SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–48662; File No. SR–PCX–2003–41]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto by the Pacific Exchange, Inc. To Trade, Either by Listing or Pursuant to Unlisted Trading Privileges, Fixed Income Exchange Traded Funds

October 20, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on September 2, 2003, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On October 14, 2003, PCX filed Amendment No. 1 to the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons, and to grant accelerated approval.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

PCX, through its wholly owned subsidiary PCX Equities, Inc. (''PCXE''), proposes to amend its rules governing the Archipelago Exchange (''ArcaEx''), the equities trading facility of PCXE. With this filing, PCX proposes to amend PCXE Rule 5.2(j)(3) to permit trading, either by listing or pursuant to unlisted trading privileges (''UTPs''), certain fixed income Exchange Traded Funds (''ETFs''). The text of the proposed rule change is below. Proposed new language is italicized; deleted language is in brackets.

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Rule 5.2(j)(3)—No change.

(A) Original Unit Listing Standards.

(i) The Investment Company must:

(a)[(I)] hold securities (*including fixed income securities*) comprising, or otherwise based on or representing an interest in, an index or portfolio or securities; or

(b)[(II)] hold securities in another registered investment company that holds securities as described in (a) above.

An index or portfolio may be revised as necessary or appropriate to maintain the quality and character of the index or portfolio.

(ii) The Investment Company must issue Units in a specified aggregate number in return for a deposit (the ''Deposit'') consisting of either:

(a)[(I)] a specified number of shares of securities (*or, if applicable, a specified portfolio of fixed income securities*) that comprise the index or portfolio, or are otherwise based on or represent an investment in securities comprising such index or portfolio, and/or a cash amount; or

(b)[(II)] shares of a registered investment company, as described in subsection (A)(i)*(a)*[(I)] above, and/or a cash amount.

(iii) Units must be redeemable, directly or indirectly, from the Investment Company for securities (*including fixed income securities*) and/or cash then comprising the Deposit. Units must pay holders periodic cash payments corresponding to the regular cash dividends or distributions declared with respect to the securities held by the Investment Company, less applicable expenses and charges.

(iv)—No change.

(B)–(D)—No change.

Commentary

.01—No change.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, PCX included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. PCX has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Purpose

The Exchange proposes to amend PCXE Rule 5.2(j)(3) to permit the listing and trading of fixed income ETFs. Additionally, PCXE seeks approval to trade, on a UTP basis, the following series of the iShares Trust: iShares 1–3 Year Treasury Index Fund, iShares 7–10 Year Treasury Index Fund, iShares 20+ Year Treasury Index Fund, and iShares GS $ InvesTop™ Corporate Bond Fund.

1. Listing and Trading ETFs

PCXE Rule 5.2(j)(3) provides standards for listing an Investment Company Unit (''ICU''), which is defined as ''a security that represents an interest in a registered investment company (''Investment Company'') that could be organized as a unit investment trust, open-end management investment company or similar entity.'' In addition to being registered under the Investment Company Act of 1940 (''1940 Act''), these securities are also registered under the Exchange Act. The Exchange proposes to amend this definition to permit the listing and trading of index-based fixed income investment products (*e.g.*, ETFs) that are based on an index of fixed income securities. Examples of such products include U.S. government securities and corporate and non-corporate (other than U.S. government) debt securities. As amended, PCXE Rule 5.2(j)(3) would accommodate the listing and trading of units of trading (''Units'')[4] based on an index of U.S. government debt securities (*e.g.*, securities issued or guaranteed by the U.S. Treasury, an agency or instrumentality of the U.S. government, or by a government-sponsored entity). Other products that could be listed or traded under this rule, as amended, could include Units based on an index of corporate and/or non-corporate debt securities.[5] The Commission has approved the requests of the American Stock Exchange LLC (''Amex''), the New York Stock Exchange (''NYSE'') and the Chicago Stock Exchange (''CHX'') to list and trade fixed income ETFs.[6] The Exchange believes that its proposed rule change is substantially similar to those filed and approved for the Amex, NYSE and CHX.

Accordingly, the Exchange proposes to amend PCXE Rule 5.2(j)(3) to specify

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* letter from Tania J. Cho, Staff Attorney, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated October 13, 2003 (''Amendment No. 1'').

[4] *See* PCXE Rule 5.1(b)(15) for the definition of ''Unit'.

[5] ICUs based on a fixed income securities index are not currently eligible for listing or trading under the Exchange's generic listing criteria (*See* PCXE Rule 5.2) pursuant to Rule 19b–4(e) of the Exchange Act. The Exchange understands that it must make separate rule filings for any additional series of such ICUs based on fixed income indices prior to listing or trading those products, even if the Exchange is only trading the product on a UTP basis.

[6] *See* Securities Exchange Act Release No. 46252 (July 24, 2002), 67 FR 49715 (July 31, 2002) (SR–Amex–2001–35) (''Amex Approval Order''); Securities Exchange Act Release No. 46299 (August 1, 2002), 67 FR 51907 (August 9, 2002) (SR–NYSE–2002–26); and Securities Exchange Act Release No. 46834 (November 14, 2002), 67 FR 70276 (November 21, 2002) (SR–CHX–2002–27).

that ETFs may be: (1) Based on a portfolio of fixed income securities; (2) issued in return for a deposit of a specified portfolio of fixed income securities and/or cash; and (3) redeemed at a holder's request by the investment company, which will pay the redeeming holder fixed income securities and/or cash.[7]

Upon approval of the proposed amendments to PCXE Rule 5.2(j)(3), the Exchange also proposes to trade, on a UTP basis, the following four series of the iShares Trust, a registered open-end management investment company (the ''Trust''): iShares 1–3 Year Treasury Index Fund, iShares 7–10 Year Treasury Index Fund, iShares 20+ Year Treasury Index Fund, and iShares GS $ InvesTop™ Corporate Bond Fund (each, a ''Fund,'' and jointly, the ''Funds'').

Each Fund will hold certain fixed income securities selected to correspond generally to the price and yield performance of a specified U.S. Treasury, Government/Credit, or Corporate Bond Index (each, an ''Underlying Index'') maintained either by Lehman Brothers, or, for the Goldman Sachs Corporate Bond Fund, by Goldman Sachs & Co. Barclays Global Fund Advisors (''Advisor'') is the investment advisor to each Fund. The Advisor is registered under the 1940 Act. The Advisor is a wholly owned subsidiary of Barclays Global Investors, N.A., which, is in turn, a wholly owned indirect subsidiary of Barclays Bank PLC of the United Kingdom. SEI Investments Distribution Co. (''Distributor''), a Pennsylvania corporation and broker-dealer registered under the Exchange Act, is the principal underwriter and distributor of Creation Unit Aggregations (as defined below) of iShares. The Distributor is not affiliated with the Exchange or the Advisor.

A. Operation of the Funds

Each Fund is designed to provide investment results that correspond generally to the price and yield performance of its Underlying Index. In seeking to achieve its respective investment objective, each Fund will utilize ''passive'' indexing investment strategies. Each Fund may fully replicate its Underlying Index, but currently intends to use a ''representative sampling'' strategy to track its Underlying Index. A Fund utilizing a representative sampling strategy generally will hold a basket of the component securities (''Component Securities'') of its Underlying Index, but it may not hold all of the Component Securities of its Underlying Index (as compared to a Fund that uses a replication strategy which invests in substantially all of the Component Securities in its Underlying Index in the same approximate proportions as in the Underlying Index).[8]

When using a representative sampling strategy, the Advisor attempts to match the risk and return characteristics of a 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 homogenous 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: duration, sector, credit rating, coupon and 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 closely to 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.[9]

According to the 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 (*e.g.*, coupon rates instead of dividend payments).

According to the Application, the 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 Fund in accordance with changes in the composition of the Underlying Index or to maintain compliance with requirements applicable to a regulated investment company (''RIC'') under the Internal Revenue Code. For example, if at the end of a calendar quarter a Fund would not comply with the RIC diversification tests, the Advisor would make adjustments to the portfolio to ensure continued RIC status. The Exchange notes, however, that Applicants do not anticipate that the Funds would need to make such adjustments, particularly since these Funds (other than the iShares Lehman Corporate Bond Fund and the iShares GS $ InvesTop™ Corporate Bond Fund) invest a very large percentage of their assets in U.S. Treasury securities.

The Exchange represents that the Advisor expects that each Fund will have a tracking error relative to the performance of its respective Underlying Index of no more than five percent (5%). Each Fund's investment objectives, policies and investment strategies will be fully disclosed in its prospectus (''Prospectus'') and statement of additional information (''SAI''). At least 90% of each of the iShares 1–3 Year Treasury Index Fund, iShares 7–10 Year Treasury Index Fund, and iShares 20+ Year Treasury Index Fund's assets will be invested in Component Securities of its respective Underlying Index. Each of these Funds

[7] *See supra,* note 4.

[8] The Commission approved an ''Application'' by the Trust, the Advisor and the Distributor (''Applicants'') for an Order under Sections 6(c) and 17(b) of the 1940 Act for the purpose of exempting the Funds from various provisions of the 1940 Act. *See* Investment Company Act Release No. 25622 (June 24, 2002) (approving File No. 812–12390). *See also supra* note 6.

[9] As stated in the Application, the Goldman Sachs Index excludes bonds with embedded options. Although the Lehman Indices may include bonds with embedded options, the bonds in each Lehman Index (and the respective Deposit Securities and Fund Securities, as defined herein) should be liquid and easily tradable because each Lehman Index consists of U.S. Treasury and agency securities and/or liquid corporate and non-corporate bonds. To the extent a particular bond is less liquid than another bond with similar characteristics, the Advisor's representative sampling techniques should permit the Advisor to replace the less liquid bond with a more liquid one. For these reasons, the Applicants do not believe the presence of bonds with embedded options in an Underlying Index, the Deposit Securities or Fund Securities would have any material impact on the creation/redemption process and the efficiency of the arbitrage mechanism for each Fund.

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 Fund track its Underlying Index, as well as in certain futures, options and swap contracts, cash and cash equivalents. For example, these 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). The iShares GS $ InvesTop™ Corporate Bond Fund generally will invest at least 90% of its assets in Component Securities of its respective Underlying Index. However, the iShares GS $ InvesTop™ Corporate Bond Fund may at times invest up to 20% of its assets in certain futures, options and swap contracts, cash and cash equivalents as well as in bonds not included in its Underlying Index, but which the Advisor believes will help the Fund track its Underlying Index and which are either (i) included in the broader index upon which such Underlying Index is based (*i.e.*, the Lehman Credit Index for the Lehman Credit VLI Index or the Goldman Sachs Investment Grade Index for the Goldman Sachs InvesTop Index); or (ii) new issues entering or about to enter the Underlying Index or the broader index upon which such Underlying Index is based.

B. Issuance of Creation Unit Aggregations

1. In General

Shares of each 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 Funds will issue and redeem iShares only in Creation Unit Aggregations.[10] 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 NAV per share of each Fund is determined at the close of the regular trading session based upon the methodology employed by the specific Fund. The Trust sells Creation Unit Aggregations of each Fund only on business days at the next determined NAV of each Fund. Each Fund will issue Creation Unit Aggregations 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 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 fund in exchange for portfolio securities of the 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 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 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 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 differences between (1) the NAV (per Creation Unit Aggregation) of the 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 Core Trading Session[11] trading on ArcaEx (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 the information at the end of the previous Business Day) for the relevant Fund. The Portfolio Deposit will be applicable to a Fund (subject to any adjustments to the Balancing Amount, as described below) in order to effect purchases of Creation Unit Aggregations of the 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 Fund will change from time to time. The composition of the Deposit Securities may change in response to adjustments to the weighting of 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 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 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.

C. Availability of Information Regarding iShares and Underlying Indices

1. In General

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

[10] 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.

[11] The Exchange operates three trading sessions each day it is open. The three trading sessions are (1) the Opening Session; (2) the Core Trading Session; and (3) the Late Trading Session. *See* PCXE Rule 7.34(a).

Deposit Securities of the Portfolio Deposit and the Balancing Amount effective as of the previous Business Day will be made available. An amount per iShare representing the sum of the estimated Balancing Amount effective through and including the previous Business Day, plus the current value of the Deposit Securities, on a per iShare basis (the ''Intra-day Optimized Portfolio Value'' or ''IOPV'') will be calculated by Bloomberg L.P. (''Bloomberg'') every 15 seconds during the Exchange's core trading hours and disseminated every 15 seconds on the Consolidated Tape. Bloomberg will use Bloomberg Generic Prices (''BGN Prices'') to reflect changing bond prices and update the IOPV throughout the day. BGN Prices are current prices on individual bonds as determined by Bloomberg using an automated pricing program that analyzes multiple bond prices contributed to Bloomberg by third-party price contributors (such as broker-dealers). BGN Prices are updated throughout the day based on an ongoing analysis of the bid/ask prices submitted by the third-party price contributors. When Bloomberg receives bid/ask prices from a price contributor, the prices are filtered and screened according to pre-determined criteria and set parameters in order to maximize the accuracy of the pricing data. The net result of this process is an individual bond ''price'' based on an analysis of multiple pricing sources. BGN Prices are available on Bloomberg systems and Applicants expect that the pricing of the Deposit Securities will be transparent to anyone with access to Bloomberg systems.

The Lehman Indices and the Goldman Sachs Index will not be calculated or disseminated intra-day. The value and return of each Lehman Index is updated on a daily basis by Lehman Brothers. Goldman Sachs updates the value and return of the Goldman Sachs Index on a daily basis.

Each Fund will make available through NSCC on a daily basis the names and required number of shares of each of the Deposit Securities in a Creation Unit Aggregation, as well as information regarding the Balancing Amount. The NAV for each Fund will be calculated and disseminated daily. There will also be disseminated a variety of data with respect to each Fund on a daily basis by means of CTA and CQ High Speed Lines; information with respect to recent NAV, shares outstanding, estimated cash amount and total cash amount per Creation Unit Aggregation will be made available prior to the opening of the Exchange. The closing prices of the Funds' Deposit Securities are available from published or other public sources, or on-line information services provided by Merrill Lynch, IDC, Bridge, Bloomberg, Lehman Brothers and other pricing services commonly used by bond mutual funds. In addition, the Web site for the Trust, which will be publicly accessible at no charge,[12] will contain the following information, on a per iShare basis, for each Fund: (a) The prior Business Day's NAV and the mid-point of the bid-ask price [13] at the time of calculation of such NAV (''Bid/Ask Price''), and a calculation of the premium or discount of such price against such NAV; and (b) data in chart format displaying the frequency distribution of discounts and premiums of the Bid/Ask Price against the NAV, within appropriate ranges, for each of the four previous calendar quarters.

2. Information Regarding the Underlying Debt Securities

The secondary market for Treasury securities is a highly organized over-the-counter market. Many dealers, and particularly the primary dealers, make markets in Treasury securities. Trading activity takes place between primary dealers, non-primary dealers, and customers of these dealers, including financial institutions, non-financial institutions and individuals. Increasingly, trading in Treasury securities occurs through automated trading systems.[14]

The primary dealers are among the most active participants in the secondary market for Treasury securities. The primary dealers and other large market participants frequently trade with each other, and most of these transactions occur through an interdealer broker.[15] The interdealer brokers provide primary dealers and other large participants in the Treasury market with electronic screens that display the bid and offer prices among dealers and allow trades to be consummated.

Quote and trade information regarding Treasury securities is widely available to market participants from a variety of sources. The electronic trade and quote systems of the dealers and interdealer brokers are one such source. Groups of dealers and interdealer brokers also furnish trade and quote information to vendors such as Bloomberg, Reuters, Bridge, Moneyline Telerate, and CQG. GovPX,[16] for example, is a consortium of leading government securities dealers and subscribers that provides market data from leading government securities dealers and interdealer brokers to market data vendors and subscribers. TradeWeb, another example, is a consortium of 18 primary dealers that, in addition to providing a trading platform, also provides market data direct to subscribers or to other market data vendors.[17]

Real-time price quotes for corporate [18] and non-corporate debt securities are available to institutional investors via proprietary systems such as Bloomberg, Reuters and Dow Jones Telerate. Additional analytical data and pricing information may also be obtained through vendors such as Bridge Information Systems, Muller Data, Capital Management Sciences, Interactive Data Corporation and Barra.

Retail investors do have access to free intra-day bellwether quotes.[19] The Bond Market Association provides links to price and other bond information sources on its investor Web site at *http://www.investinginbonds.com*. In addition, transaction prices and volume data for the most actively-traded bonds on the exchanges are published daily in newspapers and on a variety of financial Web sites.

Closing corporate and non-corporate bond prices are also available through subscription services (*e.g.*, IDC, Bridge) that provide aggregate pricing information based on prices from several dealers, as well as subscription services from broker-dealers with a large bond trading operation, such as Lehman Brothers and Goldman, Sachs & Co.

D. Redemption of iShares

Creation Unit Aggregations of each Fund will be redeemable at the NAV next determined after receipt of a request for redemption. Creation Unit Aggregations of each Fund will be redeemed principally in-kind, together with a balancing cash payment

[12] *See http://www.ishares.com.*

[13] The Bid-Ask Price of a Fund is determined using the highest bid and lowest offer on the Exchange as of the time of calculation of each Fund's NAV.

[14] *See* ''eCommerce in the Fixed-Income Markets: The 2001 Review of Electronic Transaction Systems,'' December 2001. This survey of electronic trading systems in the bond market was prepared by the staff of The Bond Market Association and is available through the Association's Web site: *http://www.bondmarkets.com.*

[15] *See e.g.,* BrokerTec Global, Cantor Fitzgerald, Garban-Intercapital, and Liberty Brokerage.

[16] *See http://www.govpx.com.*

[17] *See http://www.tradeweb.com.*

[18] *See* Securities Exchange Act Release No. 43873 (January 23, 2001), 66 FR 8131 (January 29, 2001) (SR–NASD–65) for a discussion of the Trade Reporting and Compliance Engine (''TRACE'') which requires mandatory reporting relating to price transparency and oversight for the corporate debt market.

[19] Corporate prices are available at 20-minute intervals from Capital Management Services at *http://www.bondvu.com/quotmenu.htm.*

(although, as described below, Creation Unit Aggregations may sometimes be redeemed for cash). The value of each Fund's redemption payments on a Creation Unit Aggregation basis will equal the NAV per the appropriate number of iShares of such Fund. Owners of iShares may sell their iShares in the secondary market, but must accumulate enough iShares to constitute a Creation Unit Aggregation in order to redeem through the Fund. Redemption orders must be placed by or through an Authorized Participant.

Creation Unit Aggregations of any Fund generally will be redeemable on any Business Day in exchange for Fund Securities and the Cash Redemption Payment (defined below) in effect on the date a request for redemption is made. The Advisor will publish daily through NSCC the list of securities that a creator of Creation Unit Aggregations must deliver to the Fund (the ''Creation List'') and which a redeemer will receive from the Fund (the ''Redemption List''). The Creation List is identical to the list of the names and the required numbers of shares of each Deposit Security included in the current Portfolio Deposit.

In addition, just as the purchaser of Creation Unit Aggregations delivers the Balancing Amount to the Fund, the Trust will also deliver to the redeeming Beneficial Owner in cash the ''Cash Redemption Payment.'' The Cash Redemption Payment on any given Business Day will be an amount calculated in the same manner as that for the Balancing Amount, although the actual amounts may differ in the Fund Securities received upon redemption are not identical to the Deposit Securities applicable for creations on the same day. To the extent that the Fund Securities have a value greater than the NAV of iShares being redeemed, a cash payment equal to the differential is required to be paid by the redeeming Beneficial Owner to the Fund. The Trust may also make redemptions in cash in lieu of transferring one or more Fund Securities to a redeemer if the Trust determines, in its discretion, that such method is warranted due to unusual circumstances. An unusual circumstance could arise, for example, when a redeeming entity is restrained by regulation or policy from transacting in certain Fund Securities, such as the presence of such Fund Securities, on a redeeming investment banking firm's restricted list.

E. Clearance and Settlement

The Deposit Securities and Fund Securities of each Fund will settle via free delivery through the Federal Reserve System for U.S. government securities and the DTC for corporate securities and non-corporate (other than U.S. government securities). The iShares will settle through the DTC. The Custodian will monitor the movement of the Deposit Securities and will instruct the movement of the iShares only upon validation that the Deposit Securities have settled correctly or that required collateral is in place.

As with the settlement of domestic ETF transactions outside of the NSCC Continuous Net Settlement System (the ''CNS System''), (i) iShares of the Funds and corporate and non-corporate securities (other than U.S. government securities) will clear and settle through DTC, and (ii) U.S. government securities and cash will clear and settle through the Federal Reserve system. More specifically, creation transactions will settle as follows. On settlement date (T + 3), an Authorized Participant will transfer Deposit Securities that are corporate and non-corporate bonds (other than U.S. government securities) through DTC to a DTC account maintained by the Funds' Custodian, and Deposit Securities that are U.S. government securities, together with any Balancing Amount, to the Custodian through the Federal Reserve system. Once the Custodian has verified the receipt of all the Deposit Securities (or in the case of failed delivery of one or more bonds, collateral in the amount of 105% or more of the missing Deposit Securities) and the receipt of any Balancing Amount, the Custodian will notify the Distributor and the Advisor. The Fund will issue Creation Unit Aggregations of iShares and the Custodian will deliver the iShares to the Authorized Participant through DTC. DTC will then credit the Authorized Participant's DTC account. The clearance and settlement of redemption transactions essentially reverses the process described above. After the Trust has received a redemption request in proper form and the Authorized Participant transfers Creation Unit Aggregations of iShares to the Funds' Custodian through DTC, the Trust will cause the Custodian to initiate procedures to transfer the requisite Fund Securities and any Cash Redemption Payment. On T + 3, assuming the Custodian has verified receipt of the Creation Unit Aggregations, the Custodian will transfer Fund Securities that are corporate and non-corporate bonds to the Authorized Participant through DTC and Fund Securities that are U.S. government securities, together with any Cash Redemption Payment, through the Federal Reserve system.

iShares of the Funds will be debited or credited by the Custodian directly to the DTC accounts of the Authorized Participants. With respect to domestic equity-based ETFs using the CNS System, Creation Unit Aggregations of iShares are deposited or charged to the Authorized Participants' DTC accounts through the CNS System. Since creation/redemption transactions for iShares of the Funds will not clear and settle through the CNS System, the failed delivery of one or more Deposit Securities (on a create) or one or more Fund Securities (on a redemption) will not be facilitated by the CNS System. Therefore, Authorized Participants will be required to provide collateral to cover the failed delivery of Deposit Securities in connection with an ''in-kind'' creation of iShares. In case of a failed delivery of one or more Deposit Securities, the Funds will hold the collateral until the delivery of such Deposit Security. The Funds will be protected from failure to receive the Deposit Securities because the Custodian will not effect the Fund's side of the transaction (the issuance of iShares) until the Custodian has received confirmation of receipt of the Authorized Participant's incoming Deposit Securities (or collateral for failed Deposit Securities) and Balancing Amount. In the case of redemption transactions, the Funds will be protected from failure to receive Creation Unit Aggregations of iShares because the Custodian will not now effect the Fund's side of the transaction (the delivery of Fund Securities and the Cash Redemption Payment) until the Transfer Agent has received confirmation of receipt of the Authorized Participant's incoming Creation Unit Aggregations. In order to simplify the transfer agency process and align the settlement of iShares of the Funds with the settlement of the Deposit Securities and Fund Securities, Applicants plan to settle transactions in U.S. government securities, corporate bonds, non-corporate bonds (other than U.S. government securities) and iShares on the same T + 3 settlement cycle. The issuer does not believe that the clearing and settlement process will affect the arbitrage of iShares of the Funds.

F. Dividends and Distributions

Dividends from net investment income will be declared and paid to Beneficial Owners of record at least annually by each Fund. Certain of the Funds may pay dividends, if any, on a quarterly or more frequent basis. Distributions of realized securities gains, if any, generally will be declared and paid once a year, but each Fund may make distributions on a more frequent basis to comply with the distribution requirements of the Internal Revenue Code and consistent with the 1940 Act.

Dividends and other distributions on iShares of each Fund will be distributed on a pro rata basis to Beneficial Owners of such iShares. Dividend payments will be made through the Depository and the DTC Participants to Beneficial Owners then of record with amount received from each Fund.

The Trust will not make the DTC book-entry Dividend Reinvestment Service (the ''Service'') available for use by Beneficial Owners for reinvestment of their cash proceeds, but certain individual brokers may make the Service available to their clients. The SAI will inform investors of this fact and direct interested investors to contact such investor's broker to ascertain the availability and a description of the Service through such broker. The SAI will also caution interested Beneficial Owners that they should note that each broker may require investors to adhere to specific procedures and timetables in order to participate in the Service and such investors should ascertain from their broker such necessary details. iShares acquired pursuant to the Service will be held by the Beneficial Owners in the same manner, and subject to the same terms and conditions, as for original ownership of iShares.

G. Other Issues

1. Criteria for Initial and Continued Listing

iShares are subject to the criteria for initial and continued listing of ICUs in PCXE Rule 5.2(j)(3) and PCXE Rule 5.5(g)(2), respectively. It is anticipated that a minimum of one Creation Unit (100,000 iShares) will be required to be outstanding at the start of trading. This minimum number of iShares required to be outstanding at the start of trading will be comparable to requirements that have been applied to previously traded series of ICUs.

The Exchange believes that the proposed minimum number of iShares outstanding at the start of trading is sufficient to provide market liquidity and to further the Trust's objective to seek to provide investment results that correspond generally to the price and yield performance of the Index.

2. Original and Annual Listing Fees

Because the ETFs will be traded on a UTP basis, the Exchange does not presently assess original or annual listing fees that are applicable to the fixed income ETF rule filing. However, once the fixed income ETFs are listed, the Exchange will submit a rule filing to reflect the original and annual listing fees.

3. Stop and Stop Limit Orders

Notwithstanding that the value of the ETF is derivatively priced based upon another security or index of securities, a Stop Order or Limit Order to buy or sale an ETF will be handled as provided in PCXE Rule 7.31(l) [20] and PCXE Rule 7.31(n).[21]

4. Specialist Trading of ETFs

ArcaEx does not currently offer trading by specialists. However, ArcaEx does allow trading by Market Makers (''MMs'') or Market Maker Authorized Traders (''MMATs'').[22] Nothing in the PCXE Rules should be construed to restrict a MM or MMAT in a security issued by an investment company from purchasing and redeeming the listed security, or securities that can be subdivided or converted into the listed security, from the issuer as appropriate to facilitate the maintenance of a fair and orderly market.

5. Prospectus Delivery/Disclosures

The Exchange represents that in an Information Circular to ETP Holders,[23] it will inform ETP Holders, prior to commencement of trading, of the prospectus or product description delivery requirements applicable to iShares. The Commission granted the Applicants' request for an exemptive order granting relief from a certain prospectus delivery requirement under Section 24(d) of the 1940 Act.[24] Any product description used in reliance of a Section 24(d) exemptive order will comply with all representations made therein and all conditions thereto. The Information Circular will also remind ETP Holders of their obligations to provide all purchasers of a series of Units a written description of the term and characteristics of those securities at the time of the confirmation of the first transaction in such a series. Additionally, ETP Holders will include such written description with any sales material relating to a series of Units that is provided to the customers or public.

6. Trading Halts

Any decision to halt trading of fixed income ETFs will be conducted in accordance with PCXE Rule 7.12, if circuit breaker parameters have been reached.

7. Suitability

Prior to the commencement of trading, the Exchange will issue an Information Circular informing ETP Holders of the characteristics of the fixed income ETFs and of the applicable PCXE rules, as well as the requirement of PCXE Rule 9.2(a) (''Diligence as to Accounts.''). Rule 9.2(a) generally requires members to use due diligence to learn the essential facts relative to every customer.

8. Purchases and Redemptions in Creation Unit Size

The Exchange represents that in the Information Circular referenced above, ETP Holders will be informed that procedures for purchases and redemptions of iShares in Creation Unit Size are described in the Fund prospectus and SAI, and that iShares are not individually redeemable, but may redeemed only in Creation Unit Size aggregations or multiples thereof.

9. Surveillance

The Exchange will implement written surveillance procedures for the ETFs that it trades. The Exchange intends to use its existing surveillance technology and procedures applicable to other ICUs currently trading on the Exchange.[25] The Exchange believes that these surveillance efforts will effectively monitor the trading of the Funds so as to ensure full compliance with Exchange rules and the federal securities laws.

The Exchange also recognizes that certain concerns are raised when a broker-dealer, such as Lehman or Goldman, is involved in the development and maintenance of a stock or bond index upon which an ETF

[20] On the ArcaEx, a stop order to buy (sell) becomes a market order when a transaction in the security occurs on the Exchange or on another national securities exchange or association at or above (below) the stop price. Stop Order shall not have standing in any Order Process in the Arca Book and shall not be displayed.

[21] On the ArcaEx, a stop limit order to buy (sell) becomes a limit order when a transaction in the security occurs on the Exchange or on another national securities exchange or association at or above (below) the stop price.

[22] *See* PCXE Rule 1.1(u) and PCXE Rule 7.31(v) for the definition of ''Market Maker'' and ''Market Maker Authorized Trader,'' respectively.

[23] An ETP Holder is a sole proprietorship, partnership, corporation, limited liability company or other organization in good standing that has been issued an ETP for effecting approved securities transactions on the ArcaEx. An ETP Holder must be a registered broker or dealer pursuant to Section 15 of the Exchange Act. *See* PCXE Rule 1.1(n) and PCXE Rule 1.1(m).

[24] *See* Investment Company Act Release No. 25623 (June 25, 2002).

[25] PCXE currently trades a variety of ETFs.

is based.[26] The Exchange notes that the Commission previously made a finding that Lehman and Goldman each have sufficient policies and procedures in place to prevent the misuse of material non-public information.[27] The Exchange believes that these provisions should help to address concerns raised by Goldman and Lehman's involvement in the management of the indices.

10. Hours of Trading/Minimum Price Variation

The Funds will be eligible to trade on the Exchange during each of the three trading sessions available each day the Exchange is open for business.[28] The minimum price variation for quoting will be $.01.[29]

Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Exchange Act,[30] in general, and furthers the objectives of Section 6(b)(5),[31] in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to enhance competition and to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change, as amended, will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments on the proposed rule change were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Exchange Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR–PCX–2003–41 and should be submitted by [insert date 21 days from date of publication].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that implementation of the proposed rule change, as amended, is consistent with the requirements of Section 6 of the Exchange Act,[32] and the rules and regulations thereunder applicable to a national securities exchange.[33] Specifically, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Exchange Act.[34] The Commission believes that the Exchange's proposal to list and trade fixed income ETFs (including the trading thereof on a UTP basis)[35] will provide investors with a convenient way of participating in the U.S. government, corporate and non-corporate (other than U.S. government) fixed income markets. The Exchange's proposal should help to provide investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell securities at negotiated prices throughout the business day that replicate the performance of several portfolios of stocks. The Commission believes that the availability of the Funds will provide an instrument for investors to achieve desired investment results that correspond generally to the price and yield performance of the underlying U.S. Treasury, Government/Credit, or Corporate Bond Index. The investment objective of each Fund will be to provide investment results that correspond generally to the price and yield performance of the underlying index based on fixed income securities. Accordingly, the Commission finds that the Exchange's proposal will facilitate transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[36]

iShares Trust and iShares, Inc. are each registered in the 1940 Act as an open-ended management investment company with multiple series. iShares Trust has created (or identified for creation) over 50 separate series, while iShares, Inc. has created (or identified for creation) over 20 separate series. All of these series operate (or will operate) as ETFs pursuant to six prior exemptive orders from the 1940 Act, and each of the ETFs seeks to match the return of an equity securities index. Additionally, the Commission has granted the Funds appropriate relief under various sections of the 1940 Act, including sections 6(c) and 17(b), so that each Fund may register under the 1940 Act as an open-end fund and issue shares that are redeemable in Creation Units, shares of Funds may trade in the secondary market at negotiated prices, and certain persons affiliated with a Fund by reason of owning 5% or more, and in some cases more than 25%, of its outstanding securities may do in-kind purchases and redemptions of Creation Units.[37]

Barclays is registered as an investment adviser under the 1940 Act and serves as the investment adviser to the series of iShares Trust and iShares, Inc. The Distributor acts as the principal underwriter and distributor for iShares Trust and iShares, Inc.

iShares Trust created seven new series each of which operates as an ETF seeking to match the performance of a fixed income securities index. Four of the seven indices are the following:

[26] PCX changed this sentence from the original filing to refer to a stock or bond index. Telephone call between Tania J. Cho, Staff Attorney, PCX, and Jennifer Lewis, Special Counsel, Division of Market Regulation, Commission, on October 16, 2003.

[27] *See* Amex Approval Order, *supra* note 6.

[28] *See supra,* note 8.

[29] *See* Commentary .03 to PCXE Rule 7.6(a).

[30] 15 U.S.C. 78f(b).

[31] 15 U.S.C. 78f(b)(5).

[32] 15 U.S.C. 78f.

[33] In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[34] 15 U.S.C. 78f(b)(5).

[35] The Commission notes that, pursuant to Rule 12f–5 under the Exchange Act, prior to trading a particular class or type of security pursuant to UTP, PCX must have listing standards comparable to those of the primary market on which the security is listed. 17 CFR 240.12f–5. The Commission finds that adequate rules and procedures exist to govern the trading of the Funds on PCX, pursuant to UTP.

[36] Pursuant to Section 6(b)(5) of the Exchange Act, the Commission must predicate approval of exchange trading for new products upon a finding that the introduction of the product is in the public interest. Such a finding would be difficult with respect to a product that served no investment, hedging or other economic functions, because any benefits that might be derived by market participants would likely be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

[37] Investment Company Act Release No. 25622 (June 25, 2002).

• Lehman Brothers 1–3 Year U.S. Treasury Index (containing U.S. Treasury securities with remaining maturities of between 1 and 3 years);

• Lehman Brothers 7–10 Year U.S. Treasury Index (containing U.S. Treasury securities with remaining maturities of between 7 and 10 years);

• Lehman 20+ Year U.S. Treasury Index (containing U.S. Treasury securities with remaining maturities of more than 20 years); and

• Goldman Sachs InvesTop Index (containing the 100 most liquid and representative bonds in the U.S. investment grade corporate market with remaining maturities of at least 3 years).

The Commission noted in the Amex Approval Order that this was the first ETF based on an underlying index of fixed income securities (''Fixed Income ETFs''). The Funds will operate in substantially the same manner as Equity ETFs. Like many other ETFs, each Fund will use a representative sampling strategy to track its index. With a sampling strategy, a Fund will seek to match the return of its index by holding some, but not all, of the fixed income securities contained in its underlying index. In constructing the portfolio for a Fund, Barclays will select a sample of bonds that will correlate to the duration, sector, credit rating, coupon, and embedded option characteristics of the underlying index as a whole. Barclays may also exclude less liquid bonds in order to create a more tradable portfolio to enhance arbitrage efficiency. As with its Equity ETFs, Barclays represents that the Funds will have a tracking error relative to the performance of their respective underlying indices of no more than 5%.

Shares of the Funds will be issued and redeemed in Creation Units priced at NAV in exchange for Portfolio Deposits and Redemption Baskets consisting of Bonds selected and announced by Barclays at the beginning of each business day.

The Commission finds that the Funds will provide benefits to investors in allowing investors to trade baskets of bonds in a single transaction at a cost comparable to that of trading existing equity securities and will allow investors to trade baskets of bonds throughout the day and thereby permit them to take advantage of (or protect themselves against) intra-day market movements. The Funds may make it easier for individual investors to diversify their portfolios across a broader range of assets and will provide institutional and other large investors with an alternative to futures for various hedging and other investment strategies that involve fixed income securities. Finally, the Funds will provide investors with a fund product that discloses its portfolio on a daily basis rather than semi-annually.

While the Funds will be operated in a manner that closely parallels the manner in which Equity ETFs are operated, one key potential difference may be the efficiency of the arbitrage process. The arbitrage mechanism for Equity ETFs generally has caused the market price of ETF shares to track closely the NAV of the ETF shares. With respect to liquidity of the debt securities likely to be in the ETF portfolios, to the extent these debt securities could not be readily purchased and sold, the arbitrage process would be less efficient. However, the Commission notes that the Funds will invest in some of the most liquid debt securities, including U.S. Government securities and investment grade corporate and non-corporate bonds.[38] In addition, Barclays will employ a sampling method of portfolio management that would allow the Funds to exclude any bonds contained in an underlying index that may not have sufficient liquidity for easy trading. As a result, the Commission believes that the Funds have addressed the liquidity issues that might hamper arbitrage.

In addition, differences in the degree of price transparency in the debt and equity markets could lead to larger discounts and premiums for the Funds than have been experienced by Equity ETFs. Specifically, because the pricing of debt securities can be less transparent than the pricing of equity securities, arbitrageurs might account for pricing uncertainty by waiting for greater premiums or discounts to develop in the market price of the ETF shares before engaging in arbitrage transactions.

The Commission finds that because of the nature of the particular debt securities to be included in the portfolios of the Funds (*i.e.*, U.S. Government securities and investment grade corporate and non-corporate bonds), the pricing information should be available. The Exchange has indicated that real-time price quotes for corporate and non-corporate debt securities are available to institutional investors via proprietary systems such as Bloomberg, Reuters and Dow Jones Telerate. Additional analytical data and pricing information may also be obtained through vendors such as Bridge Information Systems, Muller Data, Capital Management Sciences, Interactive Data Corporation and Barra.

The Exchange has also represented that retail investors would have access to free intra-day bellwether quotes.[39] For instance, the Bond Market Association provides links to price and other bond information sources on its investor Web site at *http://www.investinginbonds.com.* In addition, transaction prices and volume data for the most actively traded bonds on the exchanges are published daily in newspapers and on a variety of financial Web sites. Closing corporate and non-corporate bond prices are also available through subscription services (*e.g.*, IDC, Bridge) that provide aggregate pricing information based on prices from several dealers, as well as subscription services from broker-dealers with a large bond trading operation, such as Lehman Brothers and Goldman Sachs & Co.

The Commission also believes that pricing information for the Treasury securities should also be available. Quote and trade information regarding Treasury securities is widely available to market participants from a variety of sources. The electronic trade and quote systems of the dealers and interdealer brokers are one such source. Groups of dealers and interdealer brokers also furnish trade and quote information to vendors such as Bloomberg, Reuters, Bridge, Moneyline Telerate, and CQG.

PCX represents that every 15 seconds a price calculated by Bloomberg reflecting the current value of the Portfolio Deposit on a per ETF share basis for the Funds will be disseminated. To calculate this intra-day value, Bloomberg intends to use Bloomberg Generic Prices, which are current prices for individual bonds as determined by Bloomberg using an automated pricing program that analyzed multiple bond prices contributed by third-part price contributors such as broker-dealers.[40]

[38] The Goldman Sachs InvesTop Index may include investment grade corporate and non-corporate bonds issued by non-U.S. issuers (sovereign, supra-national, foreign agency, and foreign local government). In Barclays' 1940 Act Application, it stated that these bonds will be dollar denominated, registered for sale in the U.S., and traded on U.S. markets at negotiated and readily available prices. Barclays does not believe that these bonds present any unique pricing or liquidity issues and does not expect the bonds to negatively affect arbitrage efficiency. The Commission notes that if any of these major characteristics of these fixed income indices (*e.g.,* investment grade, face amount issued, maturity classification) were to materially change, the Commission would expect PCX to amend these listing standards accordingly.

[39] Corporate prices are available at 20-minute intervals from Capital Management Services at *http://www.bondvu.com/quotmenu.htm.* TRACE also disseminates last sale information on certain investment grade bonds. See *http://www.nasdbondinfo.com.*

[40] The Lehman Indices and the Goldman Sachs Index will not be calculated or disseminated intra-day. The value and return of each Lehman Index is updated on a daily basis by Lehman Brothers.

Accordingly, PCX believes that the pricing of the bonds included in the Portfolio Deposit (and in the Redemption Basket) will be transparent to anyone with access to Bloomberg systems. Because the arbitrageurs of ETF shares are generally large institutional investors, including broker-dealers, the Commission believes that these investors likely will have access to Bloomberg systems, as well as other bond pricing information sources that should permit efficient arbitrage to occur. While the Commission believes that differences in the liquidity and pricing transparency of the underlying fixed income markets, as compared to the equity markets, may result in the Funds trading at slightly higher discounts and premiums, the Commission does not believe that this effect is likely to be so substantial as to undermine the benefits that Funds will provide to the markets and to investors. The Commission expects the Exchange to review the discounts or premiums for these products and to respond appropriately if there is in fact a significant pricing disparity.

The Commission has also granted the issuer, Barclays, exemptive relief from Section 24(d) of the 1940 Act so that dealers may effect secondary market transaction in Barclays ETF shares without delivery a prospectus to the purchaser. Instead, under the exemption and under PCX's listing standards, sales in the secondary market must be accompanied by a ''product description,'' describing the ETF and its shares.[41] The Commission believes a product description, which not only highlights the basic characteristics of the product and the manner in which the ETF shares trade in the secondary market, but also highlights the differences of the Funds from existing equity ETFs and notes the unique characteristics and risks of this product, should provide market participants with adequate notice of the salient features of the product.

The Commission also notes that upon the initial listing of any ETF under PCXE Rule 5.2(j) the Exchange issues a circular to its members explaining the unique characteristics and risks of the security; in this instance, Fixed Income ETFs. In particular, the circular should include, among other things, a discussion of the risks that may be associated with the Funds, in addition to details on the composition of the fixed income indices upon which they are based and how each Fund would use a representative sampling strategy to track its index. The circular also should note Exchange members' responsibilities under PCXE Rule 9.2(a) which generally requires that members use due diligence to learn the essential facts relative to every customer. The circular also will address members' prospectus delivery requirements as well as highlight the characteristics of purchases in Funds, including that they only are redeemable in Creation Unit size aggregations. Based on these factors, the Commission finds that the proposal to trade the Funds is consistent with Section 6(b)(5) of the Exchange Act.[42]

The Commission also notes that the Exchange's rules and procedures should address the special concerns attendant to the trading of new derivative products. In particular, by imposing the Investment Company Unit listing standards in PCXE Rules 5.2(j) and 5.5(g)(2), and addressing the suitability, disclosure, and compliance requirements noted above, the Commission believes that the Exchange has addressed adequately the potential problems that could arise from the derivative nature of the Funds.

In particular, the Commission finds that adequate rules and procedures exist to govern the trading of Investment Company Units, including Funds. Funds will be deemed equity securities subject to PCX rules governing the trading of equity securities. These rules include: Business Conduct and Equity Trading Rules, such as priority, parity, and precedence of orders, market volatility related trading halt provisions pursuant to PCXE Rule 7.12, members dealing for their own accounts, specialists, odd-lot brokers, and registered traders, handling of orders and reports, duty to report transactions, comparisons of transactions, marking to the market, delivery of securities, dividends and interest, closing of contracts, and money and security loans;[43] and Conducting Business with the Public Rules, such as conduct of accounts, margin rules, and advertising.[44] PCX also will consider halting trading in any series of Investment Company Units under certain other circumstances regarding the presence of other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market. The Commission believes that the application of these rules should strengthen the integrity of the Funds.

The Commission also notes that certain concerns are raised when a broker-dealer, such as Lehman or Goldman, is involved in the development and maintenance of a stock index upon which an ETF is based. Previously, the Commission noted the importance of an exchange adopting adequate procedures to prevent the misuse of material, non-public information regarding changes to component stocks in a fixed income securities index.[45] In the Amex Approval Order, the Commission noted that Goldman and Lehman each have procedures in place to prevent the misuse of material, non-public information regarding changes to component stocks to the Funds.[46] The Commission believes that these provisions should help to address concerns raised by Goldman and Lehman's involvement in the management of the indices.

The Commission also believes that PCX has appropriate surveillance procedures in place to detect and deter potential manipulation for similar index-linked products. By applying these procedures to the Funds, the Commission believes that the potential for manipulation should be minimized, while protecting investors and the public interest.

PCX has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. PCX has requested accelerated approval because the 1940 Act Application relating to the Funds has been reviewed by the Division of Investment Management and notice of the Application has been published in the **Federal Register**.[47] The Application disclosed the characteristics and risks associated with the Funds. No comments were submitted and the Commission granted the relief requested in the Application.[48] The Funds will trade on the Exchange in the same

The value and return of the Goldman Sachs Index is updated on a daily basis by Goldman Sachs.

[41] When the Commission approved Nasdaq listing standards for ETFs, it clarified that NASD members trading equity ETFs through electronic communication networks (''ECNs'') would be subject to NASD Rules 4420(i)(2) and 4420(j)(2) requiring the delivery of product descriptions in connection with sales of ETF shares. *See* Securities Exchange Act Release No. 45920 (May 13, 2002), 67 FR 35605 (May 20, 2002). The Commission expects NASD members to observe the same standards for the secondary market trading of Funds.

[42] 15 U.S.C. 78f(b)(f).

[43] PCXE Rules 6.1–7.64.

[44] PCXE Rules 9.1–9.28.

[45] *See* Amex Approval Order, *supra* note 6.

[46] The Commission expects that the procedures implemented by Goldman and Lehman will monitor and prevent the misuse of material, non-public information as it relates to the development, maintenance and calculation of the indices.

[47] Investment Company Act Release No. 25594 (May 29, 2002), 67 FR 38681 (June 5, 2002).

[48] Investment Company Act Release No. 25622 (June 25, 2002).

manner as Investment Company Units previously approved by the Commission. Furthermore, the Commission notes that it granted accelerated approval to the request of the Amex, NYSE, and CHX to list and trade fixed income ETFs.[49] Based on the above, the Commission finds good cause to accelerate approval of the proposed rule change, as amended.

It Is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,[50] that the proposed rule change, as amended, (File No. SR–PCX 2003–41) is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[51]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03–27094 Filed 10–27–03; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–48664; File No. SR–PCX–2003–53]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. and Amendment No. 1 To Exempt ETP Holders and Sponsoring ETP Holders From the Administrative Late Charges Related to Transaction Fees by the Archipelago Exchange

October 20, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on September 24, 2003, the Pacific Exchange, Inc. (''PCX'' or ''Exchange''), through its subsidiary, PCX Equities, Inc. (''PCXE''), filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. On October 10, 2003, the Exchange filed an amendment that entirely replaced the original rule filing.[3] The PCX has designated this proposal as one establishing or changing a due, fee, or other charge imposed by the PCX under Section 19(b)(3)(A)(ii) of the Act,[4] which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange, through PCXE, proposes to amend the Schedule of Fees and Charges (''Schedule'') for the Archipelago Exchange (''ArcaEx'') to establish an exception to an administrative late charge applicable to ETP Holders and Sponsoring ETP Holders for failure to pay applicable dues, fees, or charges that are past due. The text of the proposed rule change is available at the PCX and at the Commission.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the PCX included statements concerning the purpose of and basis for its proposal and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The PCX has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange is proposing to amend ArcaEx's Schedule to establish an exception to an administrative late charge applicable to ETP Holders and Sponsoring ETP Holders who trade on ArcaEx for failure to pay dues, fees, or charges that are past due.

Currently, ArcaEx[5] assesses an administrative late charge to ETP Holders and Sponsoring ETP Holders that are substantially late in making payments to ArcaEx of dues, fees, fines or other charges.[6] The purpose of this charge is to recover ArcaEx's costs in seeking to collect such payments when they are past due and to encourage ETP Holders and Sponsoring ETP Holders to make such payments in a timely manner. ArcaEx provides invoices and related notices to ETP Holders and Sponsoring ETP Holders as follows: An initial invoice is sent approximately five days after a given month in which dues, fees or other charges are accrued. If no payment is made on the invoice within one month, ArcaEx sends the ETP Holder or Sponsoring ETP Holder a ''late'' notice on the tenth day of the month following the month in which the invoice was issued. Thereafter, if no payment is made by the twentieth of the month following issuance, ArcaEx sends a second ''late'' notice with an administrative late charge. The amount of the late charge is $250.00 or 1.0 percent of the invoice amount (whichever is greater) if the ETP Holder or Sponsoring ETP Holder is late once within the previous twelve months; and $500.00 or 1.5 percent of the invoice amount (whichever is greater) if the ETP Holder or Sponsoring ETP Holder is late more than once within the previous twelve months.

ArcaEx is proposing to establish an exception that would eliminate the requirement to pay the administrative late charges related to transaction fees. The purpose of such an exception is for business reasons in that ArcaEx is seeking to promote a more competitive level to its ETP Holders and Sponsoring ETP Holders for conducting business on ArcaEx. The administrative late charge will continue to be applied to all other dues, fees or charges that are past due.

2. Statutory Basis

The Exchange believes the proposal is consistent with Section 6(b) of the Act,[7] in general, and Section 6(b)(4) of the Act,[8] in particular, in that it provides for the equitable allocation of reasonable dues, fees and other charges among its members.

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[49] *See supra,* note 5.

[50] 15 U.S.C. 78s(b)(2).

[51] 17 CFR 200.3–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* October 9, 2003 letter from Tania J. Cho, Regulatory Policy, PCX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, and attachment (''Amendment No. 1''). Amendment No. 1 replaces and supersedes the original proposed rule change in its entirety. For purposes of calculating the 60-day abrogation period, the Commission considers the period to have commenced on October 10, 2003, the date the PCX filed Amendment No. 1. *See* section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C).

[4] 15 U.S.C. 78s(b)(3)(A)(ii).

[5] With the exception of regulatory related fees and charges, for which the PCX administer, ArcaEx administers the billing and collection of all other fees and charges.

[6] *See* Securities Exchange Act Release No. 35757 (May 24, 1995), 60 FR 28433 (May 31, 1995), (SR-PSE–95–15) (Notice of Filing and Immediate Effectiveness of the Administrative ''Late'' Charges). While this rule change in the Schedule has been operative since May 13, 1995, due to a clerical error the Schedule was not updated internally at that time. Hence, the Schedule, to date, has not reflected the late charge. This administrative error has been corrected internally by the PCX's Finance Department.

[7] 15 U.S.C. 78f(b).

[8] 15 U.S.C. 78f(b)(4).