



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

DIVISION OF  
MARKET REGULATION

April 9, 2007

Mr. Benjamin J. Haskin, Esq.  
Willkie Farr & Gallagher, LLP  
1875 K Street, N.W.  
Washington, DC 20006-1238

Re: Class Relief for Fixed Income Exchange-Traded Funds  
File No. TP 07- 57

Dear Mr. Haskin:

In your letter dated April 9, 2007, as supplemented by conversations with the staff of the Division of Market Regulation ("Staff"), you request on behalf of persons or entities engaging in transactions in shares of Fixed Income exchange-traded funds ("Shares"), exemptive relief, or no-action or interpretive advice, with respect to Rules 10a-1 and 10b-17 under the Securities Exchange Act of 1934 ("Exchange Act"), Rules 101 and 102 of Regulation M, and Rule 200(g) of Regulation SHO in connection with secondary market transactions in Shares and the creation and redemption of Shares. Our response is attached to the enclosed photocopy of your letter to avoid having to recite or summarize the facts set forth in your letter. Unless otherwise noted, defined terms in this letter have the same meaning as in your April 9, 2007 correspondence.

As you note in your letter, the Securities and Exchange Commission ("Commission") or the Staff has granted relief similar to that requested in your letter with respect to secondary market transactions in Shares and the creation and redemption of Shares in connection with other Fixed Income exchange-traded funds ("Fixed Income ETFs").<sup>1</sup> In addition to having granted individual relief for particular Fixed Income ETFs, the Staff has issued class relief covering certain transactions in other exchange-traded funds and similar products.

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<sup>1</sup> Fixed Income ETFs are investment companies registered under the Investment Company Act of 1940 (the "Investment Company Act") either as unit investment trusts or as open-end investment companies and are comprised only of fixed income securities (including convertibles). Like the shares of equity ETFs, Fixed Income ETF shares are traded by both institutional and retail investors on securities exchanges and in the over-the-counter markets at negotiated prices.

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Specifically, the Staff has issued relief to equity ETFs and commodity-based investment vehicles.<sup>2</sup>

Response:

The relief granted herein extends to all Fixed Income ETFs that continuously redeem, at net asset value, Creation Unit Aggregations of Shares, where the secondary market price of Shares do not vary substantially from the net asset value of such Shares (which will be based on the value of the Component Securities).<sup>3</sup>

Further, the Fixed Income ETFs must meet the following conditions:

- The Fixed Income ETF shares are issued by an open-end investment company or unit investment trust registered with the Commission under the Investment Company Act;
- The Fixed Income ETF shares are listed and traded on a national securities exchange or on a facility of a national securities association that has obtained approval from the Commission pursuant to Section 19(b) of the Exchange Act of a rule change regarding the listing and trading of Shares on a national securities exchange or on a facility of a national securities association (or that is relying on Rule 19b-4(e) to list and trade Shares);
- The Fixed Income ETF seeks to: (i) provide investment results that correspond to the performance of a particular Underlying Index; (ii) exceed the performance of a particular Underlying Index by a specified

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<sup>2</sup> See Letter from James A. Brigagliano, Division of Market Regulation, to Stuart M. Strauss, dated October 24, 2006, File No. TP-07-07 for Class Relief for equity-based Exchange Traded Funds. See also Letter from Racquel L. Russell, Division of Market Regulation, to George T. Simon, Foley & Lardner LLP, dated June 21, 2006, File No. TP-06-81 for commodity-based investment vehicles. See also Letter from James A. Brigagliano, Division of Market Regulation, to Clair P. McGrath, Vice President and Special Counsel, The American Stock Exchange, dated August 17, 2001, File No. TP-00-133 for Exemptive Relief for equity-based Exchange Traded Index Funds. The Commission has also recently provided expanded class relief for ETFs with respect to Section 11(d)(1) of the Exchange Act and Rules 10b-10, 11d1-2, 15c1-5, and 15c1-6 under the Exchange Act. See Letter from Catherine McGuire, Esq., Chief Counsel, Division of Market Regulation, to the Securities Industry Association Derivative Products Committee, dated November 21, 2005.

<sup>3</sup> For purposes of our response, "Component Securities" are individual Fixed Income securities that comprise the Fixed Income ETF basket and that are assembled to correspond to the performance of the specified Underlying Index.

multiple; or (iii) to correspond to the inverse of the performance of a particular Underlying Index by a specified multiple;<sup>4</sup>

- The Underlying Index must consist of only Fixed Income Securities;
- The Fixed Income ETF shares must be issued and redeemed in Creation Unit Aggregations of 50,000 shares or such other amount where the value of a creation unit is at least \$1 million at the time of issuance; and
- The intra-day proxy value of the Fixed Income ETF per share and the value of the Underlying Index must be publicly disseminated by a major market data vendor during the trading day.

The relief is further subject to the “rule specific” conditions set forth below.

#### Rule 101 of Regulation M

Generally, Rule 101 of Regulation M is an anti-manipulation regulation that, subject to certain exceptions, prohibits any “distribution participant” and its “affiliated purchasers” from bidding for, purchasing, or attempting to induce any person to bid for or purchase, any security which is the subject of a distribution until after the applicable restricted period, except as specifically permitted in the Regulation. The provisions of Rule 101 of Regulation M apply to underwriters, prospective underwriters, brokers, dealers, or other persons who have agreed to participate or are participating in a distribution of securities.

The Staff hereby confirms the prior interpretations of Regulation M provided by the Commission and the Staff to issuers of Fixed Income ETFs (as discussed more fully below) where:

- (i) No Component Security (excluding a Treasury Security) represents more than 30% of the weight of the Fixed Income ETF, and the five highest weighted Component Securities in the Fixed Income ETF do not in the aggregate account for more than 65% of the weight of the Fixed Income ETF;<sup>5</sup> and

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<sup>4</sup> A Fixed Income ETF may employ a variety of strategies to achieve its stated investment objectives. In addition, a Fixed Income ETF may require a deposit of only cash or fixed income securities, such as Treasury Securities. Likewise, redemption may be in-kind or investors may receive cash or fixed income securities as set forth in the registration statement.

<sup>5</sup> For purposes of our response, whether any one Component Security constitutes more than 25% of the total value of the Fixed Income ETF shall be determined as of the most recent rebalancing of the Fixed Income ETF's reference securities index.

- (ii) The Fixed Income ETF (except where the fund consists entirely of exempted securities) must include a minimum of 13 non-affiliated issuers.

However, where the Fixed Income ETF is wholly comprised of non-convertible Fixed Income securities that are rated "investment grade" by at least one nationally recognized statistical rating organization (as that term is used in Rule 15c3-1 in one of its generic rating categories that signifies investment grade), conditions (i) and (ii) above shall not apply.

The Staff hereby confirms that Fixed Income ETFs meeting the above requirements will be excepted under paragraph (c)(4) of Rule 101 of Regulation M, which provides an exception for redeemable securities issued by an open-end management investment company, thus permitting persons who may be deemed to be participating in a distribution of Shares to bid for or purchase Shares during their participation in such distribution.<sup>6</sup>

The Staff also confirms the interpretation of Rule 101 of Regulation M that the redemption of Creation Unit Aggregations of Shares and the receipt of Component Securities in exchange therefor by a participant in a distribution of Shares would not constitute an "attempt to induce any person to bid for or purchase a covered security, during the applicable restricted period"<sup>7</sup> within the meaning of Regulation M, and therefore would not violate Regulation M.

#### Rule 102 of Regulation M

Rule 102 of Regulation M prohibits issuers, selling security holders, or any affiliated purchaser of such person from bidding for, purchasing, or attempting to induce any person to bid for or purchase a covered security during the applicable restricted period in connection with a distribution of securities effected by or on behalf of an issuer or selling security holder.

The Staff hereby confirms that Fixed Income ETFs are excepted under paragraph (d)(4) of Rule 102 of Regulation M, thus permitting Fixed Income ETFs to redeem Shares during the continuous offering of the Shares where the Fixed Income ETF meets conditions (i) and (ii) set forth above in the discussion concerning Rule 101 of Regulation M; provided,

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<sup>6</sup> We note that Regulation M does not prohibit a distribution participant and its affiliated purchasers from bidding for and purchasing Component Securities in accordance with the exceptions contained in paragraphs (b)(6) and (c)(1) of Rule 101. Rule 101(b)(6)(i) excepts basket transactions in which bids or purchases are made in the ordinary course of business in connection with a basket of 20 or more securities in which a covered security does not comprise more than 5% of the value of the basket purchased. Rule 101(b)(6)(ii) excepts adjustments to such a basket made in the ordinary course of business as a result of a change in the composition of a standardized index. Also, Rule 101(c)(1) excepts transactions in "actively-traded securities."

<sup>7</sup> 17 CFR 242.101

however, that where the Fixed Income ETF is wholly comprised of non-convertible Fixed Income securities that are rated "investment grade" by at least one nationally recognized statistical rating organization (as that term is used in Rule 15c3-1 in one of its generic rating categories that signifies investment grade), conditions (i) and (ii) above shall not apply.

#### Rule 10a-1

Rule 200 of Regulation SHO defines "short sale" and Rule 10a-1 under the Exchange Act governs short sales generally. Paragraph (a) of Rule 10a-1 covers transactions in any security registered on a national securities exchange, if trades in such security are reported in the consolidated transaction reporting system, and prohibits short sales with respect to these securities unless such sales occur on a "plus tick," (that is, a price above the price at which the immediately preceding sale was effected), or "zero-plus tick," (that is, at the last sale price if it was higher than the last different price). Rule 10a-1 is designed to prevent the market price of a stock or other "reported security," as defined in Rule 11Aa3-1(a)(4) under the Exchange Act, from being manipulated downward by unrestricted short selling.

Given the composite and derivative nature of Fixed Income ETFs, it would not appear that trading in Shares would be susceptible to the practices that Rule 10a-1 is designed to prevent. Thus, the Commission hereby grants an exemption from Rule 10a-1 to permit sales of Shares without regard to the "tick" requirements of Rule 10a-1.

#### Rule 200(g) of Regulation SHO

Rule 200(g) of Regulation SHO provides that a broker-dealer must mark all sell orders of any equity security as "long," "short," or "short exempt." Rule 200(g)(2) requires that a short sale order must be marked "short exempt" if the seller is relying on an exception from the tick test of Rule 10a-1 of the Exchange Act or any short sale price test of any exchange or national securities association.

The Staff will not recommend to the Commission enforcement action under Rule 200(g) of Regulation SHO if a broker-dealer marks "short," rather than "short exempt," a short sale that is effected in Shares, subject to the following conditions:

- i. For each exempt short sale, the various market centers that execute such sales have instituted procedures to "mask" the short sale character of the transaction so that they are executed as short exempt;
- ii. Such market centers monitor on a regular basis to confirm that any such product or transaction continues to meet the conditions for the exemptive relief and re-institute the price test for any product or transaction that fails to satisfy such conditions;
- iii. A broker-dealer executing exempt short sales will mark such sales as "short," and in no event will such sales be marked "long;" and

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- iv. The market centers will maintain an audit trail of all such trade executions, which is capable of being produced and subject to review upon request by the Commission and other appropriate regulatory authorities.

#### Rule 10b-17

Rule 10b-17, with certain exceptions, requires an issuer of a class of publicly traded securities to give notice of certain specified actions (for example, a dividend distribution, stock split, or rights offering) relating to such class of securities in accordance with Rule 10b-17(b). Paragraph (c) of Rule 10b-17 states that the rule shall not apply to redeemable securities issued by open-end investment companies and unit investment trusts registered under the 1940 Act. Thus, with respect to a Fixed Income ETF that has been registered under the Investment Company Act as an open-end management investment company or unit investment trust, the Commission hereby grants an exemption from the requirements of Rule 10b-17 to such Fixed Income ETFs with respect to transactions in Shares notwithstanding that the Shares are issued and redeemed in Creation Unit Aggregations.

The foregoing exemptions from Rules 10a-1 and 10b-17, interpretive guidance with respect to Rules 101 and 102 of Regulation M, and no-action position taken under Rule 200(g) of Regulation SHO, are strictly limited to the application of those rules to transactions involving Shares under the circumstances described above and in your letter. Such transactions should be discontinued, pending presentation of the facts for our consideration, in the event that any material change occurs with respect to any of those facts or representations. Moreover, the foregoing exemptions from Rules 10a-1 and 10b-17, interpretive guidance with respect to Rules 101 and 102 of Regulation M, and no-action position taken under Rule 200(g) of Regulation SHO are subject to the condition that such transactions in Shares, any Component Security, or any related securities are not made for the purpose of creating actual, or apparent, active trading in or raising or otherwise affecting the price of such securities. Finally, requests for relief for products not meeting the above criteria will continue to be considered upon request on a case-by-case basis.

These exemptive, interpretive, and no-action positions are subject to modification or revocation if at any time the Commission or Staff determines that such action is necessary or appropriate in furtherance of the purposes of the Exchange Act. In addition, persons relying on these exemptions and no-action positions are directed to the anti-fraud and anti-manipulation provisions of the Exchange Act, particularly Sections 9(a), 10(b), and Rule 10b-5 thereunder. Responsibility for compliance with these and other provisions of the federal or state securities laws must rest with persons relying on these exemptive, interpretive, and no-action positions. The Staff expresses no view with respect to other questions that the

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proposed transactions may raise, including, but not limited to, the adequacy of disclosure concerning, and the applicability of other federal and state laws to, the proposed transactions.

For the Commission, by the Division of  
Market Regulation, pursuant to delegated  
authority,

A handwritten signature in black ink, reading "James A. Brigagliano". The signature is written in a cursive style with a large, stylized initial "J".

James A. Brigagliano  
Associate Director

Attachment

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April 9, 2007

Mr. James A. Brigagliano  
Associate Director, Trading Practices and Processing  
Division of Market Regulation  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549

Re: Request for Exemptive, Interpretive or No-Action Relief from Rules 10a-1 and 10b-17 under the Securities Exchange Act of 1934, Rules 101 and 102 of Regulation M, and Rule 200(g) of Regulation SHO for Fixed Income Exchange-Traded Funds

Dear Mr. Brigagliano:

The iShares Trust (the "Trust") is an open-end management investment company which was organized as a Delaware business trust on December 16, 1999. The Trust has over 125 individual series that issue and redeem shares at their net asset values ("NAVs") in aggregations of a specified number of shares.

The Trust generally lists exchange-traded fund ("ETF") shares on a national securities exchange (an "Exchange") registered with the Securities and Exchange Commission (the "Commission"). The market prices of ETF shares may vary from their NAVs, and it is not anticipated that any deviation between market price and NAV will be material.

The Trust notes that the creation and issuance by an investment company that invests in Fixed Income Securities (as defined below) of shares or units that individually trade on an Exchange, but that in large aggregations can be purchased from and redeemed with the issuing investment company, is no longer novel. The Commission has in the past ten years considered and approved many such proposals related to ETFs that invest in Fixed Income Securities. Some of these fixed income ETFs have been trading publicly for years, and the Trust is not aware of any abuses associated with them. Indeed, several of the products have been so embraced by investors that they routinely are among the highest volume securities on the exchanges on which they trade.<sup>1</sup>

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<sup>1</sup> The Commission has previously granted to the American Stock Exchange ("Amex") exemptive and no-action relief under Rules 10a-1, 10b-6, 10b-7, 10b-10, 14e-5 (formerly 10b-13), 10b-17, 11d1-2, 15c1-5, and 15c1-6 under the Exchange Act with respect to the trading of SPDRs and MidCap SPDRs<sup>TM</sup>; Select Sector SPDRs<sup>TM</sup>, and The Nasdaq-100 Trust(SM). See letter from Nancy J. Sanow, Assistant Director, Division of Market Regulation, to James F. Duffy, Senior Vice President and General Counsel, Amex, dated January 22, 1993 (regarding SPDRs);



















