

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54961; File No. SR-Amex-2006-101)

December 18, 2006

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing of a Proposed Rule Change and Amendments No. 1 and 2 Thereto Relating to the Listing and Trading of Shares of Funds of the ProShares Trust

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 24, 2006, the American Stock Exchange LLC (“Amex” or “Exchange”) 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 substantially prepared by the Exchange. On November 22, 2006, Amex submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On December 8, 2006, Amex submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> 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 proposes to list and trade the shares (the “Shares”) of eighty-one (81) funds of the ProShares Trust (the “Trust”) based on numerous underlying securities indexes.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> In Amendment No. 1, Amex proposed to list and trade the shares of twenty-four (24) additional funds of the Trust (as defined herein) and made certain clarifying changes with respect to the trading of the Shares (as defined herein). Amendment No. 1 replaced the original filing in its entirety.

<sup>4</sup> In Amendment No. 2, Amex made additional changes to clarify certain defined terms, the creation and redemption of the Shares, and the criteria for continued listing of the Shares. Amendment No. 2 replaced Amendment No. 1 in its entirety.

The text of the proposal is available on Amex's Internet Web site (<http://www.amex.com>), at Amex's principal office, and at the Commission's Public Reference Room.

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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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

Amex Rules 1000A et seq. provide standards for the listing of Index Fund Shares, which are securities issued by an open-end management investment company for exchange trading. These securities are registered under the Investment Company Act of 1940 ("1940 Act"), as well as under the Act. Index Fund Shares are defined in Amex Rule 1000A(b)(1) as securities based on a portfolio of stocks or fixed income securities that seek to provide investment results that correspond generally to the price and yield of a specified foreign or domestic stock index or fixed income securities index.

Recent amendments adopting Amex Rule 1000A(b)(2) now permit the Exchange to list and trade Index Fund Shares that seek to provide investment results that exceed the performance of an underlying securities index by a specified multiple or that seek to provide investment results that correspond to a specified multiple of the inverse or opposite of the index's performance.

The Exchange proposes to list under amended Amex Rule 1000A the Shares of eighty-one (81) new funds of the Trust that are designated as Ultra Funds, Short Funds, and UltraShort Funds (the “Funds”). Each of the Funds will have a distinct investment objective. Each Fund will attempt, on a daily basis, to achieve its investment objective by corresponding to a specified multiple of the performance, or the inverse performance, of a particular equity securities index as briefly described below. The Funds are based on the following benchmark indexes:<sup>5</sup> (1) S&P Small Cap 600 Index, (2) S&P500/Citigroup Value Index, (3) S&P500/Citigroup Growth Index, (4) S&P MidCap 400/Citigroup Value Index, (5) S&P MidCap 400/Citigroup Growth Index, (6) S&P SmallCap 600/Citigroup Value Index, (7) S&P SmallCap 600/Citigroup Growth Index, (8) Dow Jones US Basic Materials Index, (9) Dow Jones US Consumer Services Index, (10) Dow Jones US Consumer Goods Index, (11) Dow Jones US Oil and Gas Index, (12) Dow Jones US Financials Index, (13) Dow Jones US Health Care Index, (14) Dow Jones US Industrials Index, (15) Dow Jones US Real Estate Index, (16) Dow Jones US Semiconductor Index (17) Dow Jones US Technology Index, (18) Dow Jones US Utilities Index (19) Russell 2000® Index, (20) Russell Midcap® Index, (21) Russell Midcap® Growth Index, (22) Russell Midcap® Value Index, (23) Russell 1000® Index, (24) Russell 1000® Growth Index, (25) Russell 1000® Value Index, (26) Russell 2000® Growth Index, and (27) Russell 2000® Value Index (each index individually referred to as the “Underlying Index,” and all Underlying Indexes collectively referred to as the “Underlying Indexes”).<sup>6</sup> Certain Funds (the “Ultra Funds” or “Bullish Funds”) seek daily

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<sup>5</sup> A complete list of the Funds is set forth in Exhibit A to Amendment No. 2, which is available on Amex’s Internet Web site (<http://www.amex.com>).

<sup>6</sup> The Statement of Additional Information (“SAI”) for the Funds discloses that each Fund reserves the right to substitute a different Underlying Index. Substitutions can occur if an Underlying Index becomes unavailable, no longer serves the investment needs of shareholders, the Fund experiences difficulty in achieving investment results that

investment results, before fees and expenses that correspond to twice (200%) the daily performance of the Underlying Indexes. The net asset value (“NAV”) of the Shares of each of these Ultra Funds, if successful in meeting its objective, should increase, on a percentage basis, approximately twice as much as the respective Fund’s Underlying Index gains when the prices of the securities in such Underlying Index increase on a given day, and should decrease approximately twice as much as the respective Underlying Index loses when such prices decline on a given day.

In addition, the Exchange proposes to list and trade Shares of certain Funds (the “Short Funds”) that seek daily investment results, before fees and expenses, that correspond to the inverse or opposite of the daily performance (-100%) of the Underlying Indexes. If each of these Short Funds is successful in meeting its objective, the NAV of the Shares of each Short Fund should increase approximately as much, on a percentage basis, as the respective Underlying Index loses when the prices of the securities in the Underlying Index decline on a given day, or should decrease approximately as much as the respective Underlying Index gains when the prices of the securities in the Underlying Index rise on a given day.

Finally, the Exchange proposes to list and trade Shares of certain Funds (the “UltraShort Funds”) that seek daily investment results, before fees and expenses, that correspond to twice the inverse (-200%) of the daily performance of the Underlying Indexes. If each of these UltraShort

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correspond to the applicable Underlying Index, or for any other reason determined in good faith by the Board (as defined herein). In such instance, the substitute index will attempt to measure the same general market as the current Underlying Index. Shareholders will be notified (either directly or through their intermediary) if a Fund’s current Underlying Index is replaced. In the event a Fund substitutes an Underlying Index with another, different index, the Exchange will file with the Commission a Form 19b-4, which the Commission would have to approve to permit continued trading of the product based on the substitute index. See *infra* note 63 and accompanying text.

Funds is successful in meeting its objective, the NAV of the Shares of each UltraShort Fund should increase approximately twice as much, on a percentage basis, as the respective Underlying Index loses when the prices of the securities in the Underlying Index decline on a given day, or should decrease approximately twice as much as the respective Underlying Index gains when the prices of the securities in the Underlying Index rise on a given day. The Short Funds and UltraShort Funds each have investment objectives that seek investment results corresponding to an inverse performance of the Underlying Indexes and are collectively referred to as the “Bearish Funds.”

The Commission recently approved the listing and trading of certain Ultra Funds, Short Funds, and UltraShort Funds based on the S&P 500 Index, Nasdaq-100 Index, Dow Jones Industrial Average Index, and S&P MidCap 400 Index.<sup>7</sup> Each of the existing Ultra Funds is expected to gain, on a percentage basis, approximately twice as much as the benchmark Underlying Index and should lose approximately twice as much as the Underlying Index when such prices decline. Each of the existing Short Funds is expected to achieve investment results, before fees and expenses, that correspond to the inverse or opposite of the daily performance (-100%) of an Underlying Index. In addition, each of the existing UltraShort Funds is expected to achieve investment results, before fees and expenses, that correspond to twice the inverse or opposite of the daily performance (-200%) of an Underlying Index.

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<sup>7</sup> See Securities Exchange Act Release No. 52553 (October 3, 2005), 70 FR 59100 (October 11, 2005). See also Securities Exchange Act Release No. 54040 (June 23, 2006), 71 FR 37629 (June 30, 2006) (approving Amex’s proposal to list and trade shares of funds of the Trust based on certain other benchmark indexes).

ProShare Advisors LLC is the investment advisor (the “Advisor”) to each Fund. The Advisor is registered under the Investment Advisers Act of 1940.<sup>8</sup> While the Advisor will manage each Fund, the Trust’s Board of Trustees (the “Board”) will have overall responsibility for the Funds’ operations. The composition of the Board is, and will be, in compliance with the requirements of Section 10 of the 1940 Act.

SEI Investments Distribution Company (the “Distributor”), a broker-dealer registered under the Act, will act as the distributor and principal underwriter of the Shares. JPMorgan Chase Bank, N.A. will act as the index receipt agent (“Index Receipt Agent”) for which it will receive fees. The Index Receipt Agent will be responsible for transmitting the Deposit List (as defined herein) to the National Securities Clearing Corporation (“NSCC”) and for the processing, clearance, and settlement of purchase and redemption orders through the facilities of the Depository Trust Company (“DTC”) and NSCC on behalf of the Trust. The Index Receipt Agent will also be responsible for the coordination and transmission of files and purchase and redemption orders between the Distributor and the NSCC.

Shares of the Funds issued by the Trust will be a class of exchange-traded securities that represent an interest in the portfolio of a particular Fund.<sup>9</sup> The Shares will be registered in book-entry form only, and the Trust will not issue individual share certificates. The DTC or its nominee will be the record or registered owner of all outstanding Shares. Beneficial ownership of Shares will be shown on the records of DTC or DTC participants.

### Underlying Indexes

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<sup>8</sup> The Trust, Advisor, and Distributor (“Applicants”) have filed with the Commission an Amended Application for an Order under Sections 6(c) and 17(b) of the 1940 Act (the “Application”) for the purpose of exempting the Funds of the Trust from various provisions of the 1940 Act (File No. 812-12354).

The Exchange represents that the Underlying Index components comply with the generic listing standards set forth in Commentary .02 to Amex Rule 1000A.

S&P SmallCap 600 Index. The S&P SmallCap 600 Index is a measure of small-cap company U.S. stock market performance. It is a float-adjusted, market capitalization-weighted index of 600 U.S. operating companies. Securities are selected for inclusion in the index by a committee of Standard & Poor's through a non-mechanical process that factors criteria such as liquidity, price, market capitalization, financial viability, and public float. This Underlying Index<sup>10</sup> has been approved for options trading and is also the basis for an exchange traded fund ("ETF").<sup>11</sup>

S&P 500/Citigroup Value Index. The S&P 500/Citigroup Value Index is designed to provide a comprehensive measure of large-cap U.S. equity "value" performance. It is an unmanaged, float-adjusted, and market capitalization-weighted index comprised of stocks representing approximately half the market capitalization of the S&P 500 Index that have been identified as being on the value end of the growth-value spectrum. This Underlying Index<sup>12</sup> is the basis for an ETF.

S&P 500/Citigroup Growth Index. The S&P 500/Citigroup Growth Index is designed to provide a comprehensive measure of large-cap U.S. equity "growth" performance. It is an unmanaged, float-adjusted, and market capitalization-weighted index comprised of stocks representing approximately half the market capitalization of the S&P 500 Index that have been

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<sup>9</sup> The Trust is registered as a business trust under the Delaware Corporate Code.

<sup>10</sup> The shares of the iShares S&P SmallCap 600 Index Fund are traded on the Exchange.

<sup>11</sup> See Securities Exchange Act Release No. 35532 (March 24, 1995), 60 FR 16518 (March 30, 1995).

<sup>12</sup> The shares of the iShares S&P 500 Value Index Fund are traded on the Exchange.

identified as being on the growth end of the growth-value spectrum. This Underlying Index<sup>13</sup> is the basis for an ETF.

S&P MidCap 400/Citigroup Value Index. The S&P MidCap 400/Citigroup Value Index is designed to provide a comprehensive measure of mid-cap U.S. equity “value” performance. It is an unmanaged, float-adjusted, and market capitalization-weighted index comprised of stocks representing approximately half the market capitalization of the S&P MidCap 400 Index that have been identified as being on the value end of the growth-value spectrum. This Underlying Index<sup>14</sup> has been approved for options trading and is also the basis for an ETF.<sup>15</sup>

S&P MidCap 400/Citigroup Growth Index. The S&P MidCap 400/Citigroup Growth Index is designed to provide a comprehensive measure of mid-cap U.S. equity “growth” performance. It is an unmanaged, float-adjusted, and market capitalization-weighted index comprised of stocks representing approximately half the market capitalization of the S&P MidCap 400 Index that have been identified as being on the growth end of the growth-value spectrum. This Underlying Index<sup>16</sup> has been approved for options trading and is also the basis for an ETF.<sup>17</sup>

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<sup>13</sup> The shares of the iShares S&P 500 Growth Index Fund are traded on the Exchange.

<sup>14</sup> The shares of the iShares S&P MidCap 400 Value Index Fund are traded on the Exchange.

<sup>15</sup> See Securities Exchange Act Release 30290 (January 27, 1992), 57 FR 4072 (February 3, 1992).

<sup>16</sup> The shares of the iShares S&P MidCap 400 Growth Index Fund are traded on the Exchange.

<sup>17</sup> See supra note 15.

S&P Small Cap 600/Citigroup Value Index. The S&P SmallCap 600/Citigroup Value Index is designed to provide a comprehensive measure of small-cap U.S. equity “value” performance. It is an unmanaged, float-adjusted, and market capitalization-weighted index comprised of stocks representing approximately half the market capitalization of the S&P SmallCap 600 Index that have been identified as being on the value end of the growth-value spectrum. This Underlying Index<sup>18</sup> has been approved for options trading and is also the basis for an ETF.<sup>19</sup>

S&P SmallCap 600/Citigroup Growth Index. The S&P SmallCap 600/Citigroup Growth Index is designed to provide a comprehensive measure of small-cap U.S. equity “growth” performance. It is an unmanaged, float-adjusted, and market capitalization-weighted index comprised of stocks representing approximately half the market capitalization of the S&P SmallCap 600 Index that have been identified as being on the growth end of the growth-value spectrum. This Underlying Index<sup>20</sup> has been approved for options trading and is also the basis for an exchange-traded fund ETF.<sup>21</sup>

Dow Jones U.S. Basic Materials Index. The Dow Jones U.S. Basic Materials Index measures the performance of the basic materials industry of the U.S. equity market. Component companies are involved in the production of aluminum, steel, non ferrous metals, commodity chemicals, specialty chemicals, forest products, paper products, as well as the mining of precious

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<sup>18</sup> The shares of the iShares S&P SmallCap 600 Value Index Fund are traded on the Exchange.

<sup>19</sup> See supra note 11.

<sup>20</sup> The shares of the iShares S&P SmallCap 600 Growth Index Fund are traded on the Exchange.

<sup>21</sup> See supra note 11.

metals and coal. This Underlying Index<sup>22</sup> has been approved for options trading and is also the basis for an ETF.

Dow Jones U.S. Consumer Goods Index. The Dow Jones U.S. Consumer Goods Index measures the performance of consumer spending in the goods industry of the U.S. equity market. Component companies include manufacturers of automobiles and automobile parts and tires, brewers and distillers, farming and fishing operations, durable and non-durable household product manufacturers, cosmetic companies, and companies related to food and tobacco products, clothing, accessories, and footwear. This Underlying Index<sup>23</sup> is the basis for an ETF.

Dow Jones U.S. Consumer Services Index. The Dow Jones U.S. Consumer Services Index measures the performance of consumer spending in the services industry of the U.S. equity market. Component companies include airlines, broadcasting and entertainment companies, apparel and broadline retailers, food and drug retailers, media agencies, publishing companies, gambling companies, hotels, restaurants and bars, and travel and tourism companies. This Underlying Index<sup>24</sup> is the basis for an ETF.

Dow Jones U.S. Financials Index. The Dow Jones U.S. Financials Index measures the performance of the financial services industry of the U.S. equity market. Component companies include regional banks, major U.S. domiciled international banks, full line, life, and property and casualty insurance companies, companies that invest, directly or indirectly, in real estate,

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<sup>22</sup> The shares of the iShares Dow Jones U.S. Basic Materials Sector Index Fund are traded on the Exchange.

<sup>23</sup> The shares of the iShares Dow Jones U.S. Consumer Goods Sector Index Fund are traded on the Exchange.

<sup>24</sup> The shares of the iShares Dow Jones U.S. Consumer Services Sector Index Fund are traded on the Exchange.

diversified financial companies such as Fannie Mae, credit card issuers, check cashing companies, mortgage lenders, and investment advisers, securities brokers and dealers, including investment banks, merchant banks, and online brokers, and publicly traded stock exchanges. This Underlying Index<sup>25</sup> is the basis for an ETF.

Dow Jones U.S. Health Care Index. The Dow Jones U.S. Health Care Index measures the performance of the healthcare industry of the U.S. equity market. Component companies include health care providers, biotechnology companies, medical supply companies, and companies related to advanced medical devices and pharmaceuticals. This Underlying Index<sup>26</sup> is the basis for an ETF.

Dow Jones U.S. Industrials Index. The Dow Jones U.S. Industrials Index measures the performance of the industrial industry of the U.S. equity market. This Underlying Index includes component companies in sectors related to building materials, heavy construction, factory equipment, heavy machinery, industrial services, pollution control, containers and packaging, industrial diversified, air freight, marine transportation, railroads, trucking, land-transportation equipment, shipbuilding, transportation services, advanced industrial equipment, electronic components and equipment, and aerospace. This Underlying Index<sup>27</sup> is the basis for an ETF.

Dow Jones U.S. Oil & Gas Index. The Dow Jones U.S. Oil & Gas Index measures the performance of the oil and gas industry of the U.S. equity market. Component companies

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<sup>25</sup> The shares of the iShares Dow Jones U.S. Financial Services Index Fund are traded on the Exchange.

<sup>26</sup> The shares of the iShares Dow Jones U.S. Healthcare Sector Index Fund are traded on the Exchange.

<sup>27</sup> The shares of the iShares Dow Jones U.S. Industrial Sector Index Fund are traded on the Exchange.

include oil drilling equipment and service companies, oil companies-major, oil companies-secondary, pipeline companies, liquid, solid, or gaseous fossil fuel producers, and related service companies. This Underlying Index<sup>28</sup> is the basis for an ETF.

Dow Jones U.S. Real Estate Index. The Dow Jones U.S. Real Estate Index measures the performance of the real estate sector of the U.S. equity market. Component companies include those that invest directly or indirectly in the development, management, or ownership of shopping malls, apartment buildings and housing developments, and real estate investment trusts (“REITs”), which invest in apartments and office and retail properties. REITs are passive investment vehicles that invest primarily in income-producing real estate or real estate related loans or interests. This Underlying Index<sup>29</sup> has been approved for options trading and is also the basis for an ETF.

Dow Jones U.S. Semiconductor Index. The Dow Jones U.S. Semiconductor Index measures the performance of the semiconductor sub-sector of the U.S. equity market. Component companies are engaged in the production of semiconductors and other integrated chips, as well as other related products such as semiconductor capital equipment and motherboards.<sup>30</sup>

Dow Jones U.S. Technology Index. The Dow Jones U.S. Technology Index measures the performance of the technology industry of the U.S. equity market. Component companies

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<sup>28</sup> The shares of the iShares Dow Jones U.S. Energy Sector Index Fund are listed and traded on the Exchange.

<sup>29</sup> The shares of the iShares Dow Jones U.S. Real Estate Index Fund are listed and traded on the Exchange.

<sup>30</sup> Amex represents that the Dow Jones U.S. Semiconductor Index meets the Exchange’s generic standards under Amex Rule 1000A, Commentary .02.

include those involved in computers and office equipment, software, communications technology, semiconductors, diversified technology services, and Internet services. This Underlying Index<sup>31</sup> is the basis for an ETF.

Dow Jones U.S. Utilities Index. The Dow Jones U.S. Utilities Index measures the performance of the utilities industry of the U.S. equity market. Component companies include electric utilities, gas utilities, and water utilities. This Underlying Index<sup>32</sup> is the basis for an ETF.

Russell 2000® Index. The Russell 2000® Index is a measure of small-cap U.S. stock market performance. It is an adjusted, market capitalization-weighted index containing approximately 2,000 of the smallest companies in the Russell 3000® Index or approximately 8% of the total market capitalization of the Russell 3000® Index, which in turn represents approximately 98% of the investable U.S. equity market. All U.S. companies listed on the New York Stock Exchange (“NYSE”), Amex, or The Nasdaq Stock Market meeting an initial minimum (\$1) price are considered for inclusion. Reconstitution occurs annually. Securities are not replaced if they leave the index; however, new issue securities meeting other membership requirements may be added on a quarterly basis. This Underlying Index<sup>33</sup> has been approved for options trading and is also the basis for an ETF.

Russell Midcap® Index. The Russell Midcap® Index measures the performance of the 800 smallest companies in the Russell 1000® Index, which represent approximately 30% of the total market capitalization of the Russell 1000® Index. As of the latest reconstitution, the

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<sup>31</sup> The shares of the iShares Dow Jones U.S. Technology Sector Index Fund are listed and traded on the Exchange.

<sup>32</sup> The shares of the iShares Dow Jones U.S. Utilities Sector Index Fund are traded on the Exchange.

average market capitalization was approximately \$5.2 billion; the median market capitalization was approximately \$3.9 billion. The largest company in the index had an approximate market capitalization of \$14.8 billion. This Underlying Index is the basis for an ETF.<sup>34</sup>

Russell Midcap® Growth Index. The Russell Midcap® Growth Index measures the performance of those Russell Midcap companies with higher price-to-book ratios and higher forecasted growth values. The stocks are also members of the Russell 1000® Growth Index. This Underlying Index<sup>35</sup> is the basis for an ETF .

Russell Midcap® Value Index. The Russell Midcap® Value Index measures the performance of those Russell Midcap companies with lower price-to-book ratios and lower forecasted growth values. The stocks are also members of the Russell 1000® Value Index. This Underlying Index<sup>36</sup> is the basis for an ETF .

Russell 1000® Index. The Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 92% of the total market capitalization of the Russell 3000® Index. As of the latest reconstitution, the average market capitalization was approximately \$13.8 billion; the median market capitalization was approximately \$4.9 billion. The smallest company in the index had an approximate market capitalization of \$1.9 billion. This Underlying Index<sup>37</sup> is the basis for an ETF .

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<sup>33</sup> The shares of the iShares Russell 2000 Index Fund are traded on the Exchange.

<sup>34</sup> The shares of the iShares Russell Midcap Index Fund are traded on the Exchange.

<sup>35</sup> The shares of the iShares Russell Midcap Growth Index Fund are traded on the Exchange.

<sup>36</sup> The shares of the iShares Russell Midcap Value Index Fund are traded on the Exchange.

<sup>37</sup> The shares of the iShares Russell 1000 Index Fund are traded on the Exchange.

Russell 1000® Growth Index. The Russell 1000® Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. This Underlying Index<sup>38</sup> is the basis for an ETF.

Russell 1000® Value Index. The Russell 1000® Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. This Underlying Index<sup>39</sup> is the basis for an ETF.

Russell 2000® Growth Index. The Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. This Underlying Index<sup>40</sup> is the basis for an ETF.

Russell 2000® Value Index. The Russell 2000® Value Index measures the performance of those Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. This Underlying Index<sup>41</sup> is the basis for an ETF.

#### Investment Objective of the Funds

Each Bullish Fund will seek investment results that correspond, before fees and expenses, to twice (200%) the daily performance of an Underlying Index and will invest its assets based upon the same strategies as conventional index funds. Rather than holding positions in equity securities and certain financial instruments intended to create exposure to 100% of the daily performance of an Underlying Index, these Funds will hold positions in equity securities and certain financial instruments designed to create exposure equal to twice (200%), before fees and

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<sup>38</sup> The shares of the iShares Russell 1000 Growth Index Fund are traded on the Exchange.

<sup>39</sup> The shares of the iShares Russell 1000 Value Index Fund are traded on the Exchange.

<sup>40</sup> The shares of the iShares Russell 2000 Growth Index Fund are traded on the Exchange.

<sup>41</sup> The shares of the iShares Russell 2000 Value Index Fund are traded on the Exchange.

expenses, the daily performance of an Underlying Index. These Bullish Funds generally will hold at least 85% of their assets in the component equity securities of the relevant Underlying Index. The remainder of assets will be devoted to certain financial instruments<sup>42</sup> and money market instruments<sup>43</sup> that are intended to create the additional needed exposure to such Underlying Index necessary to pursue its investment objective.

The Bearish Funds will seek daily investment results, before fees and expenses, of the inverse or opposite (-100%) of the Underlying Index, in the case of the Short Funds, or twice the inverse or opposite (-200%) of the daily performance of the Underlying Index, in the case of the UltraShort Funds. Each of these Bearish Funds will not invest directly in the component securities of the relevant Underlying Index, but instead, will create short exposure to such Underlying Index. Each Bearish Fund will rely on establishing positions in Financial Instruments that provide, on a daily basis, the inverse or opposite of, or twice the inverse or opposite of, as the case may be, the performance of the relevant Underlying Index. Normally, 100% of the value of the portfolios of each Bearish Fund will be devoted to Financial Instruments and Money Market Instruments.

While the Advisor will attempt to minimize any “tracking error” between the investment results of a particular Fund and the performance (and specified multiple thereof) or the inverse performance (and specified multiple thereof) of its Underlying Index, certain factors may tend to

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<sup>42</sup> The financial instruments to be held by any of the Funds may include stock index futures contracts, options on futures contracts, options on securities and indices, equity caps, collars and floors, as well as swap agreements, forward contracts, repurchase agreements, and reverse repurchase agreements (the “Financial Instruments”).

<sup>43</sup> Money market instruments include U.S. government securities and repurchase agreements (the “Money Market Instruments”). Repurchase agreements held by the Funds will be consistent with Rule 2a-7 of the 1940 Act, *i.e.*, remaining maturities of 397 days or less and rated investment-grade.

cause the investment results of a Fund to vary from such relevant Underlying Index or specified multiple thereof.<sup>44</sup> The Bullish Funds are expected to be highly correlated to each respective Underlying Index and investment objective (0.95 or greater). The Bearish Funds are expected to be highly inversely correlated to each respective Underlying Index and investment objective (-0.95 or greater).<sup>45</sup> In each case, the Funds are expected to have a daily tracking error of less than 5% (500 basis points) relative to the specified multiple or inverse multiple of the performance of the relevant Underlying Index.

### The Portfolio Investment Methodology

The Advisor will seek to establish an investment exposure in each portfolio corresponding to each Fund's investment objective based on its "Portfolio Investment Methodology," as described below. The Exchange states that the Portfolio Investment

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<sup>44</sup> Several factors may cause a Fund to vary from the relevant Underlying Index and investment objective including: (1) a Fund's expenses, including brokerage fees (which may be increased by high portfolio turnover) and the cost of the investment techniques employed by that Fund; (2) less than all of the securities in the benchmark index being held by a Fund and securities not included in the benchmark index being held by a Fund; (3) an imperfect correlation between the performance of instruments held by a Fund, such as futures contracts, and the performance of the underlying securities in the cash market; (4) bid-ask spreads (the effect of which may be increased by portfolio turnover); (5) holding instruments traded in a market that has become illiquid or disrupted; (6) a Fund's share prices being rounded to the nearest cent; (7) changes to the benchmark Underlying Index that are not disseminated in advance; (8) the need to conform a Fund's portfolio holdings to comply with investment restrictions or policies or regulatory or tax law requirements; and (9) early and unanticipated closings of the markets on which the holdings of a Fund trade, resulting in the inability of the Fund to execute intended portfolio transactions.

<sup>45</sup> Correlation is the strength of the relationship between (1) the change in a Fund's NAV and (2) the change in the benchmark Underlying Index (investment objective). The statistical measure of correlation is known as the "correlation coefficient." A correlation coefficient of +1 indicates a perfect positive correlation while a value of -1 indicates a perfect negative (inverse) correlation. A value of zero would mean that there is no correlation between the two variables.

Methodology is a mathematical model based on well-established principles of finance that are widely used by investment practitioners, including conventional index fund managers.

As set forth in the Application, the Portfolio Investment Methodology was designed to determine for each Fund the portfolio investments needed to achieve its stated investment objectives. The Portfolio Investment Methodology takes into account a variety of specified criteria and data, the most important of which are: (1) net assets (taking into account creations and redemptions) in each Fund's portfolio at the end of each trading day, (2) the amount of required exposure to the Underlying Index, and (3) the positions in equity securities, Financial Instruments, and/or Money Market Instruments at the beginning of each trading day. The Advisor pursuant to the methodology will then mathematically determine the end-of-day positions to establish the required amount of exposure to the Underlying Index (the "Solution"), which will consist of equity securities, Financial Instruments, and/or Money Market Instruments. The difference between the start-of-day positions and the required end-of-day positions is the actual amount of equity securities, Financial Instruments, and/or Money Market Instruments that must be bought or sold for the day. The Solution represents the required exposure and, when necessary, is converted into an order or orders to be filled that same day.

Generally, portfolio trades effected pursuant to the Solution are reflected in the NAV on the first business day (T+1) after the date the relevant trade is made. Therefore, the NAV calculated for a Fund on a given day should reflect the trades executed pursuant to the prior day's Solution. For example, trades pursuant to the Solution calculated on a Monday afternoon are executed on behalf of the Fund in question on that day. These trades will then be reflected in the NAV for that Fund that is calculated as of 4:00 p.m. Eastern Time ("ET") on Tuesday.

The timeline for the Portfolio Investment Methodology is as follows. Authorized Participants (“APs” or “Authorized Participants”)<sup>46</sup> have a 3:00 p.m. ET cut-off for orders submitted by telephone, facsimile, and other electronic means of communication and a 4:00 p.m. ET cut-off for orders received via mail. AP orders by mail are exceedingly rare. Orders are received by the Distributor and relayed to the Advisor within ten (10) minutes. The Advisor will know by 3:10 p.m. ET the number of creation/redemption orders by APs for that day. Orders are then placed at approximately 3:40 p.m. ET as market-on-close orders. At 4:00 p.m. ET, the Advisor will again look at the exposure to make sure that the orders placed are consistent with the Solution, and as described above, the Advisor will execute any other transactions in Financial Instruments to assure that the Fund’s exposure is consistent with the Solution.

#### Description of Investment Techniques

In attempting to achieve its individual investment objectives, a Fund may invest its assets in equity securities, Financial Instruments, and Money Market Instruments. The Bullish Funds will hold between 85-100% of their total assets in the equity securities contained in the relevant Underlying Index. The remainder of assets, if any, will be devoted to Financial Instruments and Money Market Instruments that are intended to create additional needed exposure to such Underlying Index necessary to pursue the Bullish Funds’ investment objectives. The Bearish Funds generally will not invest in equity securities related to the applicable Underlying Index, but rather will hold only Financial Instruments and Money Market Instruments. To the extent, applicable, each Fund will comply with the requirements of the 1940 Act with respect to “cover”

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<sup>46</sup> An Authorized Participant is either (1) a broker-dealer or other participant in the continuous net settlement system of the NSCC or (2) a DTC participant who has entered into a participant agreement with the Distributor.

for Financial Instruments and thus may hold a significant portion of its assets in liquid instruments in segregated accounts.

Each Fund may engage in transactions in futures contracts on designated contract markets where such contracts trade and will only purchase and sell futures contracts traded on a U.S. futures exchange or board of trade. Each Fund will comply with the requirements of Rule 4.5 of the regulations promulgated by the Commodity Futures Trading Commission (the “CFTC”).<sup>47</sup>

Each Fund may enter into swap agreements and/or forward contracts for the purposes of attempting to gain exposure to the equity securities of its Underlying Index without actually transacting such securities. The Exchange states that the counterparties to the swap agreements and/or forward contracts will be major broker-dealers and banks. The creditworthiness of each potential counterparty is assessed by the Advisor’s credit committee pursuant to guidelines approved by the Board. Existing counterparties are reviewed periodically by the Board. Each Fund may also enter into repurchase and reverse repurchase agreements with terms of less than one year and will only enter into such agreements with (i) members of the Federal Reserve System, (ii) primary dealers in U.S. government securities, or (iii) major broker-dealers. Each Fund may also invest in Money Market Instruments, in pursuit of its investment objectives, as “cover” for Financial Instruments, as described above, or to earn interest.

The Trust will adopt certain fundamental policies consistent with the 1940 Act, and each Fund will be classified as “non-diversified” under the 1940 Act. Each Fund, however, intends to

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<sup>47</sup> The CFTC Rule 4.5 provides an exclusion for investment companies registered under the 1940 Act from the definition of the term “commodity pool operator” upon the filing of a notice of eligibility with the National Futures Association.

maintain the required level of diversification and otherwise conduct its operations so as to qualify as a “regulated investment company” or “RIC” for purposes of the Internal Revenue Code (the “Code”), in order to relieve the Trust and the Funds of any liability for Federal income tax to the extent that its earnings are distributed to shareholders.<sup>48</sup>

#### Availability of Information about the Shares and Underlying Indexes

The Trust’s Internet Web site (<http://www.proshares.com>), which is and will be publicly accessible at no charge, will contain the following information for each Fund’s Shares: (a) the prior business day’s closing NAV, the reported closing price, and a calculation of the premium or discount of such price in relation to the closing NAV; (b) data for a period covering at least the four previous calendar quarters (or the life of a Fund, if shorter) indicating how frequently each Fund’s Shares traded at a premium or discount to NAV based on the daily closing price and the closing NAV, and the magnitude of such premiums and discounts, (c) its prospectus and product description, and (d) other quantitative information, such as daily trading volume. The prospectus and/or product description for each Fund will inform investors that the Trust’s

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<sup>48</sup> In order for a Fund to qualify for tax treatment as a RIC, it must meet several requirements under the Code. Among these is the requirement that, at the close of each quarter of the Fund’s taxable year, (i) at least 50% of the market value of the Fund’s total assets must be represented by cash items, U.S. government securities, securities of other RICs, and other securities, with such other securities limited for purposes of this calculation in respect of any one issuer to an amount not greater than 5% of the value of the Fund’s assets and not greater than 10% of the outstanding voting securities of such issuer, and (ii) not more than 25% of the value of its total assets may be invested in the securities of any one issuer, or two or more issuers that are controlled by the Fund (within the meaning of Section 851 (b)(4)(B) of the Code) and that are engaged in the same or similar trades or businesses or related trades or businesses (other than U.S. government securities or the securities of other RICs).

Internet Web site has information about the premiums and discounts at which the Fund's Shares have traded.<sup>49</sup>

The Amex will disseminate for each Fund on a daily basis by means of the Consolidated Tape Association ("CT") and CQ High Speed Lines information with respect to an Indicative Intra-Day Value (the "IIV") (as defined and discussed herein), recent NAV, shares outstanding, and the estimated cash amount and total cash amount per Creation Unit. The Exchange will make available on its Internet Web site at <http://www.amex.com> daily trading volume, the closing price, the NAV, and the final dividend amounts to be paid for each Fund.

Each Fund's total portfolio composition will be disclosed on the Internet Web site of the Trust (<http://www.proshares.com> or another relevant Internet Web site as determined by the Trust) and/or the Exchange (<http://www.amex.com>). The Trust expects that Internet Web site disclosure of portfolio holdings will be made daily and will include, as applicable, the names and number of shares held of each specific equity security, the specific types of Financial Instruments and characteristics of such Financial Instruments, and the cash equivalents and amount of cash held in the portfolio of each Fund. This public Internet Web site disclosure of the portfolio composition of each Fund will coincide with the disclosure by the Advisor of the "IIV File" (as described below) and the portfolio composition file or "PCF" (as described

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<sup>49</sup> The Application requests relief from Section 24(d) of the 1940 Act, which would permit dealers to sell Shares in the secondary market unaccompanied by a statutory prospectus when prospectus delivery is not required by the Securities Act of 1933. Additionally, if a product description is being provided in lieu of a prospectus, Commentary .03 of Amex Rule 1000A requires that Amex members and member organizations provide to all purchasers of a series of Index Fund Shares a written description of the terms and characteristics of such securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time of confirmation of the first transaction in such series is delivered to such purchaser. Furthermore, any sales material will reference the availability of such circular and the prospectus.

below). Therefore, the same portfolio information (including accrued expenses and dividends) will be provided on the public Internet Web site as well as in the IIV File and PCF provided to Authorized Participants. The format of the public Internet Web site disclosure and the IIV File and PCF will differ because the public Internet Web site will list all portfolio holdings, while the IIV File and PCF will similarly provide the portfolio holdings, but in a format appropriate for Authorized Participants, *i.e.*, the exact components of a Creation Unit.<sup>50</sup> Accordingly, each investor will have access to the current portfolio composition of each Fund through the Trust's Internet Web site, at <http://www.proshares.com>, and/or at the Exchange's Internet Web site at <http://www.amex.com>.

Beneficial owners of Shares (“Beneficial Owners”) will receive all of the statements, notices, and reports required under the 1940 Act and other applicable laws. They will receive, for example, annual and semi-annual Fund reports, written statements accompanying dividend payments, proxy statements, annual notifications detailing the tax status of Fund distributions, and Form 1099-DIVs. Some of these documents will be provided to Beneficial Owners by their brokers, while others will be provided by the Fund through the brokers.

The daily closing index value and the percentage change in the daily closing index value for each Underlying Index will be publicly available on various Internet Web sites, such as at <http://www.bloomberg.com>. Data regarding each Underlying Index is also available from the respective Underlying Index provider to subscribers. Several independent data vendors also package and disseminate Underlying Index data in various value-added formats (including vendors displaying both securities and index levels and vendors displaying index levels only). The value of each Underlying Index will be updated intra-day on a real time basis as its

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<sup>50</sup> The composition will be used to calculate the NAV later that day.

individual component securities change in price. These intra-day values of each Underlying Index will be disseminated at least every 15 seconds throughout the trading day by Amex or another organization authorized by the relevant Underlying Index provider in accordance with Commentary .02(c) to Amex Rule 1000A.

### Creation and Redemption of Shares

Each Fund will issue and redeem Shares only in aggregations of at least 50,000 (“Creation Units”). Purchasers of Creation Units will be able to separate the Creation Units into individual Shares. Once the number of Shares in a Creation Unit is determined, it will not change thereafter (except in the event of a stock split or similar revaluation). The initial value of a Share for each of the Bullish Funds and Bearish Funds is expected to be in the range of \$50-\$250.

At the end of each business day, the Trust will prepare the list of names and the required number of shares of each Deposit Security (as defined herein) to be included in the next trading day’s Creation Unit for each Bullish Fund (the “Deposit List”). The Trust will then add to the Deposit List the cash information effective as of the close of business on that business day and create a PCF for each Fund, which it will transmit to NSCC before the open of business the next business day. The information in the PCF will be available to all participants in the NSCC system.

Because the NSCC’s system for the receipt and dissemination to its participants of the PCF is not currently capable of processing information with respect to Financial Instruments, the Advisor has developed an “IIV File,” which it will use to disclose the Funds’ holdings of Financial Instruments.<sup>51</sup> The IIV File will contain, for each Bullish Fund (to the extent that it

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<sup>51</sup> The Trust or the Advisor will post the IIV File to a password-protected Internet Web site before the opening of business on each business day, and all Authorized Participants and the Exchange will have access to a password and the Internet Web site containing the IIV

holds Financial Instruments) and Bearish Fund, information sufficient by itself or in connection with the PCF and other available information for market participants to calculate a Fund's IIV and effectively arbitrage such Fund.

For example, the following information would be provided in the IIV File for a Bullish Fund holding equity securities and Financial Instruments such as swaps and futures contracts and a Bearish Fund holding swaps and futures contracts: (A) the total value of the equity securities held by the Bullish Fund, (B) the notional value of the swaps held by such Funds (together with an indication of the Underlying Index on which such swap is based and whether the Funds' position is long or short), (C) the most recent valuation of the swaps held by the Funds, (D) the notional value of any futures contracts (together with an indication of the Underlying Index on which such contract is based, whether the Funds' position is long or short and the contract's expiration date) held by the Funds, (E) the number of futures contracts held by the Funds (together with an indication of the Underlying Index on which such contract is based, whether the Funds' position is long or short and the contract's expiration date), (F) the most recent valuation of the futures contracts held by the Funds, (G) the total assets and total shares outstanding of each Fund, and (H) a "net other assets" figure reflecting expenses and income of the Funds to be accrued during and through the following business day and accumulated gains or losses on the Funds' Financial Instruments through the end of the business day immediately preceding the publication of the IIV File. To the extent that any Bullish or Bearish Fund holds cash or cash equivalents about which information is not available in a PCF, information

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File. The Funds, however, will disclose each business day to the public identical information, but in a format appropriate to public investors, at the same time the Funds disclose the IIV File and PCF, as applicable, to industry participants.

regarding such Fund's cash and cash equivalent positions will be disclosed in the IIV File for such Fund.

The information in the IIV File will be sufficient for participants in the NSCC system to calculate the IIV for Bearish Funds and, together with the information on equity securities contained in the PCF, will be sufficient for calculation of the IIV for Bullish Funds, during such next business day. The IIV File, together with the applicable information in the PCF in the case of Bullish Funds, will also be the basis for the next business day's NAV calculation.

Under normal circumstances, the Bullish Funds will be created and redeemed either entirely for cash and/or for a deposit basket of equity securities ("Deposit Securities"), plus a Balancing Amount (as defined herein), as described below. Under normal circumstances, the Bearish Funds will be created and redeemed entirely for cash. The IIV File published before the open of business on a business day will, however, permit NSCC participants to calculate (by means of calculating the IIV) the amount of cash required to create a Creation Unit, and the amount of cash that will be paid upon redemption of a Creation Unit, for each Bearish Fund for that business day.

For the Bullish Funds, the PCF will be prepared by the Trust after 4:00 p.m. ET and transmitted by the Index Receipt Agent to the NSCC by 6:30 p.m. ET. All Authorized Participants and the Exchange will have access to the Internet Web site containing the IIV File. The IIV File will reflect the trades made on behalf of a Bullish Fund that business day and the creation/redemption orders for that business day. Accordingly, by 6:30 p.m. ET, Authorized Participants will know the composition of the Bullish Fund's portfolio for the next trading day.

Creation of the Bullish Funds. Typically, persons<sup>52</sup> purchasing Creation Units from a Bullish Fund must make an in-kind deposit of a basket of Deposit Securities consisting of the securities selected by the Advisor from among those securities contained in the Fund's portfolio, together with an amount of cash specified by the Advisor (the "Balancing Amount"), plus the applicable transaction fee (the "Transaction Fee"). The Deposit Securities and the Balancing Amount collectively are referred to as the "Creation Deposit." The Balancing Amount is a cash payment designed to ensure that the value of a Creation Deposit is identical to the value of the Creation Unit. The Balancing Amount is an amount equal to the difference between the NAV of a Creation Unit and the market value of the Deposit Securities.<sup>53</sup>

The Balancing Amount will be determined shortly after 4:00 p.m. ET each business day. Although the Balancing Amount for most exchange-traded funds is a small amount reflecting accrued dividends and other distributions, for the Bullish Funds it is expected to be larger due to changes in the value of the Financial Instruments, i.e., daily mark-to-market. For example, assuming a basket of Deposit Securities is valued at \$5 million for a Bullish Fund, if the market increases 10%, such basket of Deposit Securities would be equal to \$5.5 million at 4:00 p.m. ET. The value of the Bullish Fund shares would increase by 20% or \$1 million to equal \$6 million total. With such basket of Deposit Securities valued at \$5.5 million, the Balancing Amount

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<sup>52</sup> Authorized Participants are the only persons who may place orders to create and redeem Creation Units. Authorized Participants must be registered broker-dealers or other securities market participants, such as banks and other financial institutions, that are exempt from registration as broker-dealers to engage in securities transactions and who are participants in DTC. See supra note 46.

<sup>53</sup> While not typical, if the market value of the Deposit Securities is greater than the NAV of a Creation Unit, then the Balancing Amount will be a negative number, in which case the Balancing Amount will be paid by the Bullish Fund to the purchaser, rather than vice-versa.

would be \$500,000. The values of the next day's basket of Deposit Securities and Balancing Amount are announced between 5:30 p.m. ET and 6:00 p.m. ET each business day.

The Balancing Amount may, at times, represent a significant portion of the aggregate purchase price (or in the case of redemptions, the redemption proceeds). This may occur because the mark-to-market value of the Financial Instruments held by the Bullish Funds, if any, is included in the Balancing Amount. The Transaction Fee is a fee imposed by the Bullish Funds on investors purchasing (or redeeming) Creation Units.

The Trust will make available through the DTC or the Distributor on each business day, prior to the opening of trading on the Exchange, the Deposit List indicating the Deposit Securities to be included in the Creation Deposit for each Bullish Fund.<sup>54</sup> The Trust also will make available on a daily basis information about the previous day's Balancing Amount.

The Bullish Funds reserve the right to permit or require an Authorized Participant to substitute an amount of cash and/or a different security to replace any prescribed Deposit Security.<sup>55</sup> Substitutions might be permitted or required, for example, because one or more Deposit Securities may be unavailable, or may not be available in the quantity needed to make a Creation Deposit. Brokerage commissions incurred by a Fund to acquire any Deposit Security not part of a Creation Deposit are expected to be immaterial, and in any event, the Adviser may adjust the relevant Transaction Fee to ensure that the Fund collects the extra expense from the

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<sup>54</sup> In accordance with the Advisor's Code of Ethics, personnel of the Advisor with knowledge about the composition of a Creation Deposit will be prohibited from disclosing such information to any other person, except as authorized in the course of their employment, until such information is made public.

<sup>55</sup> In certain limited instances, a Bullish Fund may require a purchasing investor to purchase a Creation Unit entirely for cash. For example, on days when a substantial rebalancing of a Fund's portfolio is required, the Advisor might prefer to receive cash rather than in-kind stocks so that it has liquid resources on hand to make the necessary purchases.

purchaser. Orders to create or redeem Shares of the Bullish Funds must be placed through an Authorized Participant.

As noted below, the Exchange will disseminate through the facilities of the CT, at least every 15 seconds during the Exchange's regular trading hours, the IIV on a per Fund Share basis. The Exchange states that the Funds will not be involved in, or responsible for, the calculation or dissemination of any such amount and will make no warranty as to its accuracy.

Redemption of the Bullish Funds. Bullish Fund Shares in Creation Unit-size aggregations will be redeemable on any day on which the NYSE is open in exchange for a basket of securities ("Redemption Securities"). As it does for Deposit Securities, the Trust will make available to Authorized Participants on each business day prior to the opening of trading a list of the names and number of shares of Redemption Securities for each Fund. The Redemption Securities given to redeeming investors in most cases will be the same as the Deposit Securities required of investors purchasing Creation Units on the same day.<sup>56</sup> Depending on whether the NAV of a Creation Unit is higher or lower than the market value of the Redemption Securities, the redeemer of a Creation Unit will either receive from or pay to the Bullish Fund a cash amount equal to the difference (the "Redemption Balancing Amount"). In the typical situation where the Redemption Securities are the same as the Deposit Securities, this cash amount will be equal to the Balancing Amount described above in the creation process involving Deposit

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<sup>56</sup> There may be circumstances, however, where the Deposit Securities and Redemption Securities could differ. For example, if ABC stock were replacing XYZ stock in a Fund's Underlying Index at the close of a day's trading session, the day's prescribed Deposit Securities might include ABC, but not XYZ, while the day's prescribed Redemption Securities might include XYZ but not ABC.

Securities. The redeeming investor also must pay to the Bullish Fund a transaction fee (“Redemption Transaction Fee”) to cover transaction costs.<sup>57</sup>

A Bullish Fund has the right to make redemption payments in cash, in kind, or a combination of each, provided that the value of its redemption payments equals the NAV of the Shares tendered at the time of tender, and the Redemption Balancing Amount. The Adviser currently contemplates that Creation Units of each Bullish Fund will be redeemed principally in kind with respect to the Redemption Securities and the Redemption Balancing Amount in cash largely resulting from the value of the Financial Instruments included in the Bullish Fund.

In order to facilitate delivery of Redemption Securities, each redeeming Authorized Participant, acting on behalf of a Beneficial Owner or a DTC participant, must have arrangements with a broker-dealer, bank, or other custody provider in each jurisdiction in which any of the Redemption Securities are customarily traded. If neither the redeeming Beneficial Owner nor the Authorized Participant has such arrangements, and it is not otherwise possible to make other arrangements, the Bullish Fund may, in its discretion, redeem the Bullish Fund Shares for cash.

Creation and Redemption of the Bearish Funds. The Bearish Funds will be purchased and redeemed entirely for cash (“All-Cash Payments”). The use of an All-Cash Payment for the purchase and redemption of Creation Unit aggregations of the Bearish Funds is due to the limited transferability of Financial Instruments.

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<sup>57</sup> Redemptions in which cash is substituted for one or more Redemption Securities may be assessed a higher Redemption Transaction Fee to offset the transaction cost to the Fund of selling those particular Redemption Securities. This Redemption Transaction Fee is expected to be between \$500 and \$1,000.

The Exchange believes that Shares will not trade at a material discount or premium to the underlying securities held by a Fund based on potential arbitrage opportunities. The arbitrage process, which provides the opportunity to profit from differences in prices of the same or similar securities, increases the efficiency of the markets and serves to prevent potentially manipulative efforts. If the price of a Share deviates enough from the Creation Unit, on a per share basis, to create a material discount or premium, an arbitrage opportunity is created allowing the arbitrageur to either buy Shares at a discount, immediately cancel them in exchange for the Creation Unit, and sell the underlying securities in the cash market at a profit, or sell Shares short at a premium and buy the Creation Unit in exchange for the Shares to deliver against the short position. In both instances the arbitrageur locks in a profit and the markets move back into line.<sup>58</sup>

Placement of Creation Unit Purchases and Redemption Orders. Creation Unit aggregations of the Funds will be purchased at NAV, plus a Transaction Fee. For the Bearish Funds, the purchaser will make a cash payment by 12:00 p.m. ET on the third business day following the date on which the request was made (T+3). For the Bullish Funds, the purchaser will make an in-kind payment and/or all cash payment generally on the third business day following the date on which the request was made (T+3). Purchasers of either Fund in Creation Unit aggregations must satisfy certain creditworthiness criteria established by the Advisor and

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<sup>58</sup> In their 1940 Act Application, the Applicants stated that they do not believe that All-Cash Payments will affect arbitrage efficiency. This is because the Applicants believe it makes little difference to an arbitrageur whether Creation Unit aggregations are purchased in exchange for a basket of securities or cash. The important function of the arbitrageur is to bid the share price of any Fund up or down until it converges with the NAV. Applicants note that this can occur regardless of whether the arbitrageur is allowed to create in cash or with a basket of Deposit Securities. In either case, the arbitrageur can effectively hedge a position in a Fund in a variety of ways, including the use of market-on-close contracts to buy or sell the Financial Instruments.

approved by the Board, as provided in the participation agreement (“Participation Agreement”) between the Trust and Authorized Participants.

Creation Unit aggregations of the Bullish Funds will be redeemable either in-kind or all in cash equal to the NAV, less the Redemption Transaction Fee. Creation Unit aggregations of the Bearish Funds will be redeemable for an All-Cash Payment equal to the NAV, less the Redemption Transaction Fee. A Bullish Fund has the right to make redemption payments in cash, in kind, or a combination of each, provided that the value of its redemption payments equals the NAV of the Shares tendered for redemption at the time of tender.<sup>59</sup>

### Dividends

Dividends, if any, from net investment income will be declared and paid at least annually by each Fund in the same manner as by other open-end investment companies. Certain Funds may pay dividends on a semi-annual or more frequent basis. Distributions of realized securities gains, if any, generally will be declared and paid once a year.

Dividends and other distributions on the Shares of each Fund will be distributed, on a pro rata basis to Beneficial Owners of such Shares. Dividend payments will be made through the DTC and the DTC participants to Beneficial Owners then of record with proceeds received from each Fund.

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<sup>59</sup> The Exchange states that, in the event an Authorized Participant has submitted a redemption request in good order and is unable to transfer all or part of a Creation Unit aggregation for redemption, a Fund may nonetheless accept the redemption request in reliance on the Authorized Participant’s undertaking to deliver the missing Fund Shares as soon as possible, which undertaking shall be secured by the Authorized Participant’s delivery and maintenance of collateral. The Authorized Participant’s Participation Agreement will permit the Fund to buy the missing Shares at any time and will subject the Authorized Participant to liability for any shortfall between the cost to the Fund of purchasing the Shares and the value of the collateral.

The Trust will not make the DTC book-entry Dividend Reinvestment Service (the “Dividend Reinvestment Service”) available for use by Beneficial Owners for reinvestment of their cash proceeds, but certain individual brokers may make a Dividend Reinvestment Service available to Beneficial Owners. 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 such a 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. Shares acquired pursuant to such 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 Shares. Brokerage commissions, charges, and other costs, if any, incurred in purchasing Shares in the secondary market with the cash from the distributions generally will be an expense borne by the individual Beneficial Owners participating in reinvestment through such service.

#### Dissemination of Indicative Intra-Day Value (IIV)

In order to provide updated information relating to each Fund for use by investors, professionals, and persons wishing to create or redeem Shares, the Exchange will disseminate through the facilities of the CT: (i) continuously throughout the trading day, the market value of a Share, and (ii) at least every 15 seconds throughout the trading day, a calculation of the Indicative Intra-Day Value or “IIV”<sup>60</sup> as calculated by the Exchange (the “IIV Calculator”).<sup>61</sup>

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<sup>60</sup> The IIV is also referred to by other issuers as an “Estimated NAV,” “Underlying Trading Value,” “Indicative Optimized Portfolio Value (IOPV),” and “Intraday Value” in various places such as the prospectus and marketing materials for different exchange-traded funds.

Comparing these two figures helps an investor to determine whether, and to what extent, the Shares may be selling at a premium or a discount to NAV.

The IIV Calculator (the Exchange) will calculate an IIV for each Fund in the manner discussed below. The IIV is designed to provide investors with a reference value that can be used in connection with other related market information. The IIV does not necessarily reflect the precise composition of the current portfolio held by each Fund at a particular point in time. Therefore, the IIV on a per Share basis disseminated during Amex trading hours should not be viewed as a real time update of the NAV of a particular Fund, which is calculated only once a day. While the IIV that will be disseminated by Amex is expected to be close to the most recently calculated Fund NAV on a per share basis, it is possible that the value of the portfolio held by a Fund may diverge from the IIV during any trading day. In such case, the IIV will not precisely reflect the value of the Fund portfolio.

IIV Calculation for the Bullish Funds. The IIV Calculator (the Exchange) will disseminate the IIV throughout the trading day for the Bullish Funds holding equity securities and Financial Instruments, if any. The IIV Calculator (the Exchange) will determine such IIV by: (i) calculating the estimated current value of equity securities held by such Fund by (a) calculating the percentage change in the value of the Deposit Securities indicated on the Deposit List (as provided by the Trust) and applying that percentage value to the total value of the equity securities in the Fund as of the close of trading on the prior trading day (as provided by the Trust) or (b) calculating the current value of all of the equity securities held by the Fund (as provided by the Trust); (ii) calculating the mark-to-market gains or losses from the Fund's total return equity swap exposure based on the percentage change to the Underlying Index and the

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<sup>61</sup> The Exchange will calculate the IIV for each Fund.

previous day's notional values of the swap contracts, if any, held by such Fund (which previous day's notional value will be provided by the Trust); (iii) calculating the mark-to-market gains or losses from futures, options, and other Financial Instrument positions by taking the difference between the current value of those positions held by the Fund, if any (as provided by the Trust), and the previous day's value of such positions; (iv) adding the values from (i), (ii), and (iii) above to an estimated cash amount provided by the Trust (which cash amount will include the swap costs), to arrive at a value; and (v) dividing that value by the total shares outstanding (as provided by the Trust) to obtain current IIV.

IIV Calculation for the Bearish Funds. The IIV Calculator (the Exchange) will disseminate the IIV throughout the trading day for the Bearish Funds. The IIV Calculator (the Exchange) will determine such IIV by: (i) calculating the mark-to-market gains or losses from the Fund's total return equity swap exposure based on the percentage change to the Underlying Index and the previous day's notional values of the swap contracts, if any, held by such Fund (which previous day's notional value will be provided by the Trust); (ii) calculating the mark-to-market gains or losses from futures, options, and other Financial Instrument positions by taking the difference between the current value of those positions held by the Fund, if any (as provided by the Trust), and the previous day's value of such positions; (iii) adding the values from (i) and (ii) above to an estimated cash amount provided by the Trust (which cash amount will include the swap costs), to arrive at a value; and (iv) dividing that value by the total shares outstanding (as provided by the Trust) to obtain current IIV.

#### Criteria for Initial and Continued Listing

The Shares are subject to the criteria for initial and continued listing of Index Fund Shares under Amex Rule 1002A. A minimum of two Creation Units (at least 100,000 Shares)

will be required to be outstanding at the start of trading. This minimum number of Shares required to be outstanding at the start of trading will be comparable to requirements that have been applied to previously listed series of Portfolio Depositary Receipts and Index Fund Shares. The Exchange believes that the proposed minimum number of Shares outstanding at the start of trading is sufficient to provide market liquidity. The Exchange, pursuant to Amex Rule 1002A(a)(ii), will obtain a representation from the Trust (for each Fund), prior to listing, that the NAV per share for each Fund will be calculated daily and made available to all market participants at the same time.

The continued listing criteria provides for the delisting or removal from listing of the Shares under any of the following circumstances:

- If, following the initial twelve-month period after commencement of trading on the Exchange of a series of Index Fund Shares, there are fewer than 50 beneficial holders of the series of Index Fund Shares for 30 or more consecutive trading days; or
- If the value of the applicable Underlying Index or portfolio is no longer calculated or available on at least a 15-second delayed basis through one or more major market data vendors during the time the Shares trade on the Exchange; or
- The IIV is no longer made available on at least a 15-second delayed basis;<sup>62</sup> or

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<sup>62</sup> In the event an IIV is no longer calculated or disseminated by one or more major market data vendors, the Exchange will immediately contact the Commission.

- If such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable.

Additionally, the Exchange will file a proposed rule change pursuant to Rule 19b-4 under the Act seeking approval to continue trading the Shares of a Fund and, unless approved, the Exchange will commence delisting the Shares of such Fund if:

- The Underlying Index provider substantially changes either the Underlying Index component selection methodology or the weighting methodology; or
- A successor or substitute index is used in connection with the Shares.<sup>63</sup>

Furthermore, Amex Rule 1002A(b)(ii) establishes that, if the IIV or the Underling Index value applicable to that series of Index Fund Shares is not being disseminated as required, the Exchange may halt trading during the day in which the interruption to the dissemination of the IIV or the Underlying Index value occurs. If the interruption to the dissemination of the IIV or the Underlying Index value persists past the trading day in which it occurred, the Exchange will halt trading no later than the beginning of the trading day following the interruption.

The Exchange represents the Trust is required to comply with Rule 10A-3 under the Act for the initial and continued listing of the Shares.

#### Original and Annual Listing Fees

The Amex original listing fee applicable to the listing of the Funds is \$5,000 for each Fund. In addition, the annual listing fee applicable to the Funds under Section 141 of the Amex Company Guide will be based upon the year-end aggregate number of outstanding shares in all Funds of the Trust listed on the Exchange.

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<sup>63</sup> If the Trust uses a successor or substitute index, the Exchange's filing will address, among other things, the listing and trading characteristics of the successor or substitute index and the Exchange's surveillance procedures applicable thereto.

## Amex Trading Rules

The Shares are equity securities subject to Amex rules governing the trading of equity securities, including, among others, rules governing priority, parity and precedence of orders, specialist responsibilities, and account opening and customer suitability (Amex Rule 411).<sup>64</sup>

Stop and Stop Limit Orders. Amex Rule 154, Commentary .04(c), provides that stop and stop limit orders to buy or sell a security (other than an option, which is covered by Amex Rule 950(f) and Commentary thereto) the price of which is derivatively priced based upon another security or index of securities, may, with the prior approval of a floor official, be elected by a quotation, as set forth in Commentary .04(c)(i)-(v). The Exchange has designated Index Fund Shares, including the Shares, as eligible for this treatment.<sup>65</sup>

Amex Rule 190. Amex Rule 190, Commentary .04, applies to Index Fund Shares listed on the Exchange, including the Shares. Commentary .04 states that nothing in Rule 190(a) should be construed to restrict a specialist registered 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.

## Prospectus Delivery

The Exchange, in an Information Circular to Exchange members and member organizations, prior to the commencement of trading, will inform members and member

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<sup>64</sup> Telephone conversation between Jeffrey P. Burns, Associate General Counsel, Amex, Nyieri Nazarian, Assistant General Counsel, Amex, and Edward Cho, Special Counsel, Division of Market Regulation, Commission, on December 14, 2006 (clarifying Amex trading rules applicable to the Shares).

organizations of the application of Commentary .03 of Amex Rule 1000A to the Funds. The Circular will further inform members and member organizations of the prospectus and/or product description delivery requirements that apply to the Funds. The Application included a request that the exemptive order also grant relief from Section 24(d) of the 1940 Act. Any product description used in reliance on Section 24(d) exemptive relief will comply with all representations and conditions set forth in the Application.<sup>66</sup>

### Trading Halts

In addition to other factors that may be relevant, the Exchange may consider factors such as those set forth in Amex Rule 918C(b) in exercising its discretion to halt or suspend trading in Index Fund Shares. These factors include, but are not limited to, (1) the extent to which trading is not occurring in securities comprising an Underlying Index and/or the Financial Instruments of a Fund; or (2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. In the case of the Financial Instruments held by a Fund, the Exchange represents that a notification procedure will be implemented so that timely notice from the Advisor is received by the Exchange when a particular Financial Instrument is in default or shortly to be in default. Notification from the Advisor will be made by phone, facsimile, or e-mail. The Exchange would then determine on a case-by-case basis whether a default of a particular Financial Instrument justifies a trading halt of the Shares. Trading in shares of the Funds will also be halted if the circuit breaker parameters under Amex Rule 117 have been reached.

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<sup>65</sup> See Securities Exchange Act Release No. 29063 (April 10, 1991), 56 FR 15652 (April 17, 1991) at note 9, regarding the Exchange's designation of equity derivative securities as eligible for such treatment under Amex Rule 154, Commentary .04(c).

<sup>66</sup> See supra note 49 and accompanying text.

As noted above, Amex Rule 1002A(b)(ii) sets forth the trading halt parameters with respect to Index Fund Shares. If the IIV or the Underlying Index value applicable to that series of Index Fund Shares is not being disseminated as required, the Exchange may halt trading during the day in which the interruption to the dissemination of the IIV or the Underlying Index value occurs. If the interruption to the dissemination of the IIV or the Underlying Index value persists past the trading day in which it occurred, the Exchange will halt trading no later than the beginning of the trading day following the interruption.

#### Suitability and Information Circular

Prior to commencement of trading, the Exchange will issue an Information Circular to its members and member organizations providing guidance with regard to member firm compliance responsibilities (including suitability obligations) when effecting transactions in the Shares and highlighting the special risks and characteristics of the Funds and Shares as well as applicable Exchange rules.

This Information Circular will set forth the requirements relating to Commentary .05 to Amex Rule 411 (Duty to Know and Approve Customers). Specifically, the Information Circular will remind members of their obligations in recommending transactions in the Shares so that members have a reasonable basis to believe that (1) the recommendation is suitable for a customer given reasonable inquiry concerning the customer's investment objectives, financial situation, needs, and any other information known by such member, and (2) that the customer can evaluate the special characteristics, and is able to bear the financial risks, of such investment. In connection with the suitability obligation, the Information Circular will also provide that members make reasonable efforts to obtain the following information: (a) the customer's financial status; (b) the customer's tax status; (c) the customer's investment objectives; and (d)

such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

#### Purchases and Redemptions in Creation Unit Size

In the Information Circular referenced above, Amex members and member organizations will be informed that procedures for purchases and redemptions of Shares in Creation Units are described in each Fund's prospectus and SAI, and that Shares are not individually redeemable, but are redeemable only in Creation Unit aggregations or multiples thereof.

#### Surveillance

The Exchange represents that its surveillance procedures are adequate to properly monitor the trading of the Shares. Specifically, Amex will rely on its existing surveillance procedures governing Index Fund Shares, which have been deemed adequate under the Act. In addition, the Exchange also has a general policy prohibiting the distribution of material, non-public information by its employees.

#### Hours of Trading/Minimum Price Variation

The Funds will trade on the Exchange until 4:15 p.m. ET each business day. Shares will trade with a minimum price variation of \$.01.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>67</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>68</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating,

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<sup>67</sup> 15 U.S.C. 78f(b).

<sup>68</sup> 15 U.S.C. 78f(b)(5).

clearing, settling, processing information with respect to, and facilitating transaction in securities, and, in general, to protect investors and the public interest.

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

The Exchange believes the proposed rule change, as amended, will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange did not receive any written comments on the proposed rule change, as amended.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which Amex consents, the Commission will:

- A. by order approve such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

The Commission is considering granting accelerated approval of the proposed rule change, as amended, at the end of a 15-day comment period.<sup>69</sup>

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<sup>69</sup> Amex has requested accelerated approval of this proposed rule change, as amended, prior to the 30th day after the date of publication of the notice of the filing thereof, following the conclusion of a 15-day comment period.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-Amex-2006-101 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-Amex-2006-101. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to File Number SR-Amex-2006-101 and should be submitted on or before [insert date 15 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>70</sup>

Nancy M. Morris  
Secretary

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<sup>70</sup> 17 CFR 200.30-3(a)(12).