk and return characteristics of the Underlying Index. As part of this process, the Advisor subdivides each Underlying Index into smaller, more homogeneous pieces. These subdivisions are sometimes referred to as "cells." A cell will contain securities with similar characteristics. For fixed income indices, the Advisor generally divides the index according to the five parameters that determine a bond's risk and expected return: (1) Duration, (2) sector, (3) credit rating, (4) coupon, and (5) the presence of embedded options. When completed, all bonds in the index will have been assigned a cell. The Advisor then begins to construct the portfolio by selecting representative bonds from these cells. The representative sample of bonds chosen from each cell is designed to closely correlate to the duration, sector, credit rating, coupon, and embedded option characteristics of each cell. The characteristics of each cell when combined are, in turn, designed to closely correlate to the duration, sector, credit rating, coupon, and embedded option characteristics of the Underlying

Index as a whole. The Advisor may exclude less liquid bonds in order to create a more tradable portfolio and improve arbitrage opportunities.

According to the Original Application, the representative sampling techniques used by the Advisor to manage fixed income funds do not materially differ from the representative sampling techniques it uses to manage equity funds. Due to the differences between bonds and equities, the Advisor analyzes different information—such as dividend payments instead of coupon rates, for example.

According to the Original Application, the New Funds' use of the representative sampling strategy is beneficial for a number of reasons. First, the Advisor can avoid bonds that are "expensive names" (*i.e.*, bonds that trade at perceived higher prices or lower yields because they are in short supply) but have the same essential risk, value, duration and other characteristics as less expensive names. Second, the use of representative sampling techniques permits the Advisor to exclude bonds that it believes will soon be deleted from the Underlying Index. Third, the Advisor can avoid holding bonds it deems less liquid than other bonds with similar characteristics. Fourth, the Advisor can develop a basket that is easier to construct and cheaper to trade, thereby potentially improving arbitrage opportunities.

From time to time, adjustments may be made in the portfolio of each New Fund in accordance with changes in the composition of the Underlying Index or to maintain RIC compliance. For example, if at the end of a calendar quarter a New Fund would not comply with the RIC diversification tests, the Advisor would make adjustments to the portfolio to ensure continued RIC status. The Exchange represents that the Advisor expects that each New Fund will have a tracking error relative to the performance of its respective Underlying Index of no more than five percent (5%).<sup>6</sup> Each New Fund's investment objectives, policies and investment strategies will be fully disclosed in its Prospectus and Statement of Additional Information. Each New Fund (except the iShares Lehman U.S. Aggregate Bond Fund) will invest at least 90% of its assets in Component Securities of its respective Underlying Index. Each of these New

Funds may also invest up to 10% of its assets in bonds not included in its Underlying Index, but which the Advisor believes will help the New Fund track its Underlying Index, as well as in certain futures, options and swap contracts, cash and cash equivalents. For example, these New Funds may invest in securities not included in the relevant Underlying Index in order to reflect prospective changes in the relevant Underlying Index (such as future corporate actions and index reconstitutions, additions and deletions).

According to the Application, with respect to the iShares Lehman U.S. Aggregate Bond Fund (the "Lehman Aggregate Fund"), additional portfolio flexibility would benefit the Fund, while at the same time permitting it to closely track the performance of its Underlying Index. The Lehman Aggregate Fund will: (i) seek to track the performance of that portion of its Underlying Index comprised of U.S. Treasury securities, U.S. agency securities, corporate bonds, non-corporate bonds (*e.g.*, bonds issued by supra-national entities such as the International Monetary Fund), asset-backed securities, and commercial mortgage-backed securities (approximately 65% of the Underlying Index as of April 30, 2003) by investing a corresponding percentage of its net assets (*i.e.*, approximately 65%) in the Component Securities of its Underlying Index;<sup>7</sup> and (ii) seek to track the performance of that portion of its Underlying Index invested in U.S. agency mortgage pass-through securities (approximately 35% of the Underlying Index as of April 30, 2003) by investing a corresponding percentage of its net assets (*i.e.*, approximately 35%) through TBA transactions (as defined below) on U.S. agency mortgage pass-through securities. Through the Lehman Aggregate Fund's direct investments in Component Securities of its Underlying Index and its investments in mortgage pass-through securities through TBA transactions as described above, the Lehman Aggregate Fund will have at least 90% of its net assets invested (i) in Component Securities of its Underlying Index and (ii) in investments that have economic characteristics that are substantially identical to the economic characteristics of the Component

<sup>4</sup> The Trust, Advisor and Distributor ("Applicants") have filed with the Commission an Application for an Amended Order ("Application") under Sections 6(c) and 17(b) of the 1940 Act for the purpose of exempting the New Funds of the Trust from various provisions of the 1940 Act. (File No. 812-13003). A notice of the Application was issued in Investment Company Act Release No. 26151, August 15, 2003. The information provided in this Rule 19b-4 filing related to the New Funds is based on information included in the Application, which includes additional information regarding the Trust and the New Funds. The initial Application for additional series of the iShares Trust based on indexes of fixed income securities (File No 812-12390) is referred to herein as the "Original Application." The Original Application was approved in Investment Company Act Release No. 25622, June 25, 2002 ("Order"). See also, the Previous Approval Order, *supra* note 3, for additional information relating to series of the iShares Trust, as described in the Original Application.

<sup>5</sup> See *In the Matter of iShares Trust, et al.*, Investment Company Act Release No. 25622 (June 25, 2002) (relating to the iShares 1-3 Year Treasury Index Fund, 7-10 Year Treasury Index Fund, 20+ Year Treasury Index Fund, Treasury Index Fund, Government/Credit Index Fund, Lehman Corporate Bond Fund and GSS InvesTop Corporate Bond Fund).

<sup>6</sup> Telephone call among Mike Cavalier, Associate General Counsel, Amex; Marc McKayle, Special Counsel, Division of Market Regulation ("Division"), Commission; and Jennifer Lewis, Special Counsel, Division, Commission, on August 20, 2003.

<sup>7</sup> With respect to this portion of its portfolio, the Lehman Aggregate Fund may invest up to 10% of its portfolio in bonds not included in its Underlying Index, but which the Adviser believes will help the Lehman Aggregate Fund track its Underlying Index, as well as in certain futures, options and swap contracts, cash and cash equivalents.