

FLAHERTY & CRUMRINE PREFERRED INCOME FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

During the third fiscal quarter of 2011¹, total return on net asset value² of the Fund was -2.7%; the fiscal year-to-date return was a more pleasing +8.0%. Prior to this most recent quarter, the Fund had nine consecutive quarters of positive returns.

There was good news on the Fund's dividend during the quarter – a combination of very low borrowing cost on the Fund's leverage and relatively high income earned from the Fund's investment portfolio led to another increase in your monthly dividend. The new rate of \$0.093 (beginning in August) is 3.3% higher than the previous level.

The Federal Reserve has indicated short-term interest rates are likely to stay at present levels at least through mid-2013. The Fund's borrowing rate is not directly tied to the Fed's short-term rate target, but the correlation is high, so borrowing costs should remain at or near current levels over the same period.

On the flip side, however, the task of projecting portfolio income has become more difficult, due both to the sharp decline in interest rates and changes in the regulatory environment in which many preferred issuers operate. For instance, bank regulators here and abroad have yet to issue final guidelines for bank capital; until they do, it is hard to predict when issuers may call outstanding preferreds. We think eventually portfolio income could fall (as higher dividend paying securities are called), but we are working hard to minimize the impact.

Conditions in financial markets are largely a tale of two houses – an ongoing economic drag from the residential housing market and a struggle of governments to get their financial houses in order. While there is a detailed discussion of these topics in our Quarterly Economic Update on the Fund's website, our thoughts are summarized here.

The drop in home prices and rise in foreclosures have eroded household wealth, pushed up savings, and slowed consumer spending, thus short-circuiting the cyclical recovery the economy normally would experience coming out of a deep recession. The resulting sluggish economic growth has encouraged companies to focus on reducing debt, lowering costs, and improving productivity. This has led to an unusual combination of strong profit growth and improving credit quality for corporations, but little improvement in employment. Finally, rising savings, limited demand for new investment, and highly accommodative monetary policy have pushed US Treasury rates to 60-year lows. As long as households seek to reduce indebtedness, which we expect will continue for some time, these conditions are likely to persist.

At the same time, the deleveraging that began in the household sector has spread to the government sector. Investors are questioning governments' ability and willingness to sustain current budgets and obligations, most visibly in the sovereign debt crisis boiling over in Europe. The uncertainty over how that situation will be resolved – and its short and long-term impact on the global economy – has sent many investors to the sidelines and out of risky assets. Although politicians are moving toward resolution of these issues, the solutions are often unpopular, and progress is likely to be slow.

¹ June 1, 2011 – August 31, 2011

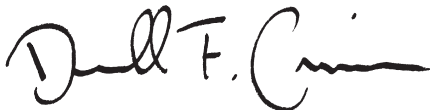
² Following the methodology required by the SEC, total return includes income and principal change, plus the impact of the Fund's leverage and expenses.

As of August 31, 12% of the Fund's portfolio consisted of securities issued or guaranteed by banks and insurance companies based in Europe. Each of these companies has operations throughout the world, but is tied most closely to economic conditions in the Eurozone. We believe these issuers are well capitalized and well managed, and therefore better able to handle market turbulence.

At the end of the day, we believe long-term investors will continue to earn attractive returns on preferred securities, although there may be some bumps along the way. We will continue to manage the Fund as we always have – in quiet times and in crisis – with a disciplined eye on credit fundamentals, relative value and risk management.

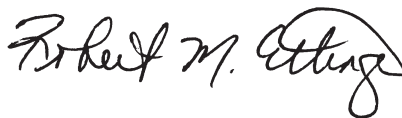
We encourage you to visit the Fund's website www.preferredincome.com for a more in-depth discussion of conditions in the preferred markets as well as the broader economy.

Sincerely,



Donald F. Crumrine
Chairman

October 14, 2011



Robert M. Ettinger
President

PORTFOLIO OVERVIEW

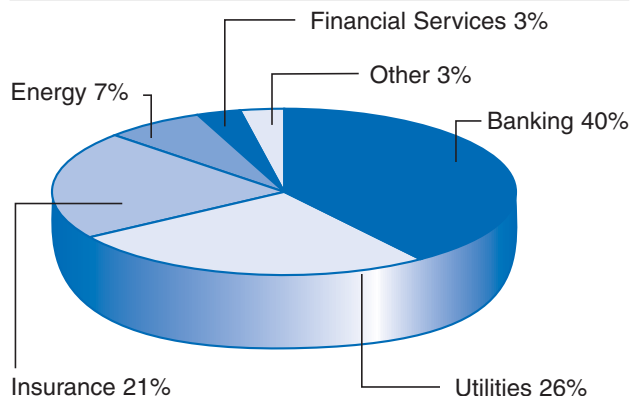
August 31, 2011 (Unaudited)

Fund Statistics

Net Asset Value	\$	11.96
Market Price	\$	13.61
Premium		13.80%
Yield on Market Price		8.20%
Common Stock Shares Outstanding		10,817,041

Industry Categories

% of Net Assets†



Moody's Ratings

% of Net Assets†

A	6.5%
BBB	74.1%
BB	16.1%
Below "BB"	0.8%
Not Rated*	0.2%
Below Investment Grade**	9.5%

* Does not include net other assets and liabilities of 2.3%.

** Below investment grade by all of Moody's, S&P, and Fitch.

Top 10 Holdings by Issuer

% of Net Assets†

Banco Santander	4.9%
HSBC Plc	4.2%
Capital One Financial	4.0%
Metlife	3.8%
PNC Financial Services	3.8%
Liberty Mutual Group	3.7%
Wells Fargo	3.3%
Southern California Edison	3.1%
Interstate Power & Light	2.8%
Enbridge Energy Partners	2.7%

% of Net Assets*†**

Holdings Generating Qualified Dividend Income (QDI) for Individuals	44%
Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)	31%

*** 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, 2011 (Unaudited)

Shares/\$ Par		Value
Preferred Securities — 93.9%		
Banking — 39.3%		
\$ 2,750,000	Astoria Capital Trust I, 9.75% 11/01/29, Series B	\$ 2,865,676 ⁽¹⁾
355,000	Banco Santander, 10.50% Pfd., Series 10	9,729,237 ^{** (1)(2)}
	Bank of America Corporation:	
15,551	6.70% Pfd.	358,451 ^{* (1)}
26,920	8.20% Pfd.	670,308 [*]
32,736	8.625% Pfd.	824,947 [*]
\$ 500,000	BankAmerica Institutional, Series A, 8.07% 12/31/26, 144A****	500,000
	Barclays Bank PLC:	
\$ 3,250,000	6.278%	2,407,031 ^{** (1)(2)}
1,200	7.75% Pfd., Series 4	29,124 ^{** (2)}
75,000	8.125% Pfd., Series 5	1,850,250 ^{** (1)(2)}
28,900	BB&T Capital Trust VI, 9.60% Pfd. 08/01/64	778,277 ⁽¹⁾
\$ 1,500,000	BBVA International Preferred, 5.919%	1,110,640 ^{** (1)(2)}
\$ 1,750,000	BNP Paribas, 7.195%, 144A****	1,522,500 ^{** (1)(2)}
\$ 4,750,000	Capital One Capital III, 7.686% 08/15/36	4,761,875 ⁽¹⁾
\$ 500,000	Capital One Capital V, 10.25% 08/15/39	522,175 ⁽¹⁾
\$ 2,500,000	Capital One Capital VI, 8.875% 05/15/40	2,545,485 ⁽¹⁾
10,000	Citigroup Capital XII, 8.50% Pfd. 03/30/40	256,563
62,300	Citigroup Capital XIII, 7.875% Pfd. 10/30/40	1,623,694 ⁽¹⁾
\$ 5,210,000	Colonial BancGroup, 7.114%, 144A****	201,887 ^{(3) ††}
2,500	Countrywide Capital IV, 6.75% Pfd. 04/01/33	55,235
9,000	FBOP Corporation, Adj. Rate Pfd., 144A****	7,020 ^{* (3)(4) †}
\$ 750,000	Fifth Third Capital Trust IV, 6.50% 04/15/37	699,375
30,000	Fifth Third Capital Trust V, 7.25% Pfd. 08/15/67	753,600
130,000	Fifth Third Capital Trust VI, 7.25% Pfd. 11/15/67	3,258,125 ⁽¹⁾
1,250	First Republic Preferred Capital Corporation, 10.50% Pfd., 144A****	1,276,563
3,750	First Tennessee Bank, Adj. Rate Pfd., 3.75% ⁽⁵⁾ , 144A****	2,433,984 ⁽¹⁾
\$ 500,000	First Tennessee Capital II, 6.30% 04/15/34, Series B	462,500
\$ 1,500,000	First Union Capital II, 7.95% 11/15/29	1,531,975 ⁽¹⁾
\$ 500,000	Fleet Capital Trust II, 7.92% 12/11/26	493,750
1	FT Real Estate Securities Company, 9.50% Pfd., 144A****	958,500
	Goldman Sachs:	
\$ 785,000	Capital I, 6.345% 02/15/34	728,187 ⁽¹⁾
\$ 1,058,000	Capital II, 5.793%	767,050 ⁽¹⁾
2,800	STRIPES Custodial Receipts, Adj. Rate, 10.70% ⁽⁵⁾ , Pvt.	1,327,200 ^{* (3)(4)}
132,900	HSBC Holdings PLC, 8.00% Pfd., Series 2	3,544,775 ^{** (1)(2)}
\$ 500,000	HSBC USA Capital Trust II, 8.38% 05/15/27, 144A****	509,013 ⁽¹⁾
145,300	HSBC USA, Inc., 6.50% Pfd., Series H	3,639,983 ^{* (1)}

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2011 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Banking — (Continued)		
\$ 1,725,000	JPMorgan Chase Capital XVIII, 6.95% 08/17/36, Series R	\$ 1,708,002 ⁽¹⁾
59,065	Keycorp Capital IX, 6.75% Pfd. 12/15/66	1,506,158 ⁽¹⁾
27,600	Keycorp Capital X, 8.00% Pfd. 03/15/68	710,976 ⁽¹⁾
\$ 550,000	Lloyds Banking Group PLC, 6.657%, 144A****	316,250** ^{(2)†}
\$ 550,000	MBNA Capital, 8.278% 12/01/26, Series A	552,063
25,000	Morgan Stanley Capital Trust VI, 6.60% Pfd. 02/01/46	614,063
\$ 860,000	NB Capital Trust IV, 8.25% 04/15/27	866,450 ⁽¹⁾
200,000	PNC Financial Services, 9.875% Pfd., Series L	5,637,500* ⁽¹⁾
\$ 1,750,000	PNC Preferred Funding Trust III, 8.70%, 144A****	1,794,187 ⁽¹⁾
1,750	Sovereign REIT, 12.00% Pfd., Series A, 144A****	2,141,729
6,025	SunTrust Capital IX, 7.875% Pfd. 03/15/68	153,110
\$ 2,400,000	Wachovia Capital Trust III, Adj. Rate, 5.56975% ⁽⁹⁾	2,109,000* ⁽¹⁾
20,000	Wachovia Preferred Funding, 7.25% Pfd., Series A	519,650 ⁽¹⁾
\$ 1,000,000	Washington Mutual, 9.75%, 144A****	25,000††
\$ 1,600,000	Webster Capital Trust IV, 7.65% 06/15/37	1,628,810 ⁽¹⁾
	Wells Fargo & Company:	
1,305	7.50% Pfd., Series L	1,358,466* ⁽¹⁾
15,000	8.00% Pfd., Series J	435,000*
\$ 500,000	Wells Fargo Capital XV, 9.75%	518,750
		<u>77,600,119</u>
Financial Services — 2.8%		
\$ 1,000,000	Claudius, Ltd. - Credit Suisse AG, 7.875%, Series B	995,000 ⁽²⁾
	Heller Financial, Inc.:	
35,000	6.687% Pfd., Series C	3,491,250* ⁽¹⁾
5,760	6.95% Pfd., Series D	583,020*
22,404	HSBC Finance Corporation, 6.36% Pfd., Series B	515,572* ⁽¹⁾
	Lehman Brothers Holdings, Inc.:	
15,000	5.67% Pfd., Series D	4,650*††
19,500	5.94% Pfd., Series C	5,070*††
25,000	6.50% Pfd., Series F	1,613*††
27,500	7.95% Pfd.	770*††
		<u>5,596,945</u>
Insurance — 19.0%		
\$ 975,000	Ace Capital Trust II, 9.70% 04/01/30	1,306,486 ⁽¹⁾⁽²⁾
\$ 250,000	AON Corporation, 8.205% 01/01/27	287,229

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 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	\$ 360,181** ⁽¹⁾⁽²⁾
\$ 3,500,000	AXA SA, 6.379%, 144A****	2,730,000** ⁽¹⁾⁽²⁾
35,900	Axis Capital Holdings, 7.50% Pfd., Series B	3,508,105 ⁽¹⁾⁽²⁾
90,600	Delphi Financial Group, 7.376% Pfd. 05/15/37	2,168,738 ⁽¹⁾
\$ 4,000,000	Everest Re Holdings, 6.60% 05/15/37	3,650,000 ⁽¹⁾
\$ 4,100,000	Liberty Mutual Group, 10.75% 06/15/58, 144A****	5,084,000 ⁽¹⁾
\$ 900,000	MetLife Capital Trust IV, 7.875% 12/15/37, 144A****	922,500 ⁽¹⁾
\$ 2,775,000	MetLife Capital Trust X, 9.25% 04/08/38, 144A****	3,288,375 ⁽¹⁾
\$ 2,400,000	MetLife, Inc., 10.75% 08/01/39	3,296,460 ⁽¹⁾
30,000	PartnerRe Ltd., 7.250% Pfd., Series E	758,400** ⁽¹⁾⁽²⁾
	Principal Financial Group:	
14,000	5.563% Pfd., Series A	1,354,938* ⁽¹⁾
105,000	6.518% Pfd., Series B	2,684,063* ⁽¹⁾
51,084	Renaissancere Holdings Ltd., 6.08% Pfd., Series C	1,161,139** ⁽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	1,159,027 ⁽¹⁾
\$ 750,000	USF&G Capital, 8.312% 07/01/46, 144A****	926,828 ⁽¹⁾
\$ 2,000,000	XL Capital Ltd., 6.50%, Series E	1,785,000 ⁽¹⁾⁽²⁾
		<u>37,533,116</u>
Utilities — 24.2%		
56,430	Alabama Power Company, 6.45% Pfd.	1,569,459* ⁽¹⁾
	Baltimore Gas & Electric Company:	
10,000	6.70% Pfd., Series 1993	1,005,938* ⁽¹⁾
2,400	7.125% Pfd., Series 1993	242,700*
20,600	Calenergy Capital Trust III, 6.50% Pfd. 09/01/27	1,019,700 ⁽¹⁾
\$ 3,458,000	COMED Financing III, 6.35% 03/15/33	3,070,604 ⁽¹⁾
15,000	Constellation Energy Group, 8.625% Pfd. 06/15/63, Series A	405,450
\$ 250,000	Dominion Resources Capital Trust I, 7.83% 12/01/27	252,548
	Dominion Resources, Inc.:	
\$ 3,500,000	7.50% 06/30/66	3,591,094 ⁽¹⁾
13,178	8.375% Pfd. 06/15/64, Series A	382,821 ⁽¹⁾
40,000	Entergy Arkansas, Inc., 6.45% Pfd.	1,000,000* ⁽¹⁾
25,000	Entergy Louisiana, Inc., 6.95% Pfd.	2,461,720* ⁽¹⁾
\$ 3,284,000	FPL Group Capital, Inc., 6.65% 06/15/67	3,181,007 ⁽¹⁾
25,000	Georgia Power Company, 6.50% Pfd., Series 2007A	2,675,000* ⁽¹⁾
7,500	Gulf Power Company, 6.45% Pfd., Series 2007A	806,784* ⁽¹⁾

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2011 (Unaudited)**

<u>Shares/\$ Par</u>		<u>Value</u>
Preferred Securities — (Continued)		
Utilities — (Continued)		
32,650	Indianapolis Power & Light Company, 5.65% Pfd.	\$ 3,056,856*
185,596	Interstate Power & Light Company, 8.375% Pfd., Series B	5,440,283 ⁽¹⁾
\$ 500,000	PECO Energy Capital Trust III, 7.38% 04/06/28, Series D	513,560 ⁽¹⁾
\$ 600,000	PPL Capital Funding, 6.70% 03/30/67, Series A	579,659 ⁽¹⁾
46,000	PPL Electric Utilities Corporation, 6.25% Pfd.	1,162,940 ⁽¹⁾
\$ 3,800,000	Puget Sound Energy, Inc., 6.974% 06/01/67	3,846,128 ⁽¹⁾
50,526	Scana Corporation, 7.70% Pfd. 01/30/65	1,437,970 ⁽¹⁾
	Southern California Edison:	
38,900	6.00% Pfd., Series C	3,825,574 ⁽¹⁾
10,700	6.125% Pfd.	1,080,700 ⁽¹⁾
12,500	6.50% Pfd., Series D	1,261,329 ⁽¹⁾
\$ 750,000	TXU Electric Capital V, 8.175% 01/30/37	221,250 ⁽³⁾
3,000	Virginia Electric & Power Company, \$6.98 Pfd.	310,031*
3,700	Wisconsin Public Service Corporation, 6.88% Pfd.	385,494*
\$ 3,250,000	WPS Resources Corporation, 6.11% 12/01/66	3,107,156 ⁽¹⁾
		<u>47,893,755</u>
Energy — 6.6%		
\$ 5,000,000	Enbridge Energy Partners LP, 8.05% 10/01/37	5,248,575 ⁽¹⁾
\$ 4,100,000	Enterprise Products Partners, 8.375% 08/01/66, Series A	4,293,914 ⁽¹⁾
3,500	Kinder Morgan GP, Inc., 8.33% Pfd., 144A****	3,545,063*
		<u>13,087,552</u>
Real Estate Investment Trust (REIT) — 0.3%		
	PS Business Parks, Inc.:	
12,500	6.70% Pfd., Series P	316,016
7,500	6.875% Pfd., Series R	191,250
		<u>507,266</u>
Miscellaneous Industries — 1.7%		
37,400	Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****	3,260,813 ⁽¹⁾
		<u>3,260,813</u>
Total Preferred Securities		
(Cost \$184,580,236)		<u>185,479,566</u>

PORTFOLIO OF INVESTMENTS (Continued)

August 31, 2011 (Unaudited)

<u>Shares/\$ Par</u>	<u>Value</u>
Corporate Debt Securities — 3.8%	
Banking — 0.2%	
\$ 415,000 Goldman Sachs Group, 6.75% 10/01/37, Sub Notes	\$ 395,097 ⁽¹⁾
	<u>395,097</u>
Insurance — 2.3%	
\$ 2,500,000 Liberty Mutual Insurance, 7.697% 10/15/97, 144A****	2,318,765 ⁽¹⁾
\$ 2,000,000 UnumProvident Corporation, 7.25% 03/15/28	2,193,754 ⁽¹⁾
	<u>4,512,519</u>
Utilities — 1.3%	
\$ 2,175,000 Southern Union Company, 8.25% 11/15/29, Senior Notes	2,684,885 ⁽¹⁾
	<u>2,684,885</u>
Total Corporate Debt Securities	
(Cost \$6,241,936)	<u>7,592,501</u>
Common Stock — 0.4%	
Banking — 0.1%	
3,620 CIT Group, Inc.	125,143*†
	<u>125,143</u>
Utilities — 0.3%	
6,250 Exelon Corporation	269,500*
14,558 PPL Corporation	420,435*
	<u>689,935</u>
Total Common Stock	
(Cost \$962,666)	<u>815,078</u>

PORTFOLIO OF INVESTMENTS (Continued)**August 31, 2011 (Unaudited)**

<u>Shares/\$ Par</u>	<u>Value</u>
Money Market Fund — 0.8%	
1,519,725 BlackRock Liquidity Funds, T-Fund	\$ 1,519,725
Total Money Market Fund (Cost \$1,519,725)	<u>1,519,725</u>
Total Investments (Cost \$193,304,563***)	98.9% 195,406,870
Other Assets And Liabilities (Net)	1.1% <u>2,221,691</u>
Total Managed Assets	<u>100.0%†</u> \$ <u>197,628,561</u>
Loan Principal Balance	<u>(68,300,000)</u>
Total Net Assets Available To Common Stock	<u>\$ 129,328,561</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, 2011, these securities amounted to \$33,762,977 or 17.1% of total managed assets.

(1) All or a portion of this security is pledged as collateral for the Fund's loan. The total value of such securities was \$151,398,640 at August 31, 2011.

(2) Foreign Issuer.

(3) Illiquid.

(4) Fair valued as of August 31, 2011.

(5) Represents the rate in effect as of the reporting date.

† 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 August 31, 2011 (Unaudited)

	<u>Value</u>
OPERATIONS:	
Net investment income	\$ 9,164,725
Net realized gain/(loss) on investments sold during the period	4,753,293
Change in net unrealized appreciation/depreciation of investments	<u>(3,770,307)</u>
Net increase in net assets resulting from operations	10,147,711
DISTRIBUTIONS:	
Dividends paid from net investment income to Common Stock Shareholders ⁽²⁾	<u>(9,092,909)</u>
Total Distributions to Common Stock Shareholders	(9,092,909)
FUND SHARE TRANSACTIONS:	
Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan	<u>712,636</u>
Net increase in net assets available to Common Stock resulting from Fund share transactions	712,636
NET INCREASE IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE PERIOD	<u><u>\$ 1,767,438</u></u>

NET ASSETS AVAILABLE TO COMMON STOCK:

Beginning of period	\$ 127,561,123
Net increase in net assets during the period	<u>1,767,438</u>
End of period	<u><u>\$ 129,328,561</u></u>

⁽¹⁾ These tables summarize the nine months ended August 31, 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 August 31, 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 0.85

Net realized and unrealized gain/(loss) on investments 0.09

Total from investment operations 0.94

DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:

From net investment income (0.84)

Total distributions to Common Stock Shareholders (0.84)

Net asset value, end of period \$ 11.96

Market value, end of period \$ 13.61

Common Stock shares outstanding, end of period 10,817,041

RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:

Net investment income † 9.30%*

Operating expenses including interest expense 2.10%*

Operating expenses excluding interest expense 1.47%*

SUPPLEMENTAL DATA: ††

Portfolio turnover rate 14%**

Total managed assets, end of period (in 000's) \$ 197,629

Ratio of operating expenses including interest expense to total managed assets 1.40%*

Ratio of operating expenses excluding interest expense to total managed assets 0.98%*

⁽¹⁾ These tables summarize the nine months ended August 31, 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)

	Total Dividends Paid	Net Asset Value	NYSE Closing Price	Dividend Reinvestment Price⁽¹⁾
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
March 31, 2011	0.0900	12.14	12.36	12.14
April 29, 2011	0.0900	12.38	12.71	12.38
May 31, 2011	0.0900	12.56	13.34	12.67
June 30, 2011	0.0900	12.37	13.45	12.78
July 29, 2011	0.0900	12.39	12.90	12.39
August 31, 2011	0.0930	11.96	13.61	12.93

⁽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, 2011, the aggregate cost of securities for federal income tax purposes was \$193,105,218, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$23,629,882 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$21,328,230.

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, 2011 is as follows:

	Total Value at August 31, 2011	Level 1 Quoted Price	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
Preferred Securities				
Banking	\$ 77,600,119	\$ 55,833,341	\$ 21,557,871	\$ 208,907
Financial Services	5,596,945	515,572	5,081,373	—
Insurance	37,533,116	22,610,503	14,922,613	—
Utilities	47,893,755	18,125,440	29,768,315	—
Energy	13,087,552	9,542,489	3,545,063	—
Real Estate Investment Trust (REIT)	507,266	507,266	—	—
Miscellaneous Industries	3,260,813	—	3,260,813	—
Corporate Debt Securities	7,592,501	3,079,982	4,512,519	—
Common Stock				
Banking	125,143	125,143	—	—
Utilities	689,935	689,935	—	—
Money Market Fund	1,519,725	1,519,725	—	—
Total Investments	<u>\$ 195,406,870</u>	<u>\$112,549,396</u>	<u>\$ 82,648,567</u>	<u>\$ 208,907</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 valuation of the Fund's investments in Level 2 and Level 3 is 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>	
	<u>Total Investments</u>	<u>Banking</u>
Balance as of 11/30/10	\$ 39,816	\$ 39,816
Accrued discounts/premiums	—	—
Realized gain/(loss)	—	—
Change in unrealized appreciation/(depreciation)	(32,796)	(32,796)
Purchases	—	—
Sales	—	—
Transfer in	201,887	201,887 ⁽¹⁾
Transfer out	—	—
Balance as of 8/31/11	\$ 208,907	\$ 208,907

⁽¹⁾ Transferred from Level 2 to Level 3 because of lack of observable market data due to decrease in market activity for these securities.

For the period ended August 31, 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 \$(32,796).

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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

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Flaherty & Crumrine

PREFERRED INCOME FUND

Quarterly Report

August 31, 2011

www.preferredincome.com