

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

During the first fiscal quarter of 2011, the total return on net asset value¹ of the Fund was +5.1%. Since the depth of the financial crisis, the Fund has delivered eight consecutive quarters of positive returns. We never tire of reporting positive returns, but our focus remains on providing high current income to shareholders.

Present conditions for the Fund's dividend are about as good as we can recall. Low short-term interest rates have continued to amplify the Fund's leverage strategy - we are able to borrow funds at historically attractive levels. At the same time, the investment portfolio is generating relatively high levels of income. We don't see anything on the immediate horizon to change these conditions, but one or both sides of the equation is likely to come under pressure sometime down the road.

As of this writing, the world is still dealing with the devastating events in Japan. Our thoughts go out to the people of Japan in these difficult times. Global financial markets were weaker in the immediate aftermath of the disaster, as investors assessed the impact. The Fund has very little direct exposure to the Japanese economy, and we do not anticipate any material decline in the credit quality of our holdings as a result of these events. Rest assured we are monitoring the impact very closely.

The situation at the Fukushima Dai-Ichi nuclear plant has raised fresh questions about nuclear power safety around the world. Since the Fund must have at least 25% of the portfolio invested in the utility industry, the topic is very relevant. *We do not believe the incident in Japan will negatively impact utility positions owned by the Fund in any material way.* In the U.S., most regulated utility companies have reduced their exposure to nuclear energy, and very few have "bet the farm" on this form of power generation.

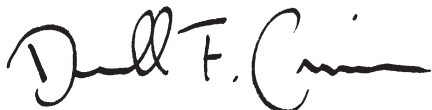
The European sovereign debt situation continues to simmer. It may boil over in Portugal and require a bailout similar to those in Greece and Ireland. This may create some turbulence in the preferred market, but the overall impact on the Fund should be modest. The Fund has no direct investments in Portuguese banks or sovereign debt. Although it does own securities issued by companies with exposure to Portugal, we believe those exposures are manageable given the strength and diversification of those companies' activities.

Preferred securities issued by banks comprise the largest portion of the Fund's portfolio and, thus, play a critical role in the Fund's strategy. Bank regulators here and abroad have analyzed bank securities in light of the financial crisis, and some conclusions have begun to trickle out. The Basel Committee on Bank Supervision, the body charged with setting global capital standards, has finalized its recommendations for bank capital, although it will be up to regulators in individual countries to adopt these standards. Bank regulators in the U.S. have until July of this year to propose new capital rules, and we expect final rules will be issued before year-end. Over time, we expect the current crop of preferred securities issued by banks to be replaced with new securities designed to conform to the new standards. As details of the new securities become known, we will study them carefully and determine their appropriateness for the Fund. Based on the information currently available, we are optimistic about the transition.

¹ Following the methodology required by the SEC, total return includes income, principal change and the impact of the Fund's leverage.

We encourage you to visit the Fund's website www.preferredincome.com for a more in-depth discussion of conditions in the preferred markets, as well as the broader economy.

Sincerely,

A handwritten signature in black ink that reads "Donald F. Crumrine". The signature is written in a cursive style with a large, sweeping "D" and a long, horizontal flourish at the end.

Donald F. Crumrine
Chairman

April 5, 2011

A handwritten signature in black ink that reads "Robert M. Ettinger". The signature is written in a cursive style with a large, sweeping "R" and a long, horizontal flourish at the end.

Robert M. Ettinger
President

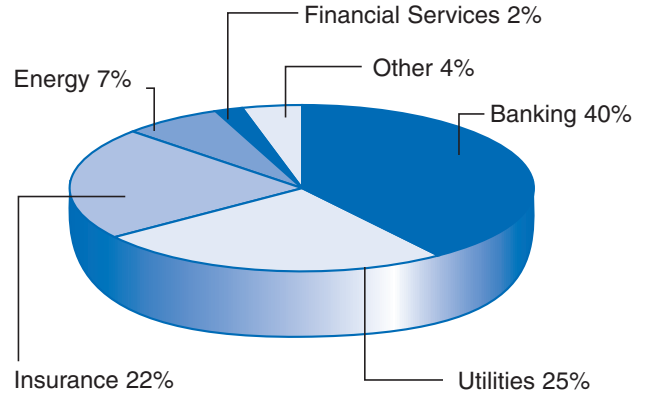
PORTFOLIO OVERVIEW
February 28, 2011 (Unaudited)

Fund Statistics

Net Asset Value	\$	12.16
Market Price	\$	12.13
Discount		0.25%
Yield on Market Price		8.90%
Common Stock Shares Outstanding		10,767,784

Industry Categories

% of Net Assets†



Moody's Ratings	% of Net Assets†
A	6.0%
BBB	73.8%
BB	17.6%
Below "BB"	0.8%
Not Rated*	0.4%
Below Investment Grade**	14.7%

* Does not include net other assets and liabilities of 1.4%.

** Below investment grade by both Moody's and S&P.

Top 10 Holdings by Issuer

% of Net Assets†

Banco Santander	5.2%
Capital One Financial	4.2%
PNC Financial Services	3.9%
Metlife	3.9%
Liberty Mutual Group	3.9%
Wells Fargo	3.9%
HSBC Plc	2.9%
Enbridge Energy Partners	2.7%
Interstate Power & Light	2.7%
Southern California Edison	2.5%

% of Net Assets*†**

Holdings Generating Qualified Dividend Income (QDI) for Individuals	40%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	26%

*** This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation.

† Net Assets includes assets attributable to the use of leverage.

PORTFOLIO OF INVESTMENTS**February 28, 2011 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — 94.8%		
Banking — 39.9%		
2,750,000	Astoria Capital Trust I, 9.75% 11/01/29, Series B	\$ 2,866,498 ⁽¹⁾
355,000	Banco Santander, 10.50% Pfd., Series 10	10,150,338 ^{** (1)(2)}
	Bank of America Corporation:	
38,015	8.625% Pfd.	992,192*
32,085	6.70% Pfd.	766,190 ^{* (1)}
\$ 500,000	BankAmerica Institutional, Series A, 8.07% 12/31/26, 144A****	510,000
	Barclays Bank PLC:	
\$ 3,250,000	6.278%	2,811,250 ^{** (1)(2)}
1,200	7.75% Pfd., Series 4	30,468 ^{** (2)}
75,000	8.125% Pfd., Series 5	1,933,500 ^{** (1)(2)}
58,500	BB&T Capital Trust VI, 9.60% Pfd. 08/01/64	1,661,400 ⁽¹⁾
\$ 1,500,000	BBVA International Preferred, 5.919%	1,218,480 ^{** (1)(2)}
\$ 750,000	BNP Paribas, 7.195%, 144A****	718,125 ^{** (2)}
\$ 4,750,000	Capital One Capital III, 7.686% 08/15/36	4,934,062 ⁽¹⁾
\$ 500,000	Capital One Capital V, 10.25% 08/15/39	546,250
\$ 2,500,000	Capital One Capital VI, 8.875% 05/15/40	2,671,875 ⁽¹⁾
62,300	Citigroup Capital XIII, 7.875% Pfd. 10/30/40	1,694,030 ⁽¹⁾
\$ 5,210,000	Colonial BancGroup, 7.114%, 144A****	260,500††
9,000	FBOP Corporation, Adj. Rate Pfd., 144A****	93,420 ^{* (3)†}
\$ 750,000	Fifth Third Capital Trust IV, 6.50% 04/15/37	736,875
15,000	Fifth Third Capital Trust V, 7.25% Pfd. 08/15/67	375,000
130,000	Fifth Third Capital Trust VI, 7.25% Pfd. 11/15/67	3,258,125 ⁽¹⁾
14,500	Fifth Third Capital Trust VII, 8.875% Pfd. 05/15/68	380,951
1,250	First Republic Preferred Capital Corporation, 10.50% Pfd., 144A****	1,291,250 ⁽¹⁾
22,500	First Republic Preferred Capital Corporation II, 8.75% Pfd., Series B, 144A****	573,750 ⁽¹⁾
3,750	First Tennessee Bank, Adj. Rate Pfd., 144A****	2,459,766 ^{* (1)}
\$ 500,000	First Tennessee Capital II, 6.30% 04/15/34, Series B	472,500
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29	1,642,954 ⁽¹⁾
\$ 1,000,000	First Union Institutional Capital I, 8.04% 12/01/26	1,025,021 ⁽¹⁾
\$ 500,000	Fleet Capital Trust II, 7.92% 12/11/26	511,250
	Goldman Sachs:	
\$ 785,000	Capital I, 6.345% 02/15/34	771,016 ⁽¹⁾
\$ 1,058,000	Capital II, 5.793%	915,170 ⁽¹⁾
2,800	STRIPES Custodial Receipts, Pvt.	1,932,000 ^{* (3)}
132,900	HSBC Holdings PLC, 8.00% Pfd., Series 2	3,599,264 ^{** (1)(2)}
\$ 500,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A****	503,249

PORTFOLIO OF INVESTMENTS (Continued)

February 28, 2011 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Banking — (Continued)		
	HSBC USA, Inc.:	
42,000	6.50% Pfd., Series H	\$ 1,025,065 ^{*(1)}
1,000	\$2.8575 Pfd.	48,375*
\$ 1,725,000	JPMorgan Chase Capital XVIII, 6.95% 08/17/36, Series R	1,815,316 ⁽¹⁾
21,360	Keycorp Capital VIII, 7.00% Pfd. 06/15/66	535,335 ⁽¹⁾
65,640	Keycorp Capital IX, 6.75% Pfd. 12/15/66	1,616,385
27,600	Keycorp Capital X, 8.00% Pfd. 03/15/68	717,048 ⁽¹⁾
\$ 550,000	Lloyds Banking Group PLC, 6.657%, 144A****	422,125 ^{** (2) †}
20,000	Morgan Stanley Capital Trust VI, 6.60% Pfd. 02/01/46	486,450
3,000	National City Capital Trust II, 6.625% Pfd. 11/15/36	74,885
\$ 860,000	NB Capital Trust IV, 8.25% 04/15/27	885,800 ⁽¹⁾
200,000	PNC Financial Services, 9.875% Pfd., Series L	5,750,000 ⁽¹⁾
\$ 1,750,000	PNC Preferred Funding Trust III, 8.70%, 144A****	1,885,084 ⁽¹⁾
1,750	Sovereign REIT, 12.00% Pfd., Series A, 144A****	1,998,938
\$ 2,400,000	Wachovia Capital Trust III, 5.80%	2,193,000 ⁽¹⁾
\$ 1,200,000	Wachovia Capital Trust V, 7.965% 06/01/27, 144A****	1,260,353 ⁽¹⁾
\$ 1,000,000	Washington Mutual, 9.75%, 144A****	25,000 ^{††}
\$ 1,600,000	Webster Capital Trust IV, 7.65% 06/15/37	1,603,968 ⁽¹⁾
15,000	Wells Fargo & Company, 8.00% Pfd., Series J	413,700*
\$ 1,000,000	Wells Fargo Capital XV, 9.75%	1,102,500 ⁽¹⁾
		<u>78,166,046</u>
Financial Services — 2.2%		
	Heller Financial, Inc.:	
33,000	6.687% Pfd., Series C	3,225,750 ^{*(1)}
5,760	6.95% Pfd., Series D	585,180*
17,904	HSBC Finance Corporation, 6.36% Pfd.	422,919*
	Lehman Brothers Holdings, Inc.:	
15,000	5.67% Pfd., Series D	4,125 ^{*††}
19,500	5.94% Pfd., Series C	5,070 ^{*††}
25,000	6.50% Pfd., Series F	1,588 ^{*††}
27,500	7.95% Pfd.	206 ^{*††}
		<u>4,244,838</u>
Insurance — 19.9%		
\$ 975,000	Ace Capital Trust II, 9.70% 04/01/30	1,218,750 ⁽¹⁾⁽²⁾
\$ 250,000	AON Corporation, 8.205% 01/01/27	280,938

PORTFOLIO OF INVESTMENTS (Continued)

February 28, 2011 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Insurance — (Continued)		
14,300	Arch Capital Group Ltd., 8.00% Pfd., Series A	\$ 361,523** ⁽¹⁾⁽²⁾
	AXA SA:	
\$ 1,750,000	6.379%, 144A****	1,603,437** ⁽¹⁾⁽²⁾
\$ 1,750,000	6.463%, 144A****	1,564,062** ⁽¹⁾⁽²⁾
35,900	Axis Capital Holdings, 7.50% Pfd., Series B	3,547,369 ⁽¹⁾⁽²⁾
90,600	Delphi Financial Group, 7.376% Pfd. 05/15/37	2,197,050 ⁽¹⁾
\$ 4,000,000	Everest Re Holdings, 6.60% 05/15/37	3,930,000 ⁽¹⁾
\$ 4,100,000	Liberty Mutual Group, 10.75% 06/15/58, 144A****	5,381,250 ⁽¹⁾
\$ 900,000	MetLife Capital Trust IV, 7.875% 12/15/37, 144A****	974,250 ⁽¹⁾
\$ 2,775,000	MetLife Capital Trust X, 9.25% 04/08/38, 144A****	3,371,625 ⁽¹⁾
\$ 2,400,000	MetLife, Inc., 10.75% 08/01/39	3,326,652 ⁽¹⁾
	Principal Financial Group:	
16,000	5.563% Pfd., Series A	1,549,000* ⁽¹⁾
87,500	6.518% Pfd., Series B	2,140,381* ⁽¹⁾
60,000	Renaissancere Holdings Ltd., 6.08% Pfd., Series C	1,404,000** ⁽¹⁾⁽²⁾
119,500	Scottish Re Group Ltd., 7.25% Pfd.	1,101,647** ^{(2)†}
\$ 1,300,000	Stancorp Financial Group, 6.90% 06/01/67	1,249,550 ⁽¹⁾
\$ 750,000	USF&G Capital, 8.312% 07/01/46, 144A****	842,974 ⁽¹⁾
\$ 2,000,000	XL Capital Ltd., 6.50%, Series E	1,870,000 ⁽¹⁾⁽²⁾
\$ 1,000,000	ZFS Finance USA Trust V, 6.50% 05/09/37, 144A****	1,002,500 ⁽¹⁾
		<u>38,916,958</u>
Utilities — 24.2%		
60,000	Alabama Power Company, 6.45% Pfd.	1,590,000*
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993	1,008,750* ⁽¹⁾
20,600	Calenergy Capital Trust III, 6.50% Pfd. 09/01/27	1,019,700
\$ 3,458,000	COMED Financing III, 6.35% 03/15/33	2,894,626 ⁽¹⁾
\$ 250,000	Dominion Resources Capital Trust I, 7.83% 12/01/27	253,572
	Dominion Resources, Inc.:	
\$ 3,500,000	7.50% 06/30/66	3,643,976 ⁽¹⁾
22,500	8.375% Pfd. 06/15/64, Series A	649,125 ⁽¹⁾
40,000	Entergy Arkansas, Inc., 6.45% Pfd.	967,500* ⁽¹⁾
20,000	Entergy Louisiana, Inc., 6.95% Pfd.	1,947,500*
\$ 2,715,000	FPL Group Capital, Inc., 6.65% 06/15/67	2,704,849 ⁽¹⁾
	Georgia Power Company:	
4,248	6.125% Pfd.	109,784*
25,000	6.50% Pfd., Series 2007A	2,607,813* ⁽¹⁾
3,000	Gulf Power Company, 6.45% Pfd., Series 2007A	303,042* ⁽¹⁾

PORTFOLIO OF INVESTMENTS (Continued)

February 28, 2011 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Utilities — (Continued)		
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	\$ 3,045,634*
185,596	Interstate Power & Light Company, 8.375% Pfd., Series B	5,301,086 ⁽¹⁾
7,146	MDU Resources Group, 4.50% Pfd. 07/08/10	583,292*
\$ 500,000	PECO Energy Capital Trust III, 7.38% 04/06/28, Series D	500,190 ⁽¹⁾
\$ 600,000	PPL Capital Funding, 6.70% 03/30/67, Series A	590,224
39,000	PPL Electric Utilities Corporation, 6.25% Pfd.	977,438*
\$ 3,800,000	Puget Sound Energy, Inc., 6.974% 06/01/67	3,775,859 ⁽¹⁾
55,500	Scana Corporation, 7.70% Pfd. 01/30/65	1,551,225 ⁽¹⁾
	Southern California Edison:	
32,100	6.00% Pfd., Series C	3,085,613 ⁽¹⁾
17,500	6.125% Pfd.	1,731,954 ⁽¹⁾
\$ 550,000	Southern Union Company, 7.20% 11/01/66	519,750 ⁽¹⁾
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37	213,750 ⁽²⁾
3,000	Virginia Electric & Power Company, \$6.98 Pfd.	307,031*
\$ 1,900,000	Wisconsin Energy Corporation, 6.25% 05/15/67	1,900,036 ⁽¹⁾
3,700	Wisconsin Public Service Corporation, 6.88% Pfd.	390,003*
\$ 3,250,000	WPS Resources Corporation, 6.11% 12/01/66	3,164,388 ⁽¹⁾
		<u>47,337,710</u>
Energy — 6.8%		
\$ 5,000,000	Enbridge Energy Partners LP, 8.05% 10/01/37	5,333,450 ⁽¹⁾
\$ 4,000,000	Enterprise Products Partners, 8.375% 08/01/66, Series A	4,319,704 ⁽¹⁾
3,500	Kinder Morgan GP, Inc., 8.33% Pfd., 144A****	3,651,156*
		<u>13,304,310</u>
Real Estate Investment Trust (REIT) — 0.2%		
12,500	PS Business Parks, Inc., 6.70% Pfd., Series P	302,156
		<u>302,156</u>
Miscellaneous Industries — 1.6%		
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****	3,230,000 ⁽¹⁾
		<u>3,230,000</u>
Total Preferred Securities		
	(Cost \$178,590,442)	<u>185,502,018</u>

PORTFOLIO OF INVESTMENTS (Continued)

February 28, 2011 (Unaudited)

<u>Shares/\$ Par</u>	<u>Value</u>
Corporate Debt Securities — 3.7%	
Banking — 0.2%	
\$ 415,000 Goldman Sachs Group, 6.75% 10/01/37, Sub Notes	\$ 426,683
	<u>426,683</u>
Insurance — 2.2%	
\$ 2,500,000 Liberty Mutual Insurance, 7.697% 10/15/97, 144A****	2,267,640 ⁽¹⁾
\$ 2,000,000 UnumProvident Corporation, 7.25% 03/15/28	2,095,080 ⁽¹⁾
	<u>4,362,720</u>
Utilities — 1.3%	
\$ 2,175,000 Southern Union Company, 8.25% 11/15/29, Senior Notes	2,474,276 ⁽¹⁾
	<u>2,474,276</u>
Total Corporate Debt Securities (Cost \$6,237,204)	<u>7,263,679</u>
Common Stock — 0.1%	
Banking — 0.1%	
3,620 CIT Group, Inc.	156,818*†
Total Common Stock (Cost \$330,325)	<u>156,818</u>
Money Market Fund — 0.7%	
1,350,318 BlackRock Liquidity Funds, T-Fund	1,350,318
Total Money Market Fund (Cost \$1,350,318)	<u>1,350,318</u>
Total Investments (Cost \$186,508,289***)	99.3% 194,272,833
Other Assets And Liabilities (Net)	0.7% <u>1,424,630</u>
Total Managed Assets	<u>100.0%‡</u> \$ 195,697,463
Loan Principal Balance	<u>(64,800,000)</u>
Total Net Assets Available To Common Stock	<u>\$ 130,897,463</u>

PORTFOLIO OF INVESTMENTS (Continued)

February 28, 2011 (Unaudited)

-
- * Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.
 - ** Securities distributing Qualified Dividend Income only.
 - *** Aggregate cost of securities held.
 - **** Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers. At February 28, 2011, these securities amounted to \$35,890,454 or 18.3% of total managed assets.
 - ⁽¹⁾ All or a portion of this security has been pledged as collateral for the Fund's loan. The total value of such securities was \$142,695,281 at February 28, 2011.
 - ⁽²⁾ Foreign Issuer.
 - ⁽³⁾ Illiquid.
 - † Non-income producing.
 - †† The issuer has filed for bankruptcy protection. As a result, the Fund may not be able to recover the principal invested and also does not expect to receive income on this security going forward.
 - ‡ The percentage shown for each investment category is the total value of that category as a percentage of total managed assets.

ABBREVIATIONS:

- Pfd.** — Preferred Securities
- Pvt.** — Private Placement Securities
- REIT** — Real Estate Investment Trust
- STRIPES** — Structured Residual Interest Preferred Enhanced Securities

STATEMENT OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK⁽¹⁾

For the period from December 1, 2010 through February 28, 2011 (Unaudited)

	<u>Value</u>
OPERATIONS:	
Net investment income	\$ 2,999,210
Net realized gain/(loss) on investments sold during the period	1,574,559
Change in net unrealized appreciation/depreciation of investments	<u>1,891,930</u>
Net increase in net assets resulting from operations	6,465,699
DISTRIBUTIONS:	
Dividends paid from net investment income to Common Stock Shareholders ⁽²⁾	<u>(3,230,335)</u>
Total Distributions to Common Stock Shareholders	(3,230,335)
FUND SHARE TRANSACTIONS:	
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan	<u>100,976</u>
Net increase in net assets available to Common Stock resulting from Fund share transactions	100,976
NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	<u><u>\$ 3,336,340</u></u>

NET ASSETS AVAILABLE TO COMMON STOCK:	
Beginning of period	\$ 127,561,123
Net increase in net assets during the period	<u>3,336,340</u>
End of period	<u><u>\$ 130,897,463</u></u>

⁽¹⁾ These tables summarize the three months ended February 28, 2011 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2010.

⁽²⁾ May include income earned, but not paid out, in prior fiscal year.

FINANCIAL HIGHLIGHTS⁽¹⁾

**For the period from December 1, 2010 through February 28, 2011 (Unaudited)
For a Common Stock share outstanding throughout the period.**

PER SHARE OPERATING PERFORMANCE:

Net asset value, beginning of period \$ 11.86

INVESTMENT OPERATIONS:

Net investment income 0.28

Net realized and unrealized gain/(loss) on investments 0.32

Total from investment operations 0.60

DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:

From net investment income (0.30)

Total distributions to Common Stock Shareholders (0.30)

Net asset value, end of period \$ 12.16

Market value, end of period \$ 12.13

Common Stock shares outstanding, end of period 10,767,784

RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:

Net investment income † 9.50%*

Operating expenses including interest expense 2.15%*

Operating expenses excluding interest expense 1.50%*

SUPPLEMENTAL DATA: ††

Portfolio turnover rate 6%**

Total managed assets, end of period (in 000's) \$ 195,697

Ratio of operating expenses including interest expense to total managed assets 1.44%*

Ratio of operating expenses excluding interest expense to total managed assets 1.00%*

⁽¹⁾ These tables summarize the three months ended February 28, 2011 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2010.

* Annualized.

** Not Annualized.

† The net investment income ratios reflect income net of operating expenses, including interest expense.

†† Information presented under heading Supplemental Data includes loan principal balance.

FINANCIAL HIGHLIGHTS (Continued)

Per Share of Common Stock (Unaudited)

	<u>Total Dividends Paid</u>	<u>Net Asset Value</u>	<u>NYSE Closing Price</u>	<u>Dividend Reinvestment Price⁽¹⁾</u>
December 31, 2010 - Extra	\$0.0300	\$11.82	\$11.62	\$11.66
December 31, 2010	0.0900	11.82	11.62	11.66
January 31, 2011	0.0900	11.92	11.80	11.90
February 28, 2011	0.0900	12.16	12.13	12.16

⁽¹⁾ Whenever the net asset value per share of the Fund's Common Stock is less than or equal to the market price per share on the reinvestment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of Common Stock will be purchased in the open market.

NOTES TO FINANCIAL STATEMENTS (Unaudited)**1. Aggregate Information for Federal Income Tax Purposes**

At February 28, 2011, the aggregate cost of securities for federal income tax purposes was \$186,308,944, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$27,784,796 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$19,820,907.

2. Additional Accounting Standards

Fair Value Measurement: The inputs and valuation techniques used to measure fair value of the Fund's investments are summarized into three levels as described in the hierarchy below:

- Level 1 – quoted prices in active markets for identical securities
- Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.)
- Level 3 – significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Transfers in and out of levels are recognized at market value at the end of the period. A summary of the inputs used to value the Fund's investments as of February 28, 2011 is as follows:

	<u>Total Value at February 28, 2011</u>	<u>Level 1 Quoted Price</u>	<u>Level 2 Significant Observable Inputs</u>	<u>Level 3 Significant Unobservable Inputs</u>
Preferred Securities				
Banking	\$ 78,166,046	\$ 52,812,015	\$ 25,260,611	\$ 93,420
Financial Services	4,244,838	422,919	3,821,919	—
Insurance	38,916,958	20,258,378	18,658,580	—
Utilities	47,337,710	11,255,196	36,082,514	—
Energy	13,304,310	—	13,304,310	—
Real Estate Investment Trust (REIT)	302,156	302,156	—	—
Miscellaneous Industries	3,230,000	—	3,230,000	—
Corporate Debt Securities	7,263,679	2,900,959	4,362,720	—
Common Stock				
Banking	156,818	156,818	—	—
Money Market Fund	1,350,318	1,350,318	—	—
Total Investments	<u>\$ 194,272,833</u>	<u>\$ 89,458,759</u>	<u>\$ 104,720,654</u>	<u>\$ 93,420</u>

The Fund did not have any significant transfers in and out of Level 1 and Level 2 during the period.

NOTES TO FINANCIAL STATEMENTS (Unaudited) (Continued)

The Fund's investments in Level 2 and Level 3 are based primarily on market information, where available. This includes, but is not limited to, prices provided by third-party providers, observable trading activity (including the recency, depth, and consistency of such information with quoted levels), and the depth and consistency of broker-quoted prices. In the event market information is not directly available, comparable information may be observed for securities that are similar in many respects to those being valued. The Fund may employ an income approach for certain securities that also takes into account credit risk, interest rate risk, and potential recovery prospects.

The following is a reconciliation of Level 3 investments for which significant unobservable inputs were used to determine fair value:

		<u>Preferred Securities</u>	
	Total Investments	Banking	
Balance as of 11/30/10	\$ 39,816	\$ 39,816	
Accrued discounts/premiums	—	—	
Realized gain/(loss)	—	—	
Change in unrealized appreciation/(depreciation)	53,604	53,604	
Net purchases/(sales)	—	—	
Transfers in and/or out of Level 3	—	—	
Balance as of 2/28/11	\$ 93,420	\$ 93,420	

For the period ended February 28, 2011, total change in unrealized gain/(loss) on Level 3 securities still held at period-end and included in the change in net assets was \$53,604.

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Directors

Donald F. Crumrine, CFA
Chairman of the Board
David Gale
Morgan Gust
Karen H. Hogan
Robert F. Wulf, CFA

Officers

Donald F. Crumrine, CFA
Chief Executive Officer
Robert M. Ettinger, CFA
President
R. Eric Chadwick, CFA
Chief Financial Officer,
Vice President and Treasurer
Chad C. Conwell
Chief Compliance Officer,
Vice President and Secretary
Bradford S. Stone
Vice President and
Assistant Treasurer
Laurie C. Lodolo
Assistant Compliance Officer,
Assistant Treasurer and
Assistant Secretary
Linda M. Puchalski
Assistant Treasurer

Investment Adviser

Flaherty & Crumrine Incorporated
e-mail: flaherty@pfdincome.com

Questions concerning your shares of Flaherty & Crumrine Preferred Income Fund?

- If your shares are held in a Brokerage Account, contact your Broker.
- If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent —
BNY Mellon Shareowner Services
P.O. Box 358035
Pittsburgh, PA 15252-8035
1-866-351-7446

This report is sent to shareholders of Flaherty & Crumrine Preferred Income Fund Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.



Flaherty & Crumrine

PREFERRED INCOME FUND

Quarterly Report

February 28, 2011

www.preferredincome.com