

each New Fund only on business days at the next determined NAV of each New Fund.

Creation Unit Aggregations will be issued by each Fund in exchange for the in-kind deposit of a portfolio securities designated by the Advisor to correspond generally to the price and yield performance of the New Fund's Underlying Index (the "Deposit Securities"). Purchasers will generally be required to deposit a specified cash payment in the manner more fully described in the Application. Creation Unit Aggregations will be redeemed by each New Fund in exchange for portfolio securities of the New Fund ("Fund Securities") and a specified cash payment in the manner more fully described herein. Fund Securities received on redemption may not be identical to Deposit Securities deposited in connection with creations of Creation Unit Aggregations for the same day.

The Distributor will act on an agency basis and will be the Trust's principal underwriter for the iShares in Creation Unit Aggregations of each New Fund. All orders to purchase iShares in Creation Unit Aggregations must be placed with the Distributor by or through an authorized participant ("Authorized Participant"). Authorized Participants, which are required to be Depository Trust Company ("DTC") participants, must enter into a participant agreement with the Distributor. The Distributor will transmit such orders to the applicable New Fund and furnish to those placing orders confirmation that the orders have been accepted. The Distributor may reject any order that is not submitted in proper form. The Distributor will be responsible for delivering the prospectus to those persons creating iShares in Creation Unit Aggregations and for maintaining records of both the orders placed with it and the confirmations of acceptance furnished by it. In addition, the Distributor will maintain a record of the instructions given to the Trust to implement the delivery of iShares.

2. In-Kind Deposit of Portfolio Securities. Payment for Creation Unit Aggregations placed through the Distributor will be made by the purchasers generally by an in-kind deposit with the New Fund of the Deposit Securities together with an amount of cash (the "Balancing Amount") specified by the Advisor in the manner described below. The Balancing Amount is an amount equal to the difference between (1) the NAV (per Creation Unit Aggregation) of the New Fund and (2) the total aggregate market value (per Creation Unit

Aggregation) of the Deposit Securities (such value referred to herein as the "Deposit Amount"). The Balancing Amount serves the function of compensating for differences, if any, between the NAV per Creation Unit Aggregation and that of the Deposit Amount. The deposit of the requisite Deposit Securities and the Balancing Amount are collectively referred to herein as a "Portfolio Deposit."

The Advisor will make available to the market through the National Securities Clearing Corporation (the "NSCC") on each Business Day, prior to the opening of trading on the Amex (currently 9:30 a.m. eastern time), the list of the names and the required number of shares of each Deposit Security included in the current Portfolio Deposit (based on information at the end of the previous Business Day) for the relevant New Fund. The Portfolio Deposit will be applicable to a New Fund (subject to any adjustments to the Balancing Amount, as described below) in order to effect purchases of Creation Unit Aggregations of the New Fund until such time as the next-announced Portfolio Deposit composition is made available.

The identity and number of shares of the Deposit Securities required for the Portfolio Deposit for each New Fund will change from time to time. The composition of the Deposit Securities may change in response to adjustments to the weighting or composition of the Component Securities in the relevant Underlying Index. These adjustments will reflect changes, known to the Advisor to be in effect by the time of determination of the Deposit Securities, in the composition of the Underlying Index being tracked by the relevant New Fund, or resulting from rebalance or additions or deletions to the relevant Underlying Index. In addition, the Trust reserves the right with respect to each New Fund to permit or require the substitution of an amount of cash (*i.e.*, a "cash in lieu" amount) to be added to the Balancing Amount to replace any Deposit Security: (1) that may be unavailable or not available in sufficient quantity for delivery to the Trust upon the purchase of iShares in Creation Unit Aggregations, or (2) that may not be eligible for trading by an Authorized Participant or the investor on whose behalf the Authorized Participant is acting.

The Lehman Aggregate Fund may invest in and hold mortgage pass-through securities on a TBA basis. Since a TBA transaction is essentially an agreement for future settlement of a mortgage security, it is not possible to accept TBAs as part of the Portfolio

Deposit. Instead, the Fund will designate the mortgage pass-through TBAs to be included in a Portfolio Deposit just as it would any other Deposit Securities of a Portfolio Deposit, and will accept "cash in lieu" of delivery of the designated mortgage pass-through TBAs. The Lehman Aggregate Fund will then enter into TBA agreements included as Deposit Securities in the Portfolio Deposit.¹³ According to the Application, this will substantially minimize the Lehman Aggregate Fund's transaction costs, enhance operational efficiencies and otherwise reduce any operational issues which the acceptance of pools of mortgage pass-through securities might otherwise present.¹⁴

c. Availability of Information Regarding iShares and Underlying Indices

On each Business Day, the list of names and amount of each treasury security, government security or corporate bond constituting the current Deposit Securities of the Portfolio

¹³ Prior to settlement of such TBA transactions, the "cash in lieu" portion of the Portfolio Deposit will be invested in cash equivalents, including money market mutual funds, and such investments, along with cash and other liquid assets identified by BGFA, will be segregated on the books and records of the Fund or its Custodian in accordance with section 18 of the 1940 Act and Investment Company Act Release 10666. Since the price of a TBA transaction includes an assumed rate of return on the cash held in anticipation of settlement, the Fund's investment in cash equivalents prior to settlement is not expected to have a material impact on potential tracking error or the Fund's ability to track its Underlying Index. In addition, since the interest or dividends that the Fund accrues on a daily basis on its investment in cash equivalents will be relatively small and will be included as part of the Cash Component published on a daily basis according to the procedures currently used for the Index Funds, Applicants expect that such dividends and interest will be reflected in the secondary market trading price of iShares of the Fund. The Commission's June 25, 2002 order relating to fixed income funds of the iShares Trust (Investment Company Act Release No. 45622) permits acceptance of a "cash-in lieu" amount to replace Deposit Securities that are unavailable for delivery or for other reasons. In addition, prior iShares orders expressly permit "cash-only purchases of Creation Unit Aggregations" where the Adviser believes such transactions would "substantially minimize * * * transactional costs or would enhance * * * operational efficiencies." See Investment Company Act Release No. 24452 (May 12, 2000).

¹⁴ Intra-day and end-of-day pricing of TBAs is available from multiple pricing sources, such as Bloomberg and Tradeweb. In addition, the fungible nature of TBAs and commonly observed execution and settlement procedures create significant pricing efficiencies and market liquidity for TBAs. TBAs typically trade at very narrow spreads on transactions of up to \$300 million or more. Since intra-day pricing of TBAs is readily available and the market for mortgage pass-through TBAs is extremely liquid, the designation of TBAs in the Portfolio Deposit and their inclusion as Fund Securities should make pricing of the Fund and the Deposit Amount more efficient and transparent, thus increasing arbitrage efficiency.