

# Information Memo

New York Stock Exchange, Inc.  
11 Wall Street  
New York, NY 10005

Market Surveillance



Number 02-45  
October 21, 2002

**ATTENTION:** CHIEF EXECUTIVE OFFICER, MANAGING PARTNERS,  
COMPLIANCE AND LEGAL DEPARTMENTS

**TO:** ALL MEMBERS AND MEMBER ORGANIZATIONS

**SUBJECT:** TRADING OF FRESCO DOW JONES STOXX 50 FUND AND  
FRESCO DOW JONES EURO STOXX 50 FUND

Trading in two listed Exchange-Traded Funds ("Funds") is scheduled to begin on the NYSE on October 21, 2002. The Funds include shares of the Fresco<sup>SM</sup> Dow Jones STOXX 50<sup>SM</sup> Fund (symbol: FEU) and Fresco<sup>SM</sup> Dow Jones EURO STOXX 50<sup>SM</sup> Fund<sup>1</sup> (symbol: FEZ), each of which is a series of Fresco<sup>SM</sup> Index Shares Funds, a registered investment company.<sup>2</sup>

The purpose of this memorandum is to outline various rules and policies that will be applicable to trading in these Funds.

## Characteristics of the Funds Generally:

The Funds are each a separate series of Fresco Index Shares Funds (the "Trust").<sup>3</sup> UBS Global Asset Management (US) Inc. ("UBS Global AM"), an indirect wholly owned asset management subsidiary of UBS AG ("UBS"), acts as the advisor (the "Advisor") to the Funds. UBS Global Asset Management International Ltd. ("UBS Global AM Ltd."), an indirect wholly owned asset management subsidiary of UBS, acts as the sub-advisor to the Funds. STOXX Limited, a joint venture among Deutsche Boerse AG, Dow Jones & Company, Inc., Euronext Paris SA and SWX Swiss Exchange ("STOXX"), provides and services the Dow Jones STOXX 50 and Dow Jones EURO STOXX 50 indexes (each an "Index" or "Underlying Index").

For a more complete description of the Funds and their respective Underlying Indices, visit the STOXX website at [www.stoxx.com](http://www.stoxx.com).

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<sup>1</sup> Fresco is a service mark of UBS AG. Dow Jones, Dow Jones Stoxx, Dow Jones Stoxx 50 and Dow Jones Euro Stoxx 50 are each service marks of Stoxx Limited.

<sup>2</sup> The Funds will be listed and traded as Investment Company Units pursuant to Section 703.16 of the Listed Company Manual (the "LCM") and the Exchange's Rule 1100.

<sup>3</sup> The Trust is registered under the Investment Company Act of 1940, as amended (the "1940 Act"). The Trust has filed with the Commission a Registration Statement on the Form N-1A under the Securities Act of 1933 as amended (the "Securities Act") and under the Investment Company Act of 1940 relating to the Fund.

### Characteristics of Funds Generally:

The investment objective of each Fund will be to provide investment results that correspond generally to the price and yield performance of its underlying index. The underlying index for Fresco<sup>SM</sup> DOW Jones STOXX 50 Fund is the Dow Jones STOXX 50 Index, which represents the performance of the 50 largest companies, across all components of the 18 Dow Jones STOXX 600<sup>SM</sup> market sector indexes. The Dow Jones STOXX 600<sup>SM</sup> market sector indexes are a subset of the pan-European Dow Jones STOXX Total Market Index and contain the 600 largest stocks traded on the major exchanges in Europe.

The underlying index for the Fresco<sup>SM</sup> Dow Jones EURO STOXX 50<sup>SM</sup> Fund. is the DOW Jones EURO STOXX 50 Index, which represents the performance of the 50 largest companies, across all components of the 18 Dow Jones EURO STOXX 600<sup>SM</sup> market sector indexes. The Dow Jones EURO STOXX 600<sup>SM</sup> market sector indexes are a subset of the Dow Jones EURO STOXX<sup>SM</sup> Total Market Index and contain the 600 largest stocks traded on the major exchanges in the Eurozone.

In seeking to achieve its respective investment objective, each Fund will utilize “passive” indexing investment strategies, attempting to replicate, before expenses, the price and yield of each Underlying Index. Each Fund generally will invest in all of the stocks comprising its Underlying Index in proportion to their weightings in the Underlying Index. However, each Fund may, in certain circumstances, purchase only a sample of stocks in its Underlying Index in proportions expected by the Advisor to replicate generally the performance of the Index as a whole, choose to overweight a stock in the Index, purchase securities not in the Index which the Advisor believes are appropriate to substitute for the securities contained in the Index, or utilize other available investment techniques in seeking to track the Index.

Each Fund will invest at least 90% of its total assets in the stocks of the Underlying Index. Each Fund may invest its remaining assets in money market instruments, convertible securities, structured notes and in options and futures contracts. Each Fund also intends to maintain the required level of diversification so as to qualify as a regulated investment company under the Internal Revenue Code (the “Code”). Compliance with the diversification requirements of the Code could limit the investment flexibility of each Fund.

### Issuance of Creation Unit Aggregations

In General. Shares of each Fund will be issued on a continuous offering basis in groups of 50,000 shares or more. These “groups” of shares are called “Creation Unit Aggregations.” The Funds will issue and redeem Fund shares only in Creation Unit Aggregations. As with other open-end investment companies, Fund shares will be

issued at the net asset value (“NAV”) per share next determined after an order in proper form is received.

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### **Exchange Rules Applicable to the Trading of these Funds**

Generally, the rules applicable to ETFs trading on a UTP basis are applicable to the Funds mentioned. See Information Memo Number 01-20 (July 31, 2001), which was issued in connection with the UTP trading of the NASDAQ 100 Trust (symbol QQQ), Standard and Poor’s Depository Receipts (symbol SPY) and the Dow Industrials DIAMONDS (symbol DIA). The applicable rules from Information Memo Number 01-20 as well as certain exemptions from the Securities Exchange Act of 1934 and NYSE Rules are reiterated below.

### **NYSE Rules Applicable to ETFs, Including these Funds**

Rule 104 - Rules 104.20 and 104.21 provide a capital requirement for specialists of \$500,000 per ETF. A specialist unit registered only in an ETF would be subject to the \$1,000,000 minimum capital requirement of Rule 104.20.

In addition, Rule 104 facilitates specialist market making in ETFs. Specialists may engage in “parity” transactions on direct destabilizing ticks without obtaining Floor Official approval. A “parity” transaction in an ETF would be a trade to bring the security into line with the value of the securities comprising the ETF, or the value of a futures contract on the index on which the ETF is based.

Rule 13 - Commentary .30 to Exchange Rule 13 provides that stop and stop limit orders in an Investment Company Unit shall be elected by a quotation, but specifies that if the electing bid on an offer is more than 0.10 points away from the last sale and is for the specialist’s dealer account, prior Floor Official approval is required for the election to be effective. This rule applies to Investment Company Units generally, including these Funds.

Rule 36.30 - Rule 36.30 governs the establishment of telephone or electronic communications between the Exchange’s trading floor and any other location. It allows specialists to have telephone lines to the floor of an options or futures exchange for the purpose of entering hedging orders.

Rule 36 provides that a specialist registered in an ETF may use a telephone or order entry terminal to enter an order in the ETF itself, in a component security of the ETF, or in an options or futures contract related to the ETF. In addition, the specialist may use a post telephone to obtain market information with respect to such ETFs, options, futures, or component securities. The text of Rule 36 makes clear that if an order in a component security of such ETF is to be executed on the Exchange, the order must be entered in compliance with NYSE Rule 112.20 and SEC Rule 11a2-2(T), and must be entered only for the purpose of hedging a position in the ETF.

The specialist may not use the post wire to call a specialist on the NYSE registered in a component stock of the ETF to enter an order, nor may the specialist use a SuperDOT terminal to send an order directly via SuperDOT to another specialist. The specialist

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registered in an ETF is not registered in the component stocks, and therefore is not permitted to initiate an "on Floor" order in such a stock.

Exchange members, including specialists, are permitted to enter an "off-Floor" order. NYSE Rule 112.20 codifies the principle that a member may use a "communication facility" on the Floor of the Exchange to call an off-Floor location and enter a proprietary order. The order is deemed to be an "off Floor" order (not an order initiated on the Floor, or an "on Floor" order), provided the order is routed through a clearing firm's order room, and is transmitted to the Floor for execution by an unaffiliated member. This latter provision is consistent with SEC Rule 11a2-2(T), which permits executions of off-floor member proprietary orders by unaffiliated members. These rules do not impose restrictions on the types of orders which may be executed pursuant to the exemptive relief provided. Under the amendment to Rule 36, any orders in a component stock of an ETF entered for execution on the Exchange from the specialist's post, either by telephone or by means of a SuperDOT terminal, would have to be routed through a clearing firm's order room and transmitted back to the Floor for execution without the specialist in the ETF interacting with the order or participating in the execution in any way.

#### Market-on-Close/ Limit-At-The-Close Policy/ Pre-Opening Price Indications Policy -

Orders in ETFs are not subject to the Exchange's Market-On-Close ("MOC")/ Limit-at-the-close ("LOC") policy concerning order entry limitations, cancellation of orders during a regulatory halt, imbalance publications, and any other limitations or procedures with respect to MOC/LOC procedures. A MOC/LOC order in an ETF can be entered at any time without regard to the limitations of the Exchange's MOC/LOC policies. In addition, the closing price of an ETF will not be subject to publication of imbalances under the Exchange's MOC/LOC policy.

Similarly, the Exchange's policies regarding mandatory dissemination of pre-opening price indications (other than ITS pre-opening notifications) in the case of significant order imbalances and potentially large price dislocation from the prior close would not apply to ETFs. Both the MOC/LOC procedures and the mandatory pre-opening price indications policy are intended to solicit offsetting contra side interest to minimize price dislocation. This rationale does not apply in the case of ETFs, which are derivatively priced in relation to, among other things, the values of the underlying component securities, regardless of the extent of an order imbalance.

Rule 105(l) - Rule 105(l), which prohibits affiliates of specialist units from acting as a primary market maker in the option on a specialty security, permits such activity with respect to options on a Fund for affiliates of specialists that have Rule 98 approved procedures in place. The Exchange believes that, as ETFs are derivatively priced, the conflicts of interest with respect to market making in both the underlying security and its

corresponding option are minimized in this case. The Exchange will also permit a Rule 98 affiliate of the ETF specialist to act in a market making capacity (but not as a specialist) in the ETF itself on another market center.

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Rule 98 - Exchange Rule 98 provides that affiliates of a specialist organization can receive an exemption from certain rules applicable to specialists (principally impacting proprietary trading and investment banking), provided they establish a system of information barriers between themselves and the affiliated specialist. One of the conditions for the Rule 98 exemption is that the specialist organization be capitalized separate and apart from any affiliate. The Exchange has deleted this requirement in the case of a specialist organization that is registered only in ETFs. The Exchange believes that the separate capitalization requirement is not required in this instance, and that the question of adequacy of capital can be appropriately addressed by the special allocation committee which will allocate the ETF. However, a specialist organization that is registered only in ETFs will remain subject to the minimum capital requirements specified in Rule 104.20.

Rule 1100 - Rule 1100(a) clarifies that NYSE rules applying to Investment Company Units (which include these Funds) also apply to securities fitting that definition that are traded on the Exchange on the basis of unlisted trading privileges.

Hours of Trading – Like other ETFs, these Funds will trade until 4:15 p.m.

### **Exemptive, Interpretive and No-Action Relief Under Federal Securities Regulations and NYSE Rules**

The Securities and Exchange Commission (“SEC”) has issued exemptive, interpretive and no-action relief from certain provisions of and rules under the Securities Exchange Act of 1934 regarding trading in the above-mentioned Funds. In addition, the Exchange has taken an interpretive position with respect to its short sale rule.

Short Sale Rules - Transactions in ETFs will not be subject to "tick" requirements of the short sale rule of the Commission (Rule 10a-1) or the Exchange (Rule 440B). Short orders must be marked SHORT or SHORT EXEMPT.

Regulation M Exemptions - Generally, Rules 101 and 102 of Regulation M prohibit any "distribution participant" and its "affiliated purchasers" from bidding for, purchasing, or attempting to induce any person to bid for or purchase, any security which is the subject of a distribution until after the applicable restricted period, except as specifically permitted in Regulation M. The provisions of the Rules apply to underwriters, prospective underwriters, brokers, dealers, and other persons who have agreed to participate or are participating in a distribution of securities.

The SEC has granted an exemption from Rule 101 under Regulation M to permit persons participating in a distribution of shares of the above-mentioned Funds to engage in secondary market transactions in such shares during their participation in

such a distribution. In addition, the SEC has granted relief under Regulation M to permit persons who may be deemed to be participating in the distribution of shares of the

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above-mentioned Funds (i) to purchase securities for the purpose of purchasing Creation Unit Aggregations of Fund shares and to (ii) tender securities for redemption in Creation Unit Aggregations. Further, the SEC has clarified that the tender of Fund shares to the Fund for redemption does not constitute a bid for or purchase of any of the Fund's securities during the restricted period of Rule 101. The SEC has also granted an exemption pursuant to paragraph (e) of Rule 102 under Regulation M to allow the redemption of Fund shares in Creation Unit Aggregations during the continuous offering of shares.

Customer Confirmations for Creation or Redemption of Fund Shares (Rule 10b-10) –

Broker-dealers who handle purchases or redemptions of Fund shares in Creation Unit size for customers will be permitted to provide such customers with a statement of the number of Creation Unit Aggregations created or redeemed without providing a statement of the identity, number and price of shares of the individual securities tendered to the Fund for purposes of purchasing Creation Unit Aggregations (“Deposit Securities”) or the identity, number and price of shares of to be delivered by the Trust to the redeeming holder (“Redemption Securities”). The composition of the securities required to be tendered to the Fund for creation purposes and of the securities to be delivered on redemption will be disseminated each business day and will be applicable to requests for creations or redemption, as the case may be, on that day. This information will be publicly available at the Exchange and will be made available to requesting broker-dealers or other persons through other third-party information providers. This exemptive relief under Rule 10b-10 with respect to creations and redemptions is subject to the following conditions:

(1) Confirmations to customers engaging in creations or redemptions must state that all information required by Rule 10b-10 will be provided upon request;

(2) Any such request by a customer for information required by Rule 10b-10 will be filed in a timely manner, in accordance with Rule 10b-10(c);

(3) Except for the identity, number and price of shares of the component securities of the Deposit Securities and Redemption Securities, as described above, confirmations to customers must disclose all other information required by Rule 10b-10(a).

SEC Rule 14e-5 –An exemption from Rule 14e-5 has been granted (but not as to the fixed income Funds as the Rule doesn't apply to debt) to permit any person acting as a dealer-manager of a tender offer for a component security of the above-mentioned non-fixed income Funds to (1) redeem Fund shares in Creation Unit Aggregations from the issuer that may include a security subject to such tender offer and (2) to purchase Fund shares during such tender offer. In addition, a no-action position has been taken under

Rule 14e-5 if a broker-dealer acting as a dealer-manager of a tender offer for a security of the Fund purchases or arranges to purchase such securities in the secondary market

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for the purpose of tendering such securities to purchase one or more Creation Unit Aggregations of shares, if made in conformance with the following:

(i) such bids or purchases are effected in the ordinary course of business, in connection with a basket of 20 or more securities in which any security that is the subject of a distribution, or any reference security, does not comprise more than 5% of the value of the basket purchased; or

(ii) purchases are effected as adjustments to such basket in the ordinary course of business as a result of a change in the composition of the underlying index; and

(iii) such bids or purchases are not effected for the purpose of facilitating such tender offer.

Section 11(d)(1); Rules 11d1-1 and 11d1-2 - Section 11(d)(1) of the Exchange Act generally prohibits a person who is both a broker and a dealer from effecting any transaction in which the broker-dealer extends credit to a customer on any security which was part of a new issue in the distribution of which he participated as a member of a selling syndicate or group within thirty days prior to such transaction. The SEC has clarified that Section 11(d)(1) does not apply to broker-dealers that engage in both proprietary and customer transactions in shares of the Funds in the secondary market but do not create Creation Unit Aggregations. The Commission has also taken a no-action position under Section 11(d)(1) of the Exchange Act that broker-dealers may treat shares of the above-mentioned Funds, for purposes of Rule 11d1-2, as "securities issued by a registered open-end investment company as defined in the Investment Company Act" and thereby extend credit or maintain or arrange for the extension or maintenance of credit on shares that have been owned by the persons to whom credit is provided for more than 30 days, in reliance on the exemption contained in the rule.

Rule 15c1-5 and 15c1-6 – The SEC has taken a no-action position with respect to Rule 15c1-5 and Rule 15c1-6 as to the required disclosure of control by a broker or dealer with respect to creations and redemptions of Fund shares and secondary market transactions therein.

### **Other Matters**

Suitability – Pursuant to Exchange Rule 405, before a member, member organization, allied member or employee of such member organization undertakes to recommend a transaction in ETF shares, such member or member organization should make a determination that such shares are suitable for such customer. If any recommendation is made with respect to such shares, the person making the recommendation should have a reasonable basis for believing at the time of making the recommendation, that

the customer has such knowledge and experience in financial matters that he or she may reasonably be expected to be capable of evaluating the risks and any special

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characteristics of the recommended transaction, and is financially able to bear the risks of the recommended transaction.

Certain Specialist Transactions in ETFs – Rule 460.10 generally precludes certain business relationships between an issuer and the specialist in the issuer's securities. Exceptions in the Rule permit specialists in ETF shares to enter into Creation Unit transactions through the Distributor to facilitate the maintenance of a fair and orderly market. A specialist Creation Unit transaction may only be effected on the same terms and conditions as any other investor, and only at the net asset value of the Fund shares. A specialist may acquire a position in excess of 10% of the outstanding issue of the Fund shares, provided, however, that a specialist registered in a security issued by an investment company may purchase and redeem the investment company unit or securities that can be subdivided or converted into such unit, from the investment company as appropriate to facilitate the maintenance of a fair and orderly market in the subject security.

Trading Halts. In order to halt the trading of an ETF, the Exchange may consider, among other things, factors such as the extent to which trading is not occurring in underlying security(s) and whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. In addition, trading in Fund shares is subject to trading halts caused by extraordinary market volatility pursuant to Exchange Rule 80B.

Prospectus Delivery. Exchange members and member organizations are hereby informed of the prospectus or Product Description delivery requirements applicable to the Funds. The Trust has obtained an exemptive order granting relief from certain prospectus delivery requirements under Section 24(d) of the 1940 Act (See Investment Company Act Release No. 25738 (October 11, 2002)). Any product description used in reliance on a Section 24(d) exemptive order will comply with all representations made therein and all conditions thereto.

Purchases and Redemptions in Creation Unit Size. Members and member organizations are hereby informed that procedures for purchases and redemptions of Fund shares in Creation Unit Size are described in the relevant Funds' prospectus, and that the Fund shares are not individually redeemable but are redeemable only in Creation Unit Size aggregations or multiples thereof.

Custom Orders. All standard orders to create a Creation Unit must be received by UBS Global AM, as principal underwriter, no later than the close of the regular trading session on the NYSE (ordinarily 4:00 p.m.) on the date such order is placed in order for creation of Creation Units to be effected based on the net asset value of Shares as next

determined on such date after receipt of the order in proper form. In the case of custom orders, the order must be received by UBS Global AM, as principal underwriter, no later than 11:00 a.m. New York time.

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Surveillance. The Exchange's surveillance procedures for Fund Shares will be similar to the procedures utilized for other Investment Company Units.

Questions concerning the matters discussed in this Memorandum may be addressed as follows:

General Questions on STOXX and EURO STOXX Funds

James P. McGowan (212) 656-2490 (Exchange Traded Funds)  
James F. Duffy (212) 656-5855 (Office of the General Counsel)

Questions on:

Suitability Mary Anne Furlong (Member Firm Regulation)  
(212) 656-4823

Specialist Issues Donald Siemer (Market Surveillance)  
(212) 656-6940

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Regina C. Mysliwicz  
Senior Vice President