

Securities of its Underlying Index (*i.e.*, TBA transactions).

According to the Application, the Lehman Aggregate Fund needs the investment flexibility to engage in TBA transactions as described above primarily because approximately 35% of the securities in the Lehman Aggregate Fund's Underlying Index are expected to be pools of U.S. agency mortgage pass-through securities.⁸ As discussed below, it is easier to trade and obtain intra-day prices of TBAs than it is to trade and obtain intra-day prices of specific pools of mortgage pass-through securities. The readily available information about intra-day pricing of TBAs and the ease with which they can be traded should make it easier to create and redeem Creation Unit Aggregations and help maintain the efficiency of the Fund's arbitrage mechanism.

The Application states that, although the market for mortgage pass-through securities is extremely deep and liquid, it is impractical to trade mortgage pass-through securities on a pool-by-pool basis, particularly when large dollar amounts are involved. For this reason, the vast majority of mortgage pools are traded using "to-be-announced" or "TBA transactions." A "TBA transaction" essentially is a purchase or sale of a pass-through security for future settlement at an agreed upon date.⁹ It

has been estimated that 90% of mortgage pass-through securities (as measured by total dollar volume) are executed as TBA trades.¹⁰ TBA transactions increase the liquidity and pricing efficiency of transactions in mortgage pass-through securities since they permit similar mortgage pass-through securities to be traded interchangeably pursuant to commonly observed settlement and delivery requirements.

The Lehman Aggregate Fund intends to use TBA transactions to acquire and maintain exposure to that portion of the Lehman U.S. Aggregate Index comprised of pools of mortgage pass-through securities in either of two ways. First, and more commonly, the Lehman Aggregate Fund will enter into TBA agreements and "roll over" such agreements prior to the settlement date stipulated in such agreements. This type of TBA transaction is commonly known as a "TBA roll." In a "TBA roll" the Lehman Aggregate Fund generally will sell the obligation to purchase the pools stipulated in the TBA agreement prior to the stipulated settlement date and will enter into a new TBA agreement for future delivery of pools of mortgage pass-through securities. Second, and less frequently, the Lehman Aggregate Fund will enter into TBA agreements and settle such transactions on the stipulated settlement date by actual receipt or delivery of the pools of mortgage pass-through securities stipulated in the TBA agreement. Since intra-day prices of TBA agreements are more readily available than intra-day prices on specific mortgage pools and because mortgage pools tend to be less liquid than TBA agreements, the use of TBA agreements should help maintain the efficiency of the Fund's arbitrage mechanism. The Lehman Aggregate Fund will accept actual delivery of mortgage pools only when the Adviser believes it is in the best interests of the Lehman Aggregate Fund and its shareholders to do so. In determining whether to accept actual delivery of mortgage pools, the Adviser will consider, among other things, the potential impact of such acceptance on the efficiency of the Lehman Aggregate Fund's arbitrage mechanism and the

Lehman Aggregate Fund's ability to track its Underlying Index. For these reasons, the Adviser believes that the ability to invest a significant portion of the Lehman Aggregate Fund's assets through TBA transactions and to maintain such exposure through the use of TBA rolls would increase the liquidity and pricing efficiency of the Lehman Aggregate Fund's portfolio. In addition, since holding a TBA position exposes the holder to substantially identical market and economic risks as holding a position in a corresponding pool of mortgage pass-through securities, the Adviser believes that the use of TBA transactions as described herein should permit the Lehman Aggregate Fund to closely track the performance of its Underlying Index.

The use of TBA transactions is not intended to help the Lehman Aggregate Fund outperform its Underlying Index, but rather to increase pricing efficiency while at the same time maintaining the Lehman Aggregate Fund's exposure to its Underlying Index.¹¹

b. Issuance of Creation Unit Aggregations

The issuance of Creation Unit Aggregations will operate, except as noted below, in a manner identical to that of the Funds described in the Previous Approval Order, and in the Original Application. The only difference between the creation process for the New Funds and that of the Funds that are the subject of the Order involves the Lehman Aggregate Fund (discussed below).

1. *In General.* Shares of each New Fund (the "iShares") will be issued on a continuous offering basis in groups of 50,000 or more. These "groups" of shares are called "Creation Unit Aggregations." The New Funds will issue and redeem iShares only in Creation Unit Aggregations.¹² As with other open-end investment companies, iShares will be issued at the net asset value ("NAV") per share next determined after an order in proper form is received. The anticipated price at which the iShares will initially trade is approximately \$100.

The NAV per share of each New Fund is determined as of the close of the regular trading session on the Amex on each day that the Amex is open. The Trust sells Creation Unit Aggregations of

⁸ As used herein, the term "U.S. agency mortgage pass-through security" or "mortgage pass-through security" refers to a category of pass-through securities backed by pools of mortgages and issued by one of several U.S. Government-sponsored enterprises: the Government National Mortgage Association ("GNMA"), Federal National Mortgage Association ("FNMA") or Federal Home Loan Mortgage Corporation ("FHLMC"). In the basic pass-through structure, mortgages with similar issuer, term and coupon characteristics are collected and aggregated into a pool. The pool is assigned a CUSIP number and undivided interests in the pool are traded and sold as pass-through securities. The holder of the security is entitled to a *pro rata* share of principal and interest payments (including unscheduled prepayments) from the pool of mortgage loans. The portion of the Lehman U.S. Aggregate Index representing the mortgage pass-through segment of the U.S. investment grade bond market is comprised of multiple pools of mortgage pass-through securities.

⁹ "TBA" refers to a mechanism for the forward settlement of agency mortgage pass-through securities, and not to a separate type of mortgage-backed security. TBA trades generally are conducted in accordance with widely-accepted "Good Delivery" guidelines published by The Bond Market Association. The Good Delivery guidelines facilitate transactions in mortgage pass-through securities by establishing commonly observed terms and conditions for execution, settlement and delivery. In a TBA trade, the buyer and seller decide on general trade parameters, such as agency, coupon, term to maturity, settlement date, par amount, and price. The actual pools delivered are determined two days prior to settlement date. TBA transactions promote efficient pricing because the Good Delivery guidelines permit only a small variance between the face amount of the pools

actually delivered and the nominal agreed upon amount. Intra-day and end-of-day pricing of TBAs is available from multiple pricing sources, such as Bloomberg and Tradeweb. The Bond Market Association publishes standard notification and settlement dates for TBA trades specifying uniform settlement dates for specific classes of securities. The most active trading market for TBA trades is usually for next-month settlement. *See generally* TBAs: *To-Be-Announced Mortgage Securities Transactions*, The Bond Market Association (1999).

¹⁰ *Id.* at 3.

¹¹ Telephone call between Mike Cavalier, Associate General Counsel, Amex; and Florence Harmon, Senior Special Counsel, Division, Commission, on August 22, 2003.

¹² Generally, each Creation Unit Aggregation will consist of 50,000 or more iShares and the estimated initial value per Creation Unit Aggregation will be approximately \$5 million.