

substantially identical market and economic risks as holding a position in a corresponding pool of mortgage pass-through securities, the Advisor believes that the use of TBA transactions as described herein should permit the Aggregate Bond Fund to closely track the performance of its Underlying Index.

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

*b. Issuance of Creation Unit Aggregations.*

1. *In General.* The issuance of Creation Unit Aggregations will operate, except as noted below, in a manner identical to that of the ETFs described in the Original Application.<sup>15</sup> Shares of each ETF (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 ETFs will issue and redeem iShares only in Creation Unit Aggregations.<sup>16</sup> 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 both Funds will initially trade on the NYSE is approximately \$100. The NYSE represents that the Aggregate Bond Fund is currently trading at \$100.82 on the Amex as of December 3, 2003.<sup>17</sup>

The NAV per share of each ETF is determined as of the close of the regular trading session on the NYSE on each day that the NYSE is open. The Trust sells Creation Unit Aggregations of each ETF only on business days at the next determined NAV of each ETF.

Creation Unit Aggregations will be issued by each ETF in exchange for the in-kind deposit of portfolio securities designated by the Advisor to correspond generally to the price and yield performance of the ETF'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 ETF in exchange for portfolio securities of the applicable ETF (the "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 ETF. All orders to purchase iShares in Creation Unit Aggregations must be placed with the Distributor by or through an authorized participant (the "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 ETF 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 ETF 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 ETF 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 Exchange (currently 9:30 a.m. eastern time), the list of the names and the required number of shares of each Deposit Security in the current Portfolio Deposit (based on information at the end of the previous Business Day) for the relevant Fund. The Portfolio Deposit will be applicable to an ETF (subject to any adjustments to the Balancing Amount, as described below) in order to effect purchases of Creation Unit Aggregations of the ETF 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 ETF 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 ETF, or resulting from rebalance or additions or deletions to the relevant Underlying Index. In addition, the Trust reserves the right with respect to each ETF 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 Aggregate Bond 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 Aggregate Bond 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 Aggregate Bond Fund will then enter into TBA agreements included as Deposit Securities in the Portfolio Deposit.<sup>18</sup>

<sup>18</sup> Prior to settlement of such TBA transactions, the "cash in lieu" portion of the Portfolio Deposit

<sup>15</sup> See Investment Company Act Release No. 25622 (June 25, 2002). Telephone conversation between Janet Kissane, Milbank, Tweed, Hadley & McCloy LLP, Counsel for NYSE, and Florence Harmon, Senior Special Counsel, Division, Commission dated December 2, 2003.

<sup>16</sup> 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.

<sup>17</sup> Telephone conversation between Janet Kissane, Milbank, Tweed, Hadley & McCloy LLP, Counsel for NYSE, and Florence Harmon, Senior Special Counsel, Division, Commission dated December 4, 2003.