

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

The combination of falling interest rates and ongoing demand for preferred securities helped the Fund produce excellent returns during its third fiscal period ending August 31, 2010. For the three month period, total return on net asset value was +12.1%. Total return using market price of Fund shares was +18.5% during the period.

It has been quite an eventful summer in the preferred securities market. We'll hit the highlights here, and readers willing to do a little extra-credit homework will find more detailed discussions on the Fund's website.

In addition to strong performance of the Fund's investment portfolio, the monthly dividend paid to shareholders was increased to \$0.089 per share from \$0.0825, commencing with the August distribution. This 7.9% increase reflects the ongoing favorable environment of relatively high yields on Fund investments and the low cost of Fund borrowings.

We expect the level of economic growth to remain tepid over the coming quarters and then to show gradual improvement. We anticipate the Fund's cost of borrowing will follow a similar path, remaining low for a period, then increasing gradually. Of course, unless income from the Fund's investments also increases, a rise in the cost of borrowing would negatively impact the distribution to shareholders.

Although economic activity has slowed recently, we do not expect the economy to fall back into recession. In fact, we see some healthy signs, such as a substantial increase in personal savings and steady levels of business investment aimed at improving productivity. As individuals save more, some of these dollars are likely to find their way into the preferred market. As companies become more efficient, their financial condition generally improves. These trends, along with declining interest rates, have helped boost the Fund's investment performance.

In the aftermath of the financial meltdown, Congress and various bank regulators set out to establish new rules to hopefully prevent a repeat of the crisis. We are now getting a better sense of how new regulations will impact the market. With passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act in July, along with increasing clarification from international bank regulators, the fog is beginning to lift on the future role of preferred securities as a source of capital for the banking industry¹.

Since our last letter, rule makers have indicated which security structures they don't like, but have yet to decide what will be okay. It is now clear that trust preferred securities, which are favored by banks as a form of capital, will not meet the new standards. As a result, not only will there be no new issues of this type, issuers will want to redeem or replace outstanding trust preferreds sooner than was previously expected. In response, prices of many bank trust preferred securities have moved higher—contributing to the Fund's strong performance.

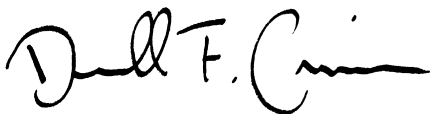
It is less clear what types of securities banks will be allowed to issue to meet future capital requirements. We are monitoring the debate closely and throwing in our two cents whenever appropriate. At this time, we believe the parties are moving toward a sensible conclusion and will ultimately induce banks to issue preferred securities suitable for the Fund's portfolio. Of course, we will stay on top of this and report important developments in these letters or on the Fund's website.

¹ The treatment of preferred securities issued by *non-banks* has not changed in any meaningful way.

As of this writing, roughly 23% of the Fund's portfolio is invested in trust preferred securities issued by U.S. banks. In light of the new rules, we think it is likely that many of these issues will be redeemed, beginning in 2013. We'll have our work cut out for us trying to replace the income on these securities, but until we have a better idea how the banks will replace these issues, it is difficult to predict the impact on the Fund.

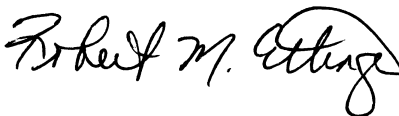
As always, we encourage you to visit www.pfdincome.com to read our Quarterly Economic Update as well as a more detailed discussion of factors affecting the wonderful world of preferred securities.

Sincerely,



Donald F. Crumrine
Chairman

October 15, 2010



Robert M. Ettinger
President

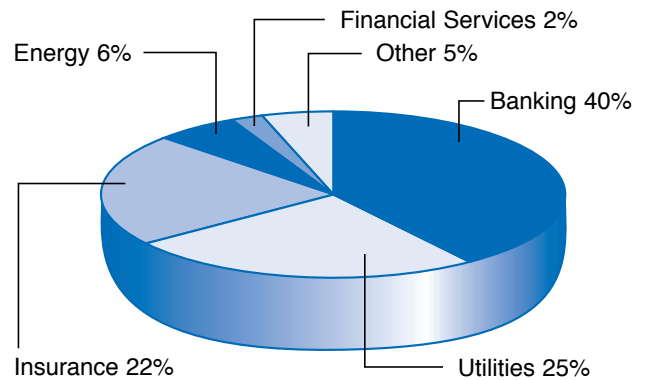
PORTFOLIO OVERVIEW
August 31, 2010 (Unaudited)

Fund Statistics

Net Asset Value	\$	11.49
Market Price	\$	12.37
Premium		7.66%
Yield on Market Price		8.63%
Common Stock Shares Outstanding		10,734,121

Industry Categories

% of Net Assets†



Moody's Ratings

% of Net Assets†

A	6.5%
BBB	71.4%
BB	19.4%
Below "BB"	0.6%
Not Rated*	0.3%
Below Investment Grade**	15.2%

* Does not include net other assets and liabilities of 1.8%.

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

Top 10 Holdings by Issuer

% of Net Assets†

Banco Santander	5.6%
Capital One Financial	4.2%
PNC Financial Services	4.1%
Liberty Mutual Group	4.0%
Comerica	3.7%
Dominion Resources	3.3%
Wells Fargo	3.2%
HSBC Plc	3.1%
Interstate Power & Light	3.0%
Metlife	3.0%

% of Net Assets*†**

Holdings Generating Qualified Dividend Income (QDI) for Individuals	41%
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**August 31, 2010 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — 95.2%		
Banking — 39.8%		
\$ 2,750,000	Astoria Capital Trust I, 9.75% 11/01/29, Series B	\$ 2,865,415 ⁽¹⁾
355,000	Banco Santander, 10.50% Pfd., Series 10	10,327,838 ^{** (1)(2)}
48,700	Bank of America Corporation, 6.70% Pfd.	1,161,008 ^{* (1)}
\$ 500,000	BankAmerica Institutional, Series A, 8.07% 12/31/26, 144A ^{****}	513,750
	Barclays Bank PLC:	
\$ 3,000,000	6.278%	2,523,750 ^{** (1)(2)}
40,000	6.625% Pfd., Series 2	952,400 ^{** (1)(2)}
6,200	7.75% Pfd., Series 4	159,774 ^{** (2)}
35,000	8.125% Pfd., Series 5	919,100 ^{** (1)(2)}
87,500	BB&T Capital Trust VI, 9.60% Pfd.	2,476,250 ⁽¹⁾
\$ 4,500,000	Capital One Capital III, 7.686% 08/15/36	4,556,250 ⁽¹⁾
\$ 500,000	Capital One Capital V, 10.25% 08/15/39	543,125
\$ 2,500,000	Capital One Capital VI, 8.875% 05/15/40	2,650,000 ⁽¹⁾
\$ 5,210,000	Colonial BancGroup, 7.114%, 144A ^{****}	138,065 ^{††}
\$ 7,250,000	Comerica Capital Trust II, 6.576% 02/20/37	6,815,000 ⁽¹⁾
9,000	FBOP Corporation, Adj. Rate Pfd., 144A ^{****}	34,740 [†]
\$ 750,000	Fifth Third Capital Trust IV, 6.50% 04/15/37	652,500
15,000	Fifth Third Capital Trust V, 7.25% Pfd. 08/15/67	374,250
14,500	Fifth Third Capital Trust VII, 8.875% Pfd. 05/15/68	383,798
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 ^{****}	2,262,891 ^{* (1)}
\$ 600,000	First Tennessee Capital I, 8.07% 01/06/27, Series A	577,274
\$ 500,000	First Tennessee Capital II, 6.30% 04/15/34, Series B	395,912
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29	1,734,587 ⁽¹⁾
\$ 1,000,000	First Union Institutional Capital I, 8.04% 12/01/26	1,024,504 ⁽¹⁾
\$ 500,000	Fleet Capital Trust II, 7.92% 12/11/26	505,000
	Goldman Sachs:	
\$ 500,000	Capital I, 6.345% 02/15/34	467,131 ⁽¹⁾
\$ 3,713,000	Capital II, 5.793%	3,002,889 ⁽¹⁾
2,500	STRIPES Custodial Receipts, Pvt.	1,312,500 [*]
135,000	HSBC Holdings PLC, 8.00% Pfd., Series 2	3,585,937 ^{** (2)}
\$ 500,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A ^{****}	527,301
	HSBC USA, Inc.:	
48,000	6.50% Pfd., Series H	1,210,502 ^{* (1)}
4,400	\$2.8575 Pfd.	208,175 ^{* (1)}
\$ 300,000	JPMorgan Chase Capital XVIII, 6.95% 08/17/36, Series R	308,773
15,000	Keycorp Capital VIII, 7.00% Pfd. 06/15/66	375,000 ⁽¹⁾

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2010 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Banking — (Continued)		
27,600	Keycorp Capital X, 8.00% Pfd.	\$ 717,600 ⁽¹⁾
\$ 550,000	Lloyds Banking Group PLC, 6.657%, 144A****	356,125** ^{(2)†}
\$ 600,000	NB Capital Trust IV, 8.25% 04/15/27	619,313 ⁽¹⁾
200,000	PNC Financial Services, 9.875% Pfd., Series F	5,712,500* ⁽¹⁾
\$ 1,750,000	PNC Preferred Funding Trust III, 8.70%, 144A****	1,812,654 ⁽¹⁾
1,750	Sovereign REIT, 12.00% Pfd., Series A, 144A****	2,038,750
\$ 2,400,000	Wachovia Capital Trust III, 5.80%	2,058,000 ⁽¹⁾
\$ 1,000,000	Washington Mutual, 9.75%, 144A****	62,500††
\$ 1,600,000	Webster Capital Trust IV, 7.65% 06/15/37	1,266,570 ⁽¹⁾
\$ 1,000,000	Wells Fargo Capital XV, 9.75%	1,096,500 ⁽¹⁾
		<u>73,150,901</u>
Financial Services — 2.0%		
5,000	Deutsche Bank Contingent Capital Trust II, 6.55% Pfd.	118,957** ⁽²⁾
33,000	Heller Financial, Inc., 6.687% Pfd., Series C	3,209,250* ⁽¹⁾
10,300	HSBC Finance Corporation, 6.36% Pfd.	248,874*
	Lehman Brothers Holdings, Inc.:	
15,000	5.67% Pfd., Series D	4,170*††
19,500	5.94% Pfd., Series C	5,265*††
25,000	6.50% Pfd., Series F	1,812*††
27,500	7.95% Pfd.	467*††
		<u>3,588,795</u>
Insurance — 19.8%		
\$ 750,000	Ace Capital Trust II, 9.70% 04/01/30	919,787 ⁽¹⁾⁽²⁾
\$ 250,000	AON Corporation, 8.205% 01/01/27	271,050
25,000	Arch Capital Group Ltd., 8.00% Pfd., Series A	646,875** ⁽¹⁾⁽²⁾
	AXA SA:	
\$ 1,750,000	6.379%, 144A****	1,435,000** ⁽¹⁾⁽²⁾
\$ 3,000,000	6.463%, 144A****	2,400,000** ⁽¹⁾⁽²⁾
35,900	Axis Capital Holdings, 7.50% Pfd., Series B	3,200,711 ⁽¹⁾⁽²⁾
90,600	Delphi Financial Group, 7.376% Pfd. 05/15/37	2,007,922 ⁽¹⁾
\$ 4,000,000	Everest Re Holdings, 6.60% 05/15/37	3,615,000 ⁽¹⁾
	Liberty Mutual Group:	
\$ 500,000	7.80% 03/15/37, 144A****	445,000 ⁽¹⁾
\$ 4,100,000	10.75% 06/15/58, 144A****	4,602,250 ⁽¹⁾
\$ 2,100,000	MetLife Capital Trust X, 9.25% 04/08/38, 144A****	2,425,500 ⁽¹⁾

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2010 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Insurance — (Continued)		
\$ 2,400,000	MetLife, Inc., 10.75% 08/01/39	\$ 3,042,778 ⁽¹⁾
	Principal Financial Group:	
16,000	5.563% Pfd., Series A	1,365,000*
70,000	6.518% Pfd., Series B	1,760,675 ⁽¹⁾
	Renaissancere Holdings Ltd.:	
131,450	6.08% Pfd., Series C	2,990,487 ^{** (1)(2)}
6,900	7.30% Pfd., Series B	173,362 ^{** (2)}
119,500	Scottish Re Group Ltd., 7.25% Pfd.	743,147 ^{** (2) †}
\$ 1,300,000	Stancorp Financial Group, 6.90% 06/01/67	1,122,577 ⁽¹⁾
\$ 750,000	USF&G Capital, 8.312% 07/01/46, 144A****	879,626 ⁽¹⁾
\$ 2,000,000	XL Capital Ltd., 6.50%, Series E	1,527,600 ⁽¹⁾⁽²⁾
\$ 1,000,000	ZFS Finance USA Trust V, 6.50% 05/09/37, 144A****	915,000
		<u>36,489,347</u>
Utilities — 25.1%		
10,000	Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993	1,005,938 ⁽¹⁾
\$ 3,458,000	COMED Financing III, 6.35% 03/15/33	3,090,332 ⁽¹⁾
\$ 250,000	Dominion Resources Capital Trust I, 7.83% 12/01/27	252,851
	Dominion Resources, Inc.:	
\$ 3,500,000	7.50%	3,574,176 ⁽¹⁾
77,000	8.375% Pfd., Series A	2,220,680 ⁽¹⁾
40,000	Entergy Arkansas, Inc., 6.45% Pfd.	967,500 ⁽¹⁾
20,000	Entergy Louisiana, Inc., 6.95% Pfd.	1,925,626*
\$ 2,000,000	FPL Group Capital, Inc., 6.65% 06/15/67	1,902,534 ⁽¹⁾
	Georgia Power Company:	
5,000	6.125% Pfd.	130,156*
25,000	6.50% Pfd., Series 2007A	2,602,345 ⁽¹⁾
3,000	Gulf Power Company, 6.45% Pfd., Series 2007A	305,270 ⁽¹⁾
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	2,930,337*
190,000	Interstate Power & Light Company, 8.375% Pfd., Series B	5,512,375*
7,146	MDU Resources Group, 4.50% Pfd. 07/08/10	570,564*
22,430	Pacific Enterprises, \$4.50 Pfd.	1,940,897 ⁽¹⁾
\$ 500,000	PECO Energy Capital Trust III, 7.38% 04/06/28, Series D	498,488 ⁽¹⁾
\$ 4,400,000	Puget Sound Energy, Inc., 6.974% 06/01/67	4,090,407 ⁽¹⁾
55,500	Scana Corporation, 7.70% Pfd.	1,574,535 ⁽¹⁾

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2010 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Utilities — (Continued)		
	Southern California Edison:	
32,100	6.00% Pfd., Series C	\$ 3,045,487 ⁽¹⁾
17,500	6.125% Pfd.	1,672,891*
\$ 3,000,000	Southern Union Company, 7.20% 11/01/66	2,722,500 ⁽¹⁾
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37	234,375
\$ 3,000,000	Wisconsin Energy Corporation, 6.25% 05/15/67	2,838,792 ⁽¹⁾
6,750	Xcel Energy, Inc., \$4.08 Pfd., Series B	532,238*
		<u>46,141,294</u>
Energy — 6.4%		
\$ 4,250,000	Enbridge Energy Partners LP, 8.05% 10/01/37	4,271,322 ⁽¹⁾
	Enterprise Products Partners:	
\$ 750,000	7.00% 06/01/67	692,249
\$ 3,250,000	8.375% 08/01/66, Series A	3,351,371 ⁽¹⁾
3,500	Kinder Morgan GP, Inc., 8.33% Pfd., 144A****	3,473,969*
		<u>11,788,911</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 — 1.9%		
40,000	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****	3,520,000 ⁽¹⁾
		<u>3,520,000</u>
Total Preferred Securities		
(Cost \$170,603,149)		<u>174,981,404</u>
Corporate Debt Securities — 2.9%		
Financial Services — 0.2%		
10,000	Ameriprise Financial, Inc., 7.75% 06/15/39	274,425 ⁽¹⁾
		<u>274,425</u>

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2010 (Unaudited)

<u>Shares/\$ Par</u>		<u>Value</u>
Insurance — 2.4%		
\$ 2,500,000	Liberty Mutual Insurance, 7.697% 10/15/97, 144A****	\$ 2,330,810 ⁽¹⁾
\$ 2,000,000	UnumProvident Corporation, 7.25% 03/15/28, Senior Notes	2,131,654 ⁽¹⁾
		<u>4,462,464</u>
Utilities — 0.3%		
20,000	Entergy Texas, Inc., 7.875% 06/01/39	575,200 ⁽¹⁾
		<u>575,200</u>
	Total Corporate Debt Securities (Cost \$4,192,390)	<u>5,312,089</u>
Common Stock — 0.1%		
Banking — 0.1%		
3,620	CIT Group, Inc.	132,782*†
	Total Common Stock (Cost \$330,325)	<u>132,782</u>
Money Market Fund — 3.7%		
6,874,830	BlackRock Provident Institutional, T-Fund	6,874,830
	Total Money Market Fund (Cost \$6,874,830)	<u>6,874,830</u>
	Total Investments (Cost \$182,000,694 ^{***})	101.9% 187,301,105
	Other Assets And Liabilities (Net)	(1.9)% (3,496,385)
	Net Assets before loan	<u>100.0%‡ \$ 183,804,720</u>
	Loan Principal Balance	<u>(60,500,000)</u>
	Total Net Assets Available To Common Stock	<u>\$ 123,304,720</u>

* 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 August 31, 2010, these securities amounted to \$32,038,931 or 17.4% of net assets before loan. These securities have been determined to be liquid under the guidelines established by the Board of Directors.

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2010 (Unaudited)

- ⁽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 \$131,217,188 at August 31, 2010.
- ⁽²⁾ Foreign Issuer.
- † 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 net assets before the loan.

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, 2009 through August 31, 2010 (Unaudited)

	<u>Value</u>
OPERATIONS:	
Net investment income	\$ 8,627,740
Net realized gain/(loss) on investments sold during the period	1,558,215
Change in net unrealized appreciation/depreciation of investments	15,197,346
Distributions to APS* Shareholders from net investment income, including changes in accumulated undeclared distributions.	<u>(70,977)</u>
Net increase in net assets resulting from operations.	25,312,324
DISTRIBUTIONS:	
Dividends paid from net investment income to Common Stock Shareholders ⁽²⁾	<u>(7,454,757)</u>
Total Distributions to Common Stock Shareholders.	(7,454,757)
FUND SHARE TRANSACTIONS:	
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan	<u>683,032</u>
Net increase in net assets available to Common Stock resulting from Fund share transactions	683,032
NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	<u><u>\$ 18,540,599</u></u>

NET ASSETS AVAILABLE TO COMMON STOCK:

Beginning of period	\$ 104,764,121
Net increase in net assets during the period	<u>18,540,599</u>
End of period	<u><u>\$ 123,304,720</u></u>

* Auction Preferred Stock.

⁽¹⁾ These tables summarize the nine months ended August 31, 2010 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2009.

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

FINANCIAL HIGHLIGHTS⁽¹⁾

**For the period from December 1, 2009 through August 31, 2010 (Unaudited)
For a Common Stock share outstanding throughout the period.**

PER SHARE OPERATING PERFORMANCE:

Net asset value, beginning of period \$ 9.82

INVESTMENT OPERATIONS:

Net investment income 0.81
Net realized and unrealized gain/(loss) on investments 1.57

DISTRIBUTIONS TO APS* SHAREHOLDERS:

From net investment income (0.01)
Total from investment operations 2.37

DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:

From net investment income (0.70)
Total distributions to Common Stock Shareholders (0.70)

Net asset value, end of period \$ 11.49

Market value, end of period \$ 12.37

Common Stock shares outstanding, end of period 10,734,121

RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:

Net investment income† 9.96%**
Net investment income, including payments to APS Shareholders† 9.88%**
Operating expenses including interest expense 2.32%**
Operating expenses excluding interest expense 1.60%**

SUPPLEMENTAL DATA:††

Portfolio turnover rate 24%***
Net assets before loan, end of period (in 000's) \$ 183,805
Ratio of operating expenses including interest expense⁽²⁾ to net assets
before loan and APS 1.55%**
Ratio of operating expenses excluding interest expense⁽²⁾ to net assets
before loan and APS 1.07%**

⁽¹⁾ These tables summarize the nine months ended August 31, 2010 and should be read in conjunction with the Fund's audited financial statements, including footnotes, in its Annual Report dated November 30, 2009.

⁽²⁾ Does not include distributions to APS Shareholders.

* Auction Preferred Stock.

** Annualized.

*** Not Annualized.

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

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

FINANCIAL HIGHLIGHTS (Continued)

Per Share of Common Stock (Unaudited)

	Total Dividends Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price⁽¹⁾
December 31, 2009	\$0.0720	\$10.31	\$10.47	\$10.31
January 29, 2010	0.0720	10.52	10.59	10.52
February 26, 2010	0.0720	10.67	11.37	10.80
March 31, 2010	0.0720	11.08	11.32	11.08
April 30, 2010	0.0720	11.24	11.93	11.33
May 28, 2010	0.0825	10.48	10.67	10.48
June 30, 2010	0.0825	10.65	11.30	10.74
July 30, 2010	0.0825	11.15	12.33	11.71
August 31, 2010	0.0890	11.49	12.37	11.75

⁽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 August 31, 2010, the aggregate cost of securities for federal income tax purposes was \$181,998,123, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$26,736,042 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$21,433,060.

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 August 31, 2010 is as follows:

	<u>Total Value at August 31, 2010</u>	<u>Level 1 Quoted Price</u>	<u>Level 2 Significant Observable Inputs</u>	<u>Level 3 Significant Unobservable Inputs</u>
Preferred Securities				
Banking	\$ 73,150,901	\$ 44,448,294	\$ 28,667,867	\$ 34,740
Financial Services	3,588,795	367,831	3,220,964	—
Insurance	36,489,347	13,790,746	22,698,601	—
Utilities	46,141,294	13,011,922	33,129,372	—
Energy	11,788,911	—	11,788,911	—
Real Estate Investment Trust (REIT)	302,156	302,156	—	—
Miscellaneous Industries	3,520,000	—	3,520,000	—
Corporate Debt Securities	5,312,089	849,625	4,462,464	—
Common Stock				
Banking	132,782	132,782	—	—
Money Market Fund	6,874,830	6,874,830	—	—
Total Investments	<u>\$187,301,105</u>	<u>\$79,778,186</u>	<u>\$107,488,179</u>	<u>\$ 34,740</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 11/30/09	\$ 49,500	\$ 49,500
Accrued discounts/premiums	—	—
Realized gain/(loss)	—	—
Change in unrealized appreciation/(depreciation)	(14,760)	(14,760)
Net purchases/(sales)	—	—
Transfers in and/or out of Level 3	—	—
Balance as of 8/31/10	\$ 34,740	\$ 34,740

For the period ended August 31, 2010, total change in unrealized gain/(loss) on Level 3 securities still held at period-end and included in the change in net assets was \$(14,760).

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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 Investment Servicing (US) Inc.
P.O. Box 43027
Providence, RI 02940-3027
1-800-331-1710

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

August 31, 2010

www.preferredincome.com