

November 8, 2000



TO: Members and Member Organizations

ATTENTION: Chief Executive Officers/Managing Partners/  
Compliance Officers/Senior Registered Options Principals

FROM: CBOE Capital Markets Division

SUBJECT: iShares<sup>SM</sup> S&P 100 Index Fund

\*\*\*THIS INFORMATION CIRCULAR IS FOR THE INTERNAL USE OF MEMBERS AND MEMBER ORGANIZATIONS AND IS NOT FOR DISTRIBUTION TO THE PUBLIC\*\*\*

This circular is an updated version of RG00-154. The iShares<sup>SM</sup> S&P 100 Index Fund is the subject of a Prospectus and Supplement of Additional Information dated May 12, 2000 as revised on September 15, 2000, and will commence trading on Friday, October 27, 2000. (Trading Symbol: OEF, CUSIP: 464287101).

## **OVERVIEW**

The iShares S&P 100 Index Fund (the "Fund") is an exchange-traded fund managed by Barclays Global Fund Advisors (BGFA) that represents ownership in an open-end management company established to hold a portfolio of stocks replicating the S&P 100 Index (OEX). The Fund holds substantially all of the securities of the S&P 100 in approximately the same proportions as reflected in the Index. The Fund operates as an index fund and will not be actively managed.

The iShares S&P 100 Index Fund has been classified as a "non-diversified" fund, meaning that the Fund is not limited by the 1940 Act with regard to the percentage of their assets that may be invested in the securities of a single issuer. The iShares S&P 100 Index Fund, however, intends to maintain the required level of diversification and otherwise conduct its operations so as to qualify as a "regulated investment company."

The iShares S&P 100 Index Fund issues and redeems shares at Net Asset Value (NAV), but only in large blocks of 50,000 shares ("Creation Units"). In addition, these Creation Unit transactions are usually in exchange for a basket of stocks and an amount of cash. Only "Participating Dealers"<sup>1</sup> can create and redeem Fund shares. As a practical matter, it is likely that only institutions or large investors will purchase or redeem S&P 100 iShares directly with the Fund.

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<sup>1</sup> A "Participating Dealer" is defined as an entity that has entered into a "Participant Agreement" with Barclays Global Fund Advisors and SEI Investments Distributors, Inc., the Fund Distributor, and has the back-office capability to effect a transfer of securities through NSCC and DTC.

The purpose of this Circular is to provide basic information to Members and Member Organizations regarding iShares S&P 100 Index Fund and to advise of certain compliance responsibilities when handling transactions in Fund shares. This is not a sales document and is not intended to be distributed to customers.

"iShares" is a registered service mark of Barclays Global Investors, N.A.

Most investors will not purchase and redeem Fund shares directly with the Fund. The iShares S&P 100 Index Fund will generally trade in “round lots” of 100 shares on the CBOE at market prices throughout the trading day, and will trade until 4:15 PM Eastern time each trading day. Trading will take place through CBOE’s stock system, SEMS, and will be subject to the stock trading rules set forth in Chapter 30 of CBOE’s *Constitution and Rules*. Last sale and quote information will be disseminated over the Consolidated Tape Authority “Tape B,” and trades will clear through the facilities of NSCC and DTC.

## **PRODUCT DESCRIPTION**

The iShares S&P 100 Index Fund is an exchange-traded security that represents ownership in an open-end management company established to hold a portfolio of stocks replicating the S&P 100 Index (OEX). The Fund is open-ended, meaning that new shares can be created, and outstanding shares redeemed, at NAV on any business day. This feature helps deter the Fund from trading at large discounts or premiums to the NAV.

Barclays Global Fund Advisors (BGFA), a subsidiary of Barclays Global Investors, N.A., is the advisor to the Fund. Investors Bank & Trust Company (IBT) is the administrator, custodian, transfer agent and securities lending agent. SEI Investments Distribution Company is the distributor for the Fund.

The price of this security will be very close to 1/10th the value of the S&P 100 Index. Share prices will be quoted in dollars and fractions with minimum increments of 1/64th. A quote of 100 1/64th would represent a price of \$100.015625 (or \$10,001.56 for an iShares round lot). Shares of the fund can be purchased or sold, in round lots of 100 shares or “odd lots” of less than 100 shares, at any time during regular Exchange hours.

All iShares S&P 100 Index Fund trades will settle through the facilities of NSCC subject to 3-day settlement. Fund shares are held in book-entry form only at The Depository Trust Company (DTC).

iShares S&P 100 pays out dividends to investors on a quarterly basis. The amount of the distribution is equal to the accrued dividends received by the trust for a given quarter less fund expenses for that quarter. iShares S&P 100 Index Fund distributes its net capital gains, if any, to investors annually.

iShares S&P 100 Index Fund shares can be created at NAV in “creation unit” block sizes (50,000 shares) by the deposit of a specified portfolio of stock closely approximating the composition of the relevant index and a specified amount of cash. Conversely, a creation unit (50,000 shares) can be redeemed at NAV for a specific portfolio of stocks and a specified cash amount. The shares of component stocks in a “creation unit” are determined by BGFA prior to the opening of trading each business day. The required cash amount is determined on the same day following the close of trading. Members are reminded to make sure that their clearing firm is registered as a Participating Dealer before undertaking to create or redeem iShares S&P 100 Fund shares.

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In conjunction with the trading of the iShares S&P 100 Index Fund, which will trade under the symbol OEF, CBOE will disseminate the following values at least once a day:

- Intra-Day Trading Value (*OEV*) – The pro-rata value of the Fund’s holdings. (Every 15 seconds)
- Shares Outstanding (*OES*) – The number of Fund shares outstanding. (Once per day)
- Net Asset Value (*OEL*) – Fund NAV based on previous day’s closing prices (Once per day)
- Accrued Dividends (*OEA*) – Dividend accrued from previous distribution. (Once per day)
- Final Dividend Amount (*OEG*) – Dividend payment at distribution (Once per day)
- Estimated Cash Component per Creation Unit (*OEP*) (Once per day)
- Total Cash Component per Creation Unit (*OEK*) (Once per day)

### **CERTAIN RISK FACTORS**

- The Fund is not actively managed. The Fund may be affected by a general decline in the market segments relating to the S&P 100. The Fund invests in the securities included in the S&P 100 Index regardless of their investment merit. BGFA does not attempt to individually select stocks or to take defensive positions in declining markets.
- Factors such as the fees and expenses of the Fund, imperfect correlation between the Fund’s stocks and those in the S&P 100, rounding of share prices, changes to the S&P 100 and regulatory policies may affect BGFA’s ability to achieve close correlation with the S&P 100. The Fund’s returns may therefore deviate from those of the S&P 100.
- Trading in iShares on the CBOE may be halted because of market conditions or for reasons that, in the view of the CBOE, make trading in iShares inadvisable. In addition, trading in iShares is subject to trading halts caused by extraordinary market volatility pursuant to CBOE “circuit breaker” rules.
- iShares may trade below, at, or above their NAV. The NAV of iShares will fluctuate with changes in the market value of the Fund’s holdings. The trading prices of iShares will fluctuate in accordance with changes in the Fund’s NAV as well as market supply and demand on the CBOE. However, given that iShares can be created and redeemed only in Creation Units at NAV (unlike shares of many closed-end funds, which frequently trade at appreciable discounts from, and sometimes at premiums to, their NAVs), it is less likely that large discounts or premiums to the NAV of iShares will be sustained.

The foregoing information is excerpted from the Prospectus, and the Exchange assumes no responsibility for the accuracy or completeness of such information. Members and associated persons of member organizations are advised to read the entire Prospectus for information relating to the iShares S&P 100 Index Fund. Copies of the Prospectus may be obtained from the Exchange upon request.

### **REGULATORY CONSIDERATIONS**

#### **GENERAL**

iShares S&P 100 Index Fund (“iShares S&P 100”) shares involve risk and are not for everyone. It is important that investors be afforded an explanation of the special characteristics and risks of the iShares S&P 100.

Member and Member Organizations are reminded that “front running” prohibitions (RG92-29)

apply to trading the iShares S&P 100 on the Exchange.

*Applicable Exchange Rules.* Trading in iShares S&P 100 is generally governed by Chapter 30 of the CBOE rules. Members are eligible to seek approval, by application submitted to the Membership Committee, to participate in the trading on the Exchange of Chapter 30 securities. Application materials may be obtained from the Membership Department.

*Trading Halts.* Pursuant to CBOE Rule 24.7, the Exchange may halt trading in iShares S&P 100 if such action is deemed appropriate. Among the factors to be considered under Rule 24.7 in making a determination whether to halt trading include, but are not limited to 1) whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the current value of the iShares S&P 100, and 2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. In addition, trading in iShares S&P 100 would be halted (along with the trading of other securities on the Exchange) if the circuit breaker parameters under CBOE Rule 6.3B are reached.

*Short Sales.* iShares S&P 100 are short sale eligible and are exempt from the tick requirements of SEC Rule 10a-1 (“Short Sale Rule”). Thus, they can be sold short on a zero or zero minus tick.

*Continuous Offering (Marginability).* iShares S&P 100 are essentially issued by an open-end management company and, as such, are in continuous distribution. However, Member Organizations that do not create iShares S&P 100, or otherwise participate in the distribution of iShares S&P 100 (but that do effect transactions for customers) may extend margin to customers at the time of such transactions. The prohibitions of Section 11(d)(1) of the Securities Exchange Act of 1934 have been deemed not applicable.

*Continuous Offering (Prospectus Delivery).* Because shares of an open-end mutual fund are deemed to be in continuous distribution, investors in iShares S&P 100, whether through Creation Unit transactions or transactions on the Exchange, must be furnished with a copy of the prospectus prior to or concurrent with the confirmation of the first transaction. Copies of the prospectus and Statement of Additional Information, which contains more detailed information on the iShares Trust and the iShares S&P 100 Index Fund can be obtained from the iShares Trust, c/o SEI Investments Distribution Company, 1 Freedom Valley Drive, Oaks, PA, 19456, telephone – 1-800- iShares. Copies may also be obtained from the CBOE and are available on CBOE’s website: [www.cboe.com](http://www.cboe.com).

## **MARGIN REQUIREMENTS**

iShares S&P 100 are margin equity securities and, therefore, purchases on margin are subject to an initial margin requirement of 50% and a maintenance margin requirement of 25%.

As noted above, iShares S&P 100 are short sale eligible. The initial margin requirement for a short sale is the short sale proceeds plus 50%. The maintenance margin requirement is the current market value of the iShares S&P 100 plus 30% (based on the estimated price per share as of June 30, 2000).

No margin is required on short OEX call (put) options covered by an equivalent long (short) position in iShares S&P 100. These provisions apply to margin accounts only. One thousand (1,000) iShares S&P 100 shares are required for each short OEX contract. Long iShares S&P 100 must be priced at the lower of current market value or short call exercise price. Any amount

by which the exercise price of a short OEX put option exceeds the current market value of short iShares S&P 100 must be added to the Regulation T requirement (for calculating excess) and maintenance margin requirement on the iShares S&P 100. [See CBOE Regulatory Circular RG99-09 for more information on writing cash settled index options on a covered basis in a margin account.]

## **CAPITAL REQUIREMENTS**

As an equity security, iShares S&P 100 will be subject to a haircut equal to 15% of market value. For OEX options market-makers, S&P 100 iShares qualify as an options hedge (permitted offset) under Exchange Rule 12.3(f)(3)(A)(vii). Under the risk-based method, there will be a 100% offset between iShares S&P 100 and OEX options. A 90% offset will apply between iShares S&P 100 and other option classes in the same product group (High Capitalization Broad Based Indexes -- US Market Product Group A).<sup>2</sup>

### **IMPACT UPON OPITONS MARKET-MAKER NET CAPITAL EXEMPTION**

***Options Market-maker that are operating under the exemptive provisions of Paragraph (b)(1) of the SEC Net Capital Rule 15c3-1 (i.e., filing FOCUS Reports on a yearly basis only) are cautioned that making markets in or trading iShares S&P 100 (or any other security that is not a CBOE listed option) in a manner that does not qualify as an options offset under risk-based haircut requirements, will lose their options market maker exemptions and become subject to the provisions of the SEC Net Capital Rule.*** Trading the iShares S&P 100 as an offset to index options market making activity is permissible and will not result in any negative impact on an options market-maker's capital exemption. Members should refer to Regulatory Circular RG97-40 for further information regarding capital requirements and structured products.

## **USALES PRACTICE**

iShares S&P 100 are considered equity securities and are subject to the provisions of Rule 30.50. A customer's account is not required to be options approved. Members and associated persons of Member Organizations should take such steps as may be reasonably necessary to assure that prospective purchasers and sellers of iShares S&P 100 reach an investment decision only after carefully considering the suitability of the security in light of their particular financial circumstances and objectives. As noted above, investors in iShares S&P 100 must be furnished with the prospectus prior to or concurrent with the confirmation of the first transaction.

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Questions regarding suitability of customer transactions in iShares S&P 100 should be directed to Barry Szurgot (312) 786-7756, questions regarding marginability should be directed to Jim Adams (312) 786-7718 and questions regarding net capital requirements should be directed to Bob Gardner (312) 786-7937. General product questions should be directed to William Speth of the Capital Markets Division in Chicago at (312) 786-7141.

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<sup>2</sup> Current indexes in the High Capitalization Broad Based Indexes- US Market Product Group "A" are OEX, SPX, NYA, NFT, DJX, XII, RAY, and RIY.