

Regulatory Circular RG01-119

Date: July 24, 2001

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

From: Capital Markets Department
Chicago Board Options Exchange

Subject: Nasdaq-100 Index Tracking SharesSM ("QQQ")

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

The purpose of this Regulatory Circular is to provide basic information to Members and Member Organizations regarding Nasdaq-100 Index Tracking SharesSM ("Nasdaq-100 SharesSM")¹ and to advise of certain compliance responsibilities when handling transactions in these securities. This is not a sales document and is not intended to be distributed to customers.

The information in this Regulatory Circular describing Nasdaq-100 SharesSM and their properties is excerpted from the Prospectus and the Exchange assumes no responsibility for the accuracy or completeness of such information.

This Regulatory Circular addresses certain matters concerning trading of Nasdaq-100 SharesSM. It is expected that trading in Nasdaq-100 SharesSM will commence on the CBOE on or about July 27, 2001 under the ticker symbol QQQ.

Background: Nasdaq-100 SharesSM represent ownership in the Nasdaq-100 TrustSM, a long-term unit investment trust established to accumulate and hold a portfolio of the equity securities that comprise the Nasdaq-100 Index[®]. Nasdaq-100 SharesSM are intended to provide investment results that generally correspond to the price and dividend yield performance of the Nasdaq-100 Index[®], and its initial market value approximates 1/40 the value of the Nasdaq-100 Index[®]. Nasdaq-100 SharesSM can be bought or sold throughout the trading day like shares of stock.

The sponsor of the unit investment trust is Nasdaq-Amex Investment Product Services, Inc., which is wholly owned subsidiary of The Nasdaq Stock Market, Inc. The Bank of

New York is the Trustee for the Nasdaq-100 TrustSM and ALPS Mutual Funds Services, Inc., a registered broker-dealer, is distributor for the Trust.

Creations and Redemptions: Nasdaq-100 SharesSM can be created in Creation Unit block sizes of 50,000 shares (or multiples thereof) by the deposit into the Nasdaq-100 TrustSM of a specified portfolio of stocks substantially similar in composition on weighting to stocks in the Nasdaq-100 Index[®] and a specified cash amount. Conversely, a Creation Unit of 50,000 Nasdaq-100 SharesSM (or multiples thereof) can be redeemed for a specific portfolio of stocks and a specified cash amount. The shares of component stocks in a Creation Unit are determined by the Trustee prior to the opening of trading each business day. The required cash amount is determined on the same day following the close of trading. As a practical matter, only large institutions or large investors will have the capability to create or redeem Nasdaq-100 SharesSM directly with the Trust.

Applicable Rules: Trading in Nasdaq-100 SharesSM is governed by CBOE Rules 30.54 and 31.5.L as well as Chapter 30 of CBOE's Rules. Members should read and familiarize themselves with the provisions of these rules and, where appropriate, develop procedures to assure adherence to such provisions. Members should particularly note that CBOE will monitor trading activity for compliance with CBOE Rule 30.76 "Trade-Through Rule".

Product Description and Prospectus: A complete description of Nasdaq-100 SharesSM can be found in the prospectus for the Nasdaq-100 TrustSM Series 1 dated January 30, 2001. The prospectus must be delivered to customers upon request.

In addition, CBOE Rule 30.54 requires members to provide all purchasers of Nasdaq-100 SharesSM in the secondary market with a written Product Description for Nasdaq - 100 SharesSM in a form approved by the Exchange or prepared by the Trust not later than the time a confirmation of the first transaction in Nasdaq-100 SharesSM is delivered to such purchaser. The Product Description must also accompany Nasdaq-100 SharesSM sales materials sent out by members. Any other written materials provided by members to customers or the public referencing Nasdaq-100 SharesSM as an investment vehicle must include a statement in a form approved by the Exchange, that a Product Description and prospectus are available upon request from a broker.

Additionally, member organizations carrying an omnibus account for a non-member broker-dealer will be required to inform such non-member that execution of an order to purchase Nasdaq-100 SharesSM for such omnibus account will be deemed to constitute agreement by the non-member to make the Product Description available to its customers on the same terms as member firms.

Copies of both the Product Description and the prospectus may be obtained from Nasdaq-Amex Investment Product Services, Inc., c/o The American Stock Exchange, 86 Trinity Place, New York, New York 10006.

Trading Halts: Nasdaq-100 SharesSM trading will be halted if the Exchange's circuit breaker parameters have been reached.² The Exchange may also consider other factors when deciding whether to halt or suspend trading Nasdaq-100 SharesSM. These factors include, but are not limited to (1) the extent to which trading is not occurring in stocks underlying the Nasdaq-100 Index[®]; and (2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

Net Dividends: If dividends of the underlying stocks exceed Trust expenses in a quarter, an income net of expense amount - a pro rata amount (less accumulated Trust expenses) of regular cash dividends for the stocks in the Trust that have gone ex-dividend - will be paid quarterly on the last business day of April, July, October and January. Quarterly accrual periods begin on the ex-dividend date. Based on historical dividend payment rates of securities in the Nasdaq-100 Index[®] and estimated ordinary expenses of the Trust, little or no such dividend distributions are currently anticipated. The Net Accrued Dividend will be disseminated under Symbol QXV.DV.

Net Asset Value: The net asset value (NAV) of a Nasdaq-100 SharesSM unit will be calculated each business day at approximately 3:00 p.m. Chicago time and disseminated the next day under ticker symbol QXV.NV. The NAV represents the aggregate closing market value of the underlying portfolio of Nasdaq-100 Index[®] securities in the Nasdaq-100 TrustSM plus any accrued dividends and other Trust assets, minus accumulated Trust expenses and other Trust liabilities on a per share basis.

Trading Information: A round lot is 100 Nasdaq-100 SharesSM; odd lots (*i.e.*, less than 100 Nasdaq-100 SharesSM) can be traded as well. Quotations will be expressed in dollars and cents, with a minimum increment of one cent per Nasdaq-100 SharesSM unit. Trade settlement will be three business days. Nasdaq-100 SharesSM are held in book-entry form only at DTC.

Short Sale Rule: In its no-action letter, the SEC has granted an exemption from SEC Rule 10a-1 (short-sale rule) to permit sales of Nasdaq-100 SharesSM on a minus or zero-minus tick. **In this connection, the Exchange emphasizes that CBOE rules require members organizations effecting short sales for customers or their proprietary accounts to make prior arrangements to borrow the securities.** A market-maker or specialist is exempt from the pre-borrowing requirements in fulfilling market-maker obligations, however, they are not exempt from buy-ins. The possibility of a buy-in exists whenever a market-maker sells stock short that was not pre-borrowed, thereby failing to deliver, or when borrowed shares cannot be returned to the lender upon demand. (See Regulatory Circulars 95-69 – *Delivery of Securities When Selling Short* and 97-70 – *Stock Buy-Ins*.)

Margin : With regard to Section 11(d)(1) of the Securities Exchange Act of 1934, the SEC has issued a no-action letter that permits broker-dealers who do not create Nasdaq-100 SharesSM (but do engage in both proprietary and customer transactions in Nasdaq-100 SharesSM exclusively in the secondary market) to extend credit to customers at the time of such trades.

Nasdaq-100 SharesSM are margin equity securities and, therefore, purchases on margin are subject to an initial margin requirement of 50% and a maintenance margin requirement of 25%.

As noted above, Nasdaq-100 SharesSM are short sale eligible. The initial margin requirement for a short sale is the short sale proceeds plus 50%. The maintenance margin requirement is the current market value of the Nasdaq-100 SharesSM plus 30% (based on the price per share as of July 13, 2001).

No margin is required on short QQQ, NDX or MNX call (put) options covered by an equivalent long (short) position in Nasdaq-100 SharesSM. A short QQQ call option covered by an equivalent long position in Nasdaq-100 SharesSM is permitted in a cash account, as QQQ options are physically settled. Covered call treatment may not be extended to NDX and MNX options in a cash account. One hundred (100) Nasdaq-100

SharesSM are required for each short QQQ contract, 4,000 shares for each short NDX option contract, and 400 shares for each short MNX option contract. Long Nasdaq-100 SharesSM must be priced at the lower of current market value or short call exercise price. Any amount by which the exercise price of a short put option exceeds the current market value of short Nasdaq-100 SharesSM must be added to the Regulation T requirement (for calculating excess) and maintenance margin requirement on the Nasdaq-100 SharesSM. (Options on Nasdaq-100 SharesSM are physically settled in Nasdaq-100 SharesSM while NDX and MNX are cash settled. With respect to NDX and MNX, see CBOE Regulatory Circular RG99-09 for more information on writing cash settled index options on a covered basis in a margin account.)

Net Capital Requirements: As an equity security, Nasdaq-100 SharesSM will be subject to a haircut equal to 15% of market value. For QQQ, NDX and MNX options market-makers, Nasdaq-100 SharesSM qualify as an options hedge (permitted offset) under Exchange Rule 12.3(f)(3)(A)(vii). Under the risk-based method, there will be a 100% offset between Nasdaq-100 SharesSM and QQQ, NDX and MNX options. A 75% offset will apply between Nasdaq-100 SharesSM and other option classes in the same product group (Non High Capitalization Broad Based Indexes - US NASD Market Product Group).⁻³

IMPACT UPON OPTIONS MARKET-MAKER NET CAPITAL EXEMPTION

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

No-Action/Exemption Letter: As indicated, the SEC has issued a no-action letter concerning, among other matters, short sales and customer margin requirements. See SEC no-action exemption letter to the American Stock Exchange, dated March 3, 1999, which relates to SEC Rules 10a-1, 10b-10, 10b-13, 10b-17, 11d1 -1, 11d1-2, 15c1-5, 15c1-6 and Regulation M.

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

Questions regarding suitability of customer transactions in Nasdaq-100 SharesSM should be directed to Barry Szurgot (312) 786-7756, questions regarding marginability should

be directed to Jim Adams (312) 786-7718 and questions regarding net capital requirements should be directed to Bob Gardner (312) 786-7937. General product questions should be directed to Adam Gurwitz of the Capital Markets Department at (212) 803-1400.

Footnotes

¹ The “Nasdaq-100 Index Tracking SharesSM”, “Nasdaq-100 Index[®]”, “Nasdaq-100[®]”, “Nasdaq Stock Market[®],” “Nasdaq-100 Shares”, and “Nasdaq-100 Trust” are trademarks and service marks of Nasdaq and have been licensed for use by the Chicago Board Options Exchange pursuant to a License Agreement with Nasdaq.

² Pursuant to Exchange Rule 6.3B, “The Exchange shall halt trading in all securities whenever a marketwide trading halt commonly known as a circuit breaker is initiated on the New York Stock Exchange in response to extraordinary market conditions”. Circuit breaker parameters, which are based on changes in the Dow Jones Industrial Average, and the duration of a halt are published periodically in the Exchange Bulletin. The current circuit breaker parameters are also on the Exchange’s web site at www.cboe/TradTool/Volatile.asp.

³ Current indexes in the High Capitalization Broad Based Indexes – US NASD Market Product Group are QQQ, NDX, MNX and XOC.