

NW, Washington, DC 20549-0609, facts bearing upon whether the application has been made in accordance with the rules of the BSE and what terms, if any, should be imposed by the Commission for the protection of investors. The Commission, based on the information submitted to it, will issue an order granting the application after the date mentioned above, unless the Commission determines to order a hearing on the matter.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 25961; 812-12911]

### PowerShares Exchange-Traded Fund Trust, et al.; Notice Of Application

March 4, 2003.

**AGENCY:** Securities and Exchange Commission ("Commission").

**ACTION:** Notice of an application for an order under section 6(c) of the Investment Company Act of 1940 (the "Act") for an exemption from sections 2(a)(32), 5(a)(1), 22(d), and 24(d) of the Act and rule 22c-1 under the Act, and under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1) and (a)(2) of the Act.

**SUMMARY OF APPLICATION:** Applicants request an order that would permit (a) series of an open-end management investment company, whose portfolios will consist of the component securities of certain domestic equity securities indexes, to issue shares of limited redeemability; (b) secondary market transactions in the shares of the series to occur at negotiated prices on the American Stock Exchange LLC ("AMEX") or other national securities exchange; (c) dealers to sell shares of the series of the Trust to purchasers in the secondary market unaccompanied by a prospectus, when prospectus delivery is not required by the Securities Act of 1933 (the "Securities Act"); and (d) affiliated persons of the series to deposit securities into, and receive securities from, the series in connection with the purchase and redemption of aggregations of the series' shares.

**APPLICANTS:** PowerShares Exchange-Traded Fund Trust; (the "Trust"), PowerShares Capital Management LLC (the "Adviser"), and ALPS Distributors, Inc. (the "Distributor").

**FILING DATES:** The application was filed on December 16, 2002, and amended on January 24, 2003. Applicants have agreed to file an amendment during the notice period, the substance of which is reflected in this notice.

**HEARING OR NOTIFICATION OF HEARING:** An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on March 27, 2003, and should be accompanied by proof of service on applicants, in the form of an affidavit, or for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

**ADDRESSES:** Secretary, Commission, 450 Fifth Street NW., Washington, DC 20549-0609. Applicants: Trust and Adviser, 855 West Prairie Avenue, Wheaton, IL 60187; Distributor, 1625 Broadway, Suite 2200, Denver, CO 80202.

**FOR FURTHER INFORMATION CONTACT:** Bruce R. MacNeil, Senior Counsel, at (202) 942-0634, or Michael W. Mundt, Senior Special Counsel, at (202) 942-0564 (Division of Investment Management, Office of Investment Company Regulation).

**SUPPLEMENTARY INFORMATION:** The following is a summary of the application. The complete application may be obtained for a fee at the Commission's Public Reference Branch, 450 Fifth Street, NW., Washington, DC 20549-0102 (telephone (202) 942-8090).

#### Applicants' Representations

1. The Trust is an open-end management investment company registered under the Act and organized as a Massachusetts business trust. The Trust intends to offer two series (each a "Fund," which term includes "Future Funds" as defined below). The Adviser is registered as an investment adviser under the Investment Advisers Act of 1940 and will serve as the investment adviser to each Fund. The Distributor, a broker-dealer registered under the Securities Exchange Act of 1934 (the "Exchange Act"), will serve as the

principal underwriter for each Index Fund. The Adviser may in the future retain one or more sub-advisers for managing one or more of the Funds for which it will act as the investment adviser.

2. Each Fund will invest in a portfolio of equity securities ("Portfolio Securities") generally consisting of the component securities of a specified domestic equity securities index (the "Underlying Indexes").<sup>1</sup> In the future, applicants may offer additional Funds based on other Underlying Indexes ("Future Funds"). Any Future Fund will (a) be advised by the Adviser or an entity controlled by or under common control with the Adviser and (b) comply with the terms and conditions of the order. No entity that creates, compiles, sponsors or maintains an Underlying Index is or will be an affiliated person, as defined in section 2(a)(3) of the Act, or an affiliated person of an affiliated person, of the Trust, the Adviser, any sub-adviser to a Fund, the Distributor, or a promoter of a Fund.

3. The investment objective of each Fund will be to provide investment results that generally correspond, before fees and expenses, to the total return of the relevant Underlying Index.<sup>2</sup> Intraday values of each Underlying Index will be disseminated every 15 seconds throughout the trading day. Each Fund will utilize as an investment approach either a replication strategy or a representative sampling strategy. An Index Fund using a replication strategy generally will hold most of the component securities of the Underlying Index in the same approximate proportions as the Underlying Index, but may not hold all of the securities that comprise the Underlying Index in certain instances. This may be the case when, for example, a potential component security is illiquid or when there are practical difficulties or substantial costs involved in holding every security in an Underlying Index. An Index Fund using a representative sampling strategy seeks to hold a representative sample of the component securities of the Underlying Index and will invest in some but not all of the component securities of its Underlying Index.<sup>3</sup> Applicants anticipate that a

<sup>1</sup> Dynamic Market Portfolio Intellidex and Dynamic OTC Portfolio Intellidex are the Underlying Indexes for the initial Funds.

<sup>2</sup> A Fund will invest at least 90% of its assets in the component securities of its Underlying Index. A Fund may invest up to 10% of its assets in securities, options and futures not included in the Underlying Index but which the Adviser believes will help the Fund track the Underlying Index.

<sup>3</sup> The stocks selected for inclusion in an Index Fund by the Advisor will have aggregate investment characteristics (based on market capitalization and

<sup>5</sup> 17 CFR 200.30-3(a)(1).

Fund that utilizes a representative sampling strategy will not track its Underlying Index with the same degree of accuracy as an investment vehicle that invested in every component security of the Underlying Index with the same weighting as the Underlying Index. Applicants expect that each Fund will have a tracking error relative to the performance of its respective Underlying Index of less than 5 percent.

4. Shares of the initial Index Funds ("Shares") will be sold in aggregations of 50,000 Shares, and Shares of Future Index Funds will be sold in aggregations of either 25,000 or 50,000 Shares (such aggregations, "Creation Units"), as specified in the relevant prospectus. The price of a Creation Unit will range from \$1,000,000 to \$12,500,000. Creation Units may be purchased only by or through a party that has entered into an agreement with the Distributor regarding creations and redemptions of Creation Units (an "Authorized Participant"). An Authorized Participant must be either (a) a broker-dealer or other participant in the continuous net settlement system of the National Securities Clearing Corporation, a clearing agency that is registered with the Commission, or (b) a participant in the Depository Trust Company ("DTC") system. Creation Units generally will be issued in exchange for an in-kind deposit of securities and cash. A Fund also may sell Creation Units on a cash-only basis in limited circumstances. An investor wishing to purchase a Creation Unit from a Fund will have to transfer to the Fund a "Fund Deposit" consisting of: (a) A portfolio of securities that has been selected by the Adviser to correspond to the returns on the relevant Underlying Index ("Deposit Securities"), and (b) a cash payment to equalize any differences between the market value per Creation Unit of the Deposit Securities and the net asset value ("NAV") per Creation Unit ("Cash Component").<sup>4</sup> An investor purchasing

industry weightings), fundamental characteristics (such as return variability, earnings valuation and yield) and liquidity measures similar to those of the relevant Underlying Index taken in its entirety.

<sup>4</sup> On each business day, prior to the opening of trading on the AMEX, the Adviser or Sub-Adviser will make available a list of the names and the required number of shares of each Deposit Security required for the Fund Deposit for each Fund. That Fund Deposit will apply to all purchases of Creation Units until a new Fund Deposit for a Fund is announced. Each Fund reserves the right to permit or require the substitution of an amount of cash in lieu of depositing some or all of the Deposit Securities in certain circumstances. The AMEX or other Stock Exchange (as defined below) will disseminate every 15 seconds throughout the trading day via the facilities of the Consolidated Tape Association an amount representing on a per

a Creation Unit from a Fund will be charged a fee ("Transaction Fee") to prevent the dilution of the interests of the remaining shareholders resulting from the Fund incurring costs in connection with the purchase of the Creation Units.<sup>5</sup> Each Fund will disclose the Transaction Fees charged by the Fund in its prospectus and the method of calculating the Transaction Fees in its prospectus or statement of additional information ("SAI").

5. Orders to purchase Creation Units of a Fund will be placed with the Distributor who will be responsible for transmitting each order to each Fund. The Distributor will issue, and maintain records of, confirmations of acceptance to purchasers of Creation Units and delivery instructions to the Trust (to implement the delivery of Creation Units). The Distributor will also be responsible for delivering prospectuses to purchasers of Creation Units.

6. Persons purchasing Creation Units from a Fund may hold the Shares or sell some or all of them in the secondary market. Shares of the Funds will be listed on the AMEX or other U.S. national securities exchange, as defined in section 2(a)(26) of the Act (each, including AMEX, a "Stock Exchange") and traded in the secondary market in the same manner as other equity securities. A Stock Exchange specialist ("Specialist") will be assigned to make a market in Shares. The price of Shares traded on a Stock Exchange will be based on a current bid/offer market. Each Share is currently expected to have a market value of between \$40 and \$250. Transactions involving the sale of Shares in the secondary market will be subject to customary brokerage commissions and charges.

7. Applicants expect that purchasers of Creation Units will include institutional investors and arbitrageurs (which could include institutional investors). The Specialist, in providing for a fair and orderly secondary market for Shares, also may purchase Creation Units for use in its market-making activities. Applicants expect that secondary market purchasers of Shares will include both institutional and retail investors.<sup>6</sup> Applicants expect that the

share basis the sum of the current value of the Deposit Securities and the estimated Cash Component.

<sup>5</sup> When a Fund permits a purchaser to substitute cash for Deposit Securities, the purchaser may be assessed an additional fee to offset the brokerage and other transaction costs associated with using cash to purchase the requisite Deposit Securities.

<sup>6</sup> Shares will be registered in book-entry form only. DTC or its nominee will be the registered owner of all outstanding Shares. DTC or its participants will maintain records reflecting the beneficial owners of Shares.

price at which the Shares trade will be disciplined by arbitrage opportunities created by the ability to continually purchase or redeem Creation Units at their NAV, which should ensure that the Shares will not trade at a material discount or premium in relation to their NAV.

8. Shares will not be individually redeemable. Shares will only be redeemable in Creation Units through a Fund. To redeem, an investor will have to accumulate enough Shares to constitute a Creation Unit. An investor redeeming a Creation Unit generally will receive (a) the Portfolio Securities designated to be delivered for Creation Unit redemptions on the date the request for redemption is made ("Redemption Securities"), which may not be identical to the Deposit Securities applicable to the purchase of Creation Units, and (b) a "Cash Redemption Payment," consisting of an amount calculated in the same manner as the Cash Component, although the actual amount of the Cash Redemption Payment may differ from the Cash Component if the Redemption Securities are not identical to the Deposit Securities on a given day. An investor may receive the cash equivalent of a Redemption Security upon its request if, for example, the investor were constrained from effecting transactions in the Redemption Security by regulation or policy.

9. A redeeming investor will pay a Transaction Fee to offset transaction costs, whether the redemption proceeds are in kind or cash. When an investor redeems for cash rather than in kind, the investor may pay a higher Transaction Fee. Such Transaction Fee will be calculated in the same manner as a Transaction Fee payable in connection with the purchase of a Creation Unit.

10. Applicants state that neither the Trust nor any Fund will be marketed or otherwise held out as a "mutual fund." Rather, applicants state that each Fund will be marketed as an "exchange-traded fund." No Fund marketing materials (other than as required in the prospectus) will refer to a Fund as an "open-end" or "mutual fund," except to contrast a Fund with a conventional open-end management investment company. In all marketing materials where the method of obtaining, buying, or selling Shares is described, applicants will include a statement to the effect that Shares are not redeemable through a Fund except in Creation Units. The same type of disclosure will be provided in each Fund's prospectus, SAI, advertising materials, and all reports to shareholders. The Funds will provide copies of their annual and semi-

annual shareholder reports to DTC participants for distribution to beneficial holders of Shares.

#### Applicants' Legal Analysis

1. Applicants request an order under section 6(c) of the Act granting an exemption from sections 2(a)(32), 5(a)(1), 22(d), and 24(d) of the Act and rule 22c-1 under the Act; and under sections 6(c) and 17(b) of the Act granting an exemption from sections 17(a)(1) and (a)(2) of the Act.

2. Section 6(c) of the Act provides that the Commission may exempt any person, security or transaction, or any class of persons, securities or transactions, from any provision of the Act, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

#### *Sections 5(a)(1) and 2(a)(32) of the Act*

3. Section 5(a)(1) of the Act defines an "open-end company" as a management investment company that is offering for sale or has outstanding any redeemable security of which it is the issuer. Section 2(a)(32) of the Act defines a redeemable security as any security, other than short-term paper, under the terms of which the holder, upon its presentation to the issuer, is entitled to receive approximately his proportionate share of the issuer's current net assets, or the cash equivalent. Because Shares will not be individually redeemable, applicants request an order that would permit the Trust to register as an open-end management investment company and issue Shares that are redeemable in Creation Units only. Applicants state that investors may purchase Shares in Creation Units from each Fund and redeem Creation Units. Applicants further state that because the market price of Shares will be disciplined by arbitrage opportunities, investors should be able to sell Shares in the secondary market at prices that do not vary substantially from their NAV.

#### *Section 22(d) of the Act and Rule 22c-1 Under the Act*

4. Section 22(d) of the Act, among other things, prohibits a dealer from selling a redeemable security, which is currently being offered to the public by or through a principal underwriter, except at a current public offering price described in the prospectus. Rule 22c-1 under the Act generally requires that a dealer selling, redeeming, or repurchasing a redeemable security do so only at a price based on its NAV. Applicants state that secondary market

trading in Shares will take place at negotiated prices, not at a current offering price described in the prospectus, and not at a price based on NAV. Thus, purchases and sales of Shares in the secondary market will not comply with section 22(d) of the Act and rule 22c-1 under the Act. Applicants request an exemption under section 6(c) from these provisions.

5. Applicants assert that the concerns sought to be addressed by section 22(d) of the Act and rule 22c-1 under the Act with respect to pricing are equally satisfied by the proposed method of pricing Shares. Applicants maintain that while there is little legislative history regarding section 22(d), its provisions, as well as those of rule 22c-1, appear to have been designed to (a) prevent dilution caused by certain riskless-trading schemes by principal underwriters and contract dealers, (b) prevent unjust discrimination or preferential treatment among buyers resulting from sales at different prices, and (c) assure an orderly distribution of investment company shares by eliminating price competition from dealers offering shares at less than the published sales price and repurchasing shares at more than the published redemption price.

6. Applicants believe that none of these purposes will be thwarted by permitting Shares to trade in the secondary market at negotiated prices. Applicants state that (a) secondary market trading in Shares does not involve the Funds as parties and cannot result in dilution of an investment in Shares, and (b) to the extent different prices exist during a given trading day, or from day to day, such variances occur as a result of third-party market forces, such as supply and demand. Therefore, applicants assert that secondary market transactions in Shares will not lead to discrimination or preferential treatment among purchasers. Finally, applicants contend that the proposed distribution system will be orderly because arbitrage activity will ensure that the difference between the market price of Shares and their NAV remains narrow.

#### *Section 24(d) of the Act*

7. Section 24(d) of the Act provides, in relevant part, that the prospectus delivery exemption provided to dealer transactions by section 4(3) of the Securities Act does not apply to any transaction in a redeemable security issued by an open-end investment company. Applicants request an exemption from section 24(d) to permit dealers selling Shares to rely on the

prospectus delivery exemption provided by section 4(3) of the Securities Act.<sup>7</sup>

8. Applicants state that Shares will be listed on a Stock Exchange and will be traded in a manner similar to other equity securities, including the shares of closed-end investment companies. Applicants note that dealers selling shares of closed-end investment companies in the secondary market generally are not required to deliver a prospectus to the purchaser. Applicants contend that Shares, as a listed security, merit a reduction in the compliance costs and regulatory burdens resulting from the imposition of prospectus delivery obligations in the secondary market. Because Shares will be exchange-listed, prospective investors will have access to several types of market information about Shares. Applicants state that information regarding market price and volume will be continually available on a real-time basis throughout the day on brokers' computer screens and other electronic services. The previous day's closing price and volume information for Shares also will be published daily in the financial section of newspapers. The website maintained for the Trust will include, for each Fund, the prior business day's NAV, the mid-point of the bid-ask spread at the time of calculation of NAV ("Bid-Ask Price") and calculation of the premium or discount of the Bid-Ask Price at the time of calculation of the NAV against such NAV, and data in chart format displaying the frequency distribution of discounts and premiums of the Bid/Ask Price against the NAV, within

<sup>7</sup> Applicants do not seek relief from the prospectus delivery requirement for non-secondary market transactions, including purchases of Creation Units or those involving an underwriter. Applicants state that persons purchasing Creation Units will be cautioned in a Fund's prospectus that some activities on their part may, depending on the circumstances, result in their being deemed statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act. For example, a broker-dealer firm and/or its client may be deemed a statutory underwriter if it takes Creation Units after placing an order with the Adviser, breaks them down into the constituent Shares, and sells Shares directly to its customers, or if it chooses to couple the purchase of a supply of new Shares with an active selling effort involving solicitation of secondary market demand for Shares. A Fund's prospectus will state that whether a person is an underwriter depends upon all the facts and circumstances pertaining to that person's activities. A Fund's prospectus also will state that dealers who are not "underwriters" but are participating in a distribution (as contrasted to ordinary secondary market trading transactions), and thus dealing with Shares that are part of an "unsold allotment" within the meaning of section 4(3)(C) of the Securities Act, would be unable to take advantage of the prospectus delivery exemption provided by section 4(3) of the Securities Act.

appropriate ranges, for each of the four previous calendar quarters.<sup>8</sup>

9. Investors also will receive a product description ("Product Description") describing a Fund and its Shares. Applicants state that, while not intended as a substitute for a Prospectus, the Product Description will contain information about Shares that is tailored to meet the needs of investors purchasing Shares in the secondary market.

#### *Sections 17(a)(1) and (2) of the Act*

10. Section 17(a) of the Act generally prohibits an affiliated person of a registered investment company, or an affiliated person of such a person, from selling any security to or purchasing any security from the company. Section 2(a)(3) of the Act defines "affiliated person" to include any person directly or indirectly owning, controlling, or holding with power to vote 5% or more of the outstanding voting securities of the other person and any person directly or indirectly controlling, controlled by, or under common control with, the other person. Section 2(a)(9) of the Act provides that a control relationship will be presumed where one person owns more than 25% of another person's voting securities. Applicants state that because the definition of "affiliated person" includes any person owning 5% or more of an issuer's outstanding voting securities, every purchaser of a Creation Unit will be affiliated with the Fund so long as fewer than twenty Creation Units are in existence, and any purchaser that owns more than 25% more of a Fund's outstanding Shares will be affiliated with a Fund.

Applicants request an exemption from section 17(a) under sections 6(c) and 17(b), to permit persons that are affiliated persons of the Funds solely by virtue of a 5% or more or more than 25% ownership interest (or affiliated persons of such affiliated persons that are not otherwise affiliated with the Funds) to purchase and redeem Creation Units through "in-kind" transactions.

11. Section 17(b) of the Act authorizes the Commission to exempt a proposed transaction from section 17(a) of the Act if evidence establishes that the terms of the transaction, including the consideration to be paid or received, are reasonable and fair and do not involve overreaching on the part of any person concerned, and the proposed transaction is consistent with the policies of the registered investment

company and the general provisions of the Act. Applicants contend that no useful purpose would be served by prohibiting the affiliated persons of a Fund described above from purchasing or redeeming Creation Units through "in-kind" transactions. The deposit procedure for in-kind purchases and the redemption procedure for in-kind redemptions will be the same for all purchases and redemptions. Deposit Securities and Redemption Securities will be valued under the same objective standards applied to valuing Portfolio Securities. Therefore, applicants state that in-kind purchases and redemptions will afford no opportunity for the affiliated persons, and the affiliated persons of the affiliated persons, described above, of a Fund to effect a transaction detrimental to the other holders of Shares. Applicants also believe that in-kind purchases and redemptions will not result in abusive self-dealing or overreaching by these persons of the Index Fund.

#### **Applicants' Conditions**

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. Applicants will not register a Future Fund by means of filing a post-effective amendment to the Trust's registration statement or by any other means, unless (a) applicants have requested and received with respect to such Future Fund, either exemptive relief from the Commission or a no-action letter from the Division of Investment Management of the Commission; or (b) the Future Fund will be listed on a Stock Exchange without the need for a filing pursuant to rule 19b-4 under the Exchange Act.

2. Each Fund's prospectus and Product Description will clearly disclose that, for purposes of the Act, Shares are issued by the Fund and that the acquisition of Shares by investment companies is subject to the restrictions of section 12(d)(1) of the Act.

3. As long as the Trust operates in reliance on the requested order, the Shares will be listed on a Stock Exchange.

4. Neither the Trust nor any Fund will be advertised or marketed as an open-end fund or a mutual fund. Each Fund's prospectus will prominently disclose that the Shares are not individually redeemable shares and will disclose that the owners of the Shares may acquire those Shares from the Fund and tender those Shares for redemption to the Fund in Creation Units only. Any advertising material that describes the purchase or sale of Creation Units or refers to redeemability will prominently disclose

that the Shares are not individually redeemable and that owners of the Shares may acquire those Shares from the Fund and tender those Shares for redemption to the Fund in Creation Units only.

5. The website for the Trust, which is and will be publicly accessible at no charge, will contain the following information, on a per Share basis, for each Fund: (a) The prior business day's NAV and the Bid/Ask Price, and a calculation of the premium or discount of the Bid/Ask Price at the time of calculation of NAV against such NAV; and (b) data in chart format displaying the frequency distribution of discounts and premiums of the daily Bid/Ask Price against the NAV, within appropriate ranges, for each of the four previous calendar quarters. In addition, the Product Description for each Fund will state that the website for the Fund has information about the premiums and discounts at which the Fund's Shares have traded.

6. The prospectus and annual report for each Fund will also include: (a) The information listed in condition 5(b), (i) in the case of the prospectus, for the most recently completed year (and the most recently completed quarter or quarters, as applicable) and (ii) in the case of the annual report, for the immediately preceding five years, as applicable; and (b) the following data, calculated on a per Share basis for one, five and ten year periods (or life of the Funds), (i) the cumulative total return and the average annual total return based on NAV and Bid/Ask Price, and (ii) the cumulative total return of the relevant Underlying Index.

7. Before a Fund may rely on the order, the Commission will have approved, pursuant to rule 19b-4 under the Exchange Act, a Stock Exchange rule requiring Stock Exchange members and member organizations effecting transactions in Shares to deliver a Product Description to purchasers of Shares.

For the Commission, by the Division of Investment Management, under delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>8</sup> The Bid/Ask Price per Share of a Fund is determined using the highest bid and the lowest offer on the Stock Exchange at the time of calculation of such Fund's NAV.