FLAHERTY & CRUMRINE PREFERRED INCOME OPPORTUNITY FUND

To the Shareholders of Flaherty & Crumrine Preferred Income Opportunity Fund:

The fiscal year ended on a positive note, posting solid returns for the third consecutive quarter. As can be seen in the table below, the eye-popping performance of recent periods tells only part of the story, but one we are happy to report!

TOTAL RETURN ON NET ASSET VALUE
FOR PERIODS ENDED NOVEMBER 30, 2009

	Actual Returns			Average Annualized Returns			
	Three Months	Six Months	One Year	Three Years	Five Years	Ten Years	Life of Fund[2]
Flaherty & Crumrine Preferred Income Opportunity Fund[1]	16.3%	45.7%	88.4%	-5.6%	-0.1%	5.1%	7.4%
Barclays Capital U.S. Aggregate Index[3]	2.9%	6.2%	11.6%	6.4%	5.5%	6.4%	6.7%
S&P 500 Index[4]	7.9%	20.5%	25.2%	-5.8%	0.7%	-0.6%	7.7%

(1) In prior periods, the Fund included the performance of funds in Lipper's Domestic Investment-Grade funds category, which reflected the equally-weighted average performance returns of all closed-end funds in the category in each month during the period. The category last included closed-end funds in the U.S. Mortgage and Corporate Debt BBB Rated sub-categories and has included other sub-categories in prior periods. With Lipper no longer publishing these results in a comparable format, the Fund will no longer include these results. For the period ended November 30, 2009, this category returned 5.8%, 15.4%, 31.0%, 3.9%, 4.5%, 6.2% and 6.5% (for the three month, six month, one year, three year, five year, ten year and since inception periods).

(2) Since inception on February 13, 1992.

(3) The Barclays Capital U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. It is generally considered to be representative of the domestic, investment-grade, fixed-rate, taxable bond market. Unless otherwise noted, index returns reflect the reinvestment of dividends and capital gains, if any, but do not reflect fees, brokerage commissions or other expenses of investing. This index was formerly known as the Lehman Brothers U.S. Aggregate Index.

(4) The S&P 500 is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The financial crisis of the past two years claimed countless casualties and caused greater market volatility in the preferred market than any time in memory. A double digit return, up or down, was unusual before the crisis, yet such numbers have recently become more common.[1]

For all of fiscal 2009, the NAV *increased* 88.4% as the market for preferred securities came back to life. Although recent performance is impressive, it has not been enough to offset the decline of 48.1% in fiscal 2008. Unfortunately, it takes a lot more positive percentage returns to overcome a given amount of negative return. And if that's not enough to induce some head scratching, the analysis is further complicated by changes in the amount of leverage used by the Fund. We delve more deeply into these numbers, as well as returns on the market price of Fund shares, in the discussion section.

[1] The Fund's interest rate hedging strategy generally helps dampen volatility of returns, but the decision to temporarily suspend such hedging late last year has had little impact on performance (more on this later).

To help readers put the Fund's performance in context, we've included returns for broader fixed-income and equity markets. Other performance comparisons are discussed more thoroughly in the discussion section which follows.

Conditions in the preferred securities market have improved dramatically. Efforts by various government agencies, especially the Federal Reserve, have clearly helped stabilize the financial sector; prices of securities issued by commercial banks and insurance companies have recovered much of their lost value. Another factor contributing to the rebound in the preferred market is the absence of alternative investments such as asset-backed securities, collateralized debt obligations and commercial mortgage-backed securities. Investors have returned to more traditional investments like preferred securities, as the supply of "alternative" products has virtually disappeared.

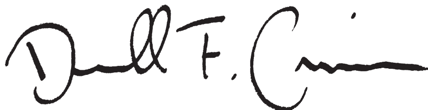
Although risks remain, the outlook for the preferred securities market seems bright. Market liquidity has improved and new securities are being issued. Confidence in the banking sector has improved, as banks have repaid more than 70% of the TARP preferreds issued during the height of the financial crisis. There are also indications that increased standardization of preferred security structures may be coming down the road, something investors would welcome.

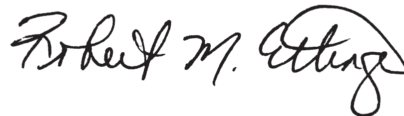
The fact that the government used preferred stock investments to provide capital to distressed companies is an indication of how important these securities are in the world of finance. Without preferred securities, the number of companies that failed during the financial crisis would likely have been far greater.

In another sign of better times, the Fund announced an increase in the monthly distribution to $0.0575 from $0.050 beginning with the December 2009 dividend. Several factors contributed to the increase, including changes to the Fund's leverage. The impact of leverage, investment income and Fund expenses on the amount of the dividend can get confusing, but it is important for shareholders to understand how the distributions are determined. We attempt to clarify things a bit in the discussion section.

More information is always available on the Fund's website, including expanded discussion of many of the topics in this letter. In addition, our thoughts on the economic outlook are published quarterly and posted to the site. We encourage you to visit the website at www.preferredincome.com.

Sincerely,





Donald F. Crumrine
Chairman of the Board

Robert M. Ettinger
President

January 21, 2010

DISCUSSION TOPICS

The Fund's Portfolio Results and Components of Total Return on NAV

The table below reflects the performance of each investment technique available for use by the Fund to achieve its objective, namely: (a) investing in a portfolio of securities; (b) hedging that portfolio of securities against significant increases in long-term interest rates (see the following discussion on interest rate hedging); and (c) utilizing leverage to enhance returns to shareholders. Next, we compute the impact of the Fund's operating expenses. All of the parts are summed to determine the total return on NAV.

Components of PFO's Total Return on NAV
for the Fiscal Year Ended November 30, 2009

	*Six Months**	*One Year*
Total Return on Unleveraged Securities Portfolio (including principal and income)	+29.9%	+56.0%
Return from Interest Rate Hedging Strategy	0.0%	0.0%
Impact of Leverage (including leverage expense)	+16.7%	+34.6%
Expenses (excluding leverage expense)	-0.9%	-2.2%
Total Return on NAV	**+45.7%**	**+88.4%**

* Actual, not annualized.

By the end of the Fund's fiscal year ended November 30th, the preferred market had recovered dramatically from the lows it reached in 2008 and early 2009. More importantly, as can be seen by comparing the total return on the securities portfolio (the first row of the above table) to the index results in the following table, the Fund's portfolio outperformed the three largest segments of the market. The fourth segment of the market, adjustable rate preferred securities, constitutes roughly 3% of the entire preferred market as well as of the Fund's portfolio.

Total Returns of Bank of America Merrill Lynch Preferred Securities Indices*
for Periods Ended November 30, 2009

	Six Months	*One Year*
BofA Merrill Lynch 8% Capped DRD Preferred Stock Index℠	+20.5%	+25.1%
BofA Merrill Lynch 8% Capped Hybrid Preferred Securities Index℠	+13.9%	+27.8%
BofA Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index℠	+26.8%	+49.2%
BofA Merrill Lynch Adjustable Preferred Stock, 7% Constrained Index℠	+43.0%	+87.9%

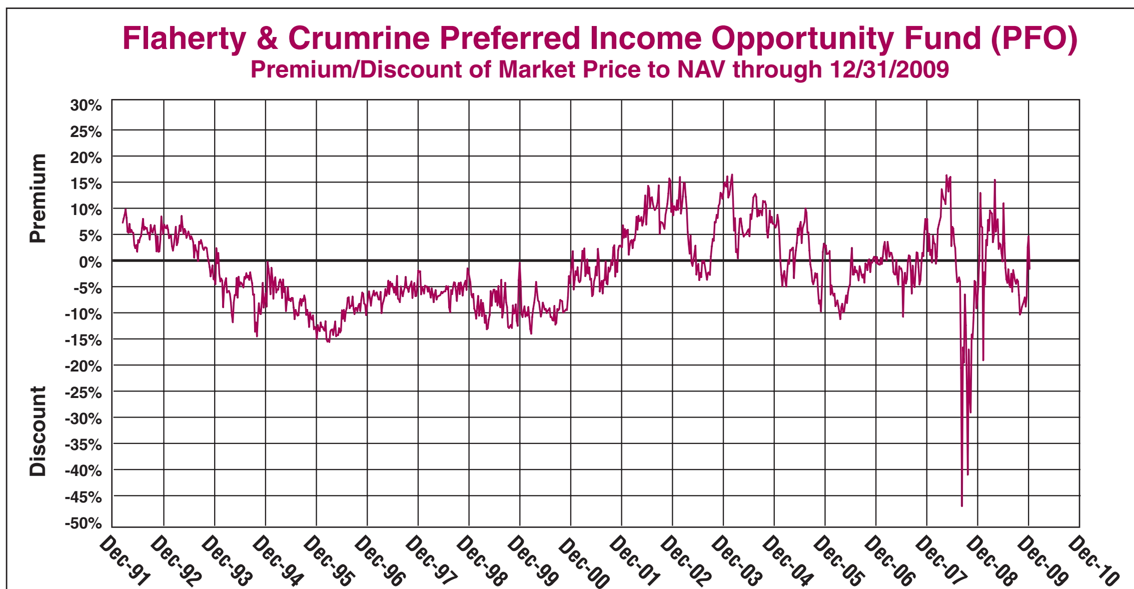
* The Bank of America Merrill Lynch 8% Capped DRD Preferred Stock Index℠ includes investment grade preferred securities issued by both corporations and government agencies that qualify for the corporate dividend received deduction with issuer concentration capped at a maximum of 8%. The Bank of America Merrill Lynch 8% Capped Hybrid Preferred Securities Index℠ includes taxable, fixed-rate, U.S. dollar-denominated investment-grade, preferred securities listed on a U.S. exchange with issuer concentration capped at 8%. The Bank of America Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index℠ includes investment grade fixed rate or fixed-to-floating rate $1,000 par securities that receive some degree of equity credit from the rating agencies or their regulators with issuer concentration capped at a maximum of 8%. The Bank of America Merrill Lynch Adjustable Preferred Stock, 7% Constrained Index℠ includes adjustable rate preferred securities issued by U.S. corporations and government agencies with issuer concentration capped at a maximum of 7%. All index returns include interest and dividend income and, unlike the Fund's returns, are unmanaged and do not reflect any expenses.

The bottom line of the Fund's performance (as well as the bottom line of the first table) demonstrates how leverage benefited common stock shareholders during the past year. In contrast to the experience during fiscal 2008, the strategy of using leverage to increase current income magnified the positive returns over the Fund's fiscal 2009, and, even net of its expenses, caused the NAV of the Fund (with the added benefit of leverage) to significantly outperform the three largest unleveraged preferred market indices.

Total Return on Market Price of Fund Shares

While our focus is primarily on managing the Fund's investment portfolio, an investor's actual return is comprised of monthly dividend payments plus changes in the Fund's *market price*. After hitting lows in late 2008, the Fund's market price improved dramatically in 2009, and for the twelve months ending November 30, 2009, the total return on market price of Fund shares was +110.5%.

In a perfect world the market price of Fund shares would closely track the Fund's net asset value. As can be seen from the graph below, this often is not the case. For most of the past year the market price has been below the NAV (in market parlance, "trading at a discount"). Recently, the discount narrowed and the market price is more in line with the underlying value of each Fund share.



Based on a closing price of $8.27 on December 31st, the current distribution rate on the market price of the Fund's shares (assuming the current monthly distribution of $0.0575 does not change) is 8.3%. In our opinion, this distribution rate measures up favorably with most comparable investment opportunities.

Preferred Market Conditions

Conditions in the preferred securities market have improved markedly since the very dark days of last winter. By late February 2009, prices on preferred securities had fallen to such a degree that the market seemed to be predicting few companies would survive. And while the severe economic downturn did claim its victims, the vast majority of companies appear to be well on the way to full recovery.

By most measures, key aspects of the preferred market are returning to normal levels. Trading has improved; there has been a steady supply of new issues; market participation appears widespread; and valuation metrics appear more consistent with other market segments. Of course, the most important measure of whether the preferred market has returned to normal levels is price. In our opinion, prices on much of the universe of preferred securities remain attractive, especially when compared to pre-crisis levels.

Since March, there have been almost thirty new preferred issues, totaling over $16 billion. Although some of the new issues have been in exchange for older preferred securities, there has been new supply, and investors appear to have an appetite for more.

Perceptions of credit quality have also improved recently. Bolstered by banks returning bailout funds to the government (discussed below), investor confidence is coming back. The market reacted positively to each announcement of the Troubled Asset Relief Program (TARP) repayment, especially those of Bank of America and Citigroup. In addition to paying back the government, a number of banks raised new capital (common and preferred) in a sign that traditional financing sources are opening up again.

Though banks have the most preferred securities outstanding, preferred securities of insurance companies and public utilities constitute the other large sectors of the preferred securities universe. The insurance industry has generally benefited from improved investment performance and very few natural catastrophes. A number of insurance companies repurchased a portion of their outstanding preferred securities in recent months; in turn, the market prices of their remaining securities have risen substantially. Utilities, largely unaffected by the financial crisis, have continued to perform well, as investors seek perceived safety and diversification.

From time to time, the national credit rating agencies, primarily Moody's, Standard & Poor's, and Fitch, have revised the methodology they use to rate preferred securities. We rely primarily on our own research to evaluate credit quality, but the impact of public ratings can't be ignored. So when the agencies recently announced changes (once again!) to the methodology they employ in rating preferred securities, we were a bit dismayed. However, the market took it in stride, and despite a number of downgrades, prices changed little, if at all.

In December, a little known, but extremely important international committee based in Basel, Switzerland, proposed stricter guidelines for the way banks account for capital raised by issuing preferred securities. From our initial read of the guidelines, it appears that, after a transition period, in order for banks to receive the most favorable regulatory treatment from preferred capital, the issues will have to look more like old fashioned perpetual preferred stock. In addition, the U.S. Congress is considering new regulations for financial institutions that will affect many of the issuers in the Fund's portfolio. Of course, we'll monitor these developments closely and keep you informed, but we are optimistic that these changes will be beneficial to the Fund.

The preferred securities market, much like the broader stock and bond markets, took some severe hits during the financial crisis, and we still expect some bumps in the road to complete recovery in our markets. That being said, we aren't surprised by the extent of the ongoing recovery, even if the speed at which it has occurred has been faster than we imagined.

Bank Repayment of TARP Preferred and Impact on Preferred Investors

In aggregate, U.S. banks have repaid about $188 billion of the roughly $264 billion in preferred capital purchased from them by the TARP. Focusing on the 19 largest banks that were subject to the Supervisory

Capital Assessment Program (SCAP), 18 of these banks received approximately $221 billion in TARP capital and 12 of them have repaid about $182 billion as of December 18, 2009[2]. This has turned out to be a significantly faster timetable for repayment than most market participants expected, and it highlights that (1) policies implemented to protect the financial system were largely effective and (2) the health of the banking system is improving rapidly.

All of the money-center banks and most of the major trust banks have repaid their TARP capital. These institutions have viewed repayment as important to their business. They believe that customers have a higher degree of confidence doing business – particularly when it involves counterparty risk – with a bank that has repaid the Treasury.

On the other hand, most regional and community banks have not yet repaid their TARP capital. This is not a bad thing for preferred investors. Although our assessment of their ability to repay TARP capital varies among regional and community banks, we believe that it is prudent for them to hold on to the capital at this time. While economic and financial conditions have improved, aggregate loan losses are still increasing. We expect them to peak in 2010, but some geographic regions and loan categories (e.g., commercial real estate) are likely to turn around more slowly. Regional and community banks, particularly smaller ones, tend to have more geographic, and often more loan-category, concentration than larger money-center banks, which makes them more exposed to those uncertainties. As a result, we do not fault these banks for holding on to their TARP capital for a while longer. If the economic recovery proceeds as expected and loan losses begin to trend down, we expect that most of the remaining banks will repay their TARP capital in 2010. However, banks with tough geographic footprints or concentrations of problem loans may not repay their TARP capital for several more years, and some will not survive at all.

As preferred investors, we care more about the quality of a bank's loan book, its business prospects, and the quantity and composition of its capital than whether or not it has repaid the TARP. We generally are happy to see banks repay the Treasury as long as they issue a meaningful amount of common equity to fund the repayment – something nearly all of the banks that have repaid the TARP have done.

Status of the Fund's Hedging Strategy

The Fund suspended its interest rate hedging program as the financial crisis intensified in the autumn of 2008. There were three principal reasons why we suspended the program at the time. First, the relationship between preferred securities' prices and the Fund's hedging instruments (Treasury bond futures, interest rate swaps, and options on both) was turned on its head during the financial crisis. Historically, preferred prices had tended to rise (fall) in periods of falling (rising) long-term Treasury rates, but as the financial crisis unfolded, the opposite occurred: preferred prices plunged while Treasury and swap rates fell as investors sold risky assets and raced into Treasuries. This meant that hedging interest rates using put options on Treasury futures as had been done historically added risk to the Fund, which emphatically is not the objective of the hedging program. Second, the cost of hedging rose dramatically as the yield curve steepened and options

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[2] Citigroup received a total of $45 billion in TARP capital and issued $7.1 billion in additional preferreds to the U.S. Treasury as payment for insurance on $301 billion of troubled assets. Treasury later exchanged $25 billion of TARP preferred for common equity. (We include this amount as "repaid," since it is no longer a Citigroup obligation.) As part of the repayment plan announced on December 14, 2009, Citigroup will repay the balance of $20 billion in TARP preferred, but $5.3 billion of the "additional preferreds" will remain outstanding. The other banks that have repaid their TARP capital are: American Express, Bank of America, BB&T Bank, Bank of New York Mellon, Capital One Financial, Goldman Sachs, JP Morgan Chase, Morgan Stanley, State Street Bank & Trust, U.S. Bancorp, and Wells Fargo

prices rose sharply. Finally, preferred securities became exceptionally cheap and were likely to offer high returns to shareholders even if Treasury yields increased moderately. Add them up, and we believed that hedging simply would not work under the market conditions at the time. (For a more detailed explanation, see "Update on Hedging Strategy," July 6, 2009 on the Fund's web site.)

Looking at the hedging strategy currently, we conclude that it remains too early to reinstate the hedging program. Although some preferred securities are starting to move in concert with the general level of long-term Treasury rates, most are not. For the preferred market as a whole, correlations between movements in prices of preferreds and the hedge instruments we use are increasing, but they remain well below their historical levels. While hedging today probably would not add to risk as it did during the height of the crisis, it still would not do much to reduce it. Meanwhile, the cost of hedging remains high, and preferreds remain attractively priced.

However, it does appear that the preferred market is gradually moving back toward a stronger relationship with swaps and Treasuries, even if that progress is insufficient to persuade us to reestablish the hedging program at this time. As the financial system heals, preferred securities are likely to reconnect with long-term benchmark Treasury rates. When they do, we will consider hedging again.

The Fund's Leverage

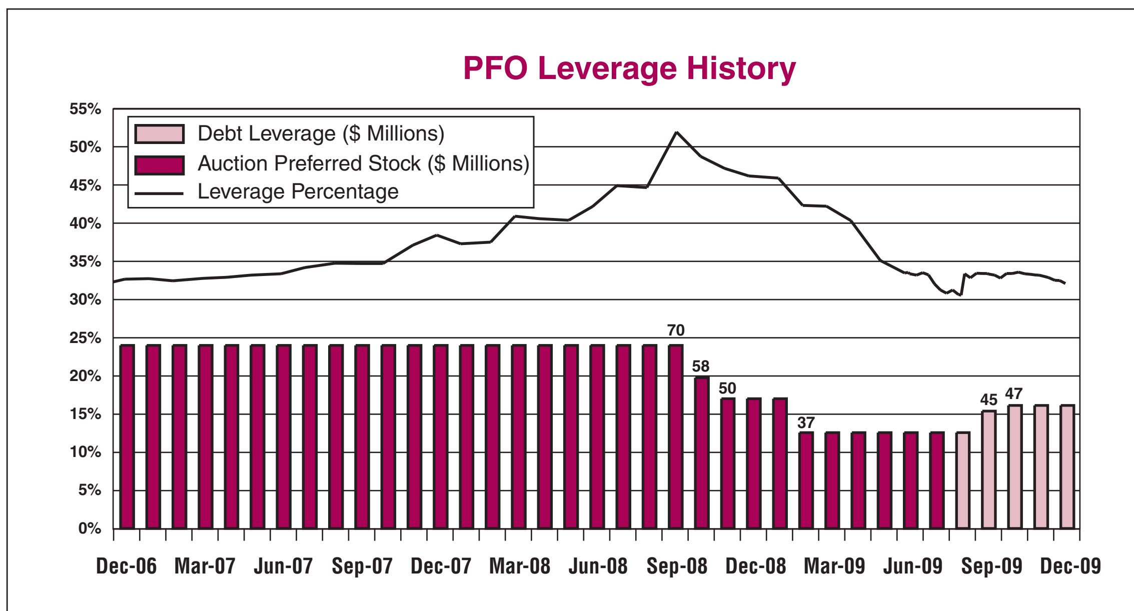
As we have discussed in the past, there have been important changes in the Fund's leverage since the beginning of the credit crisis. Most notably, during the past year, the Fund redeemed all of its remaining outstanding auction preferred stock, and instead began using debt for leverage. Equally important, the amount of leverage in the Fund in dollars and as a percent of total assets has changed.

Leverage is an important part of the Fund's strategy to produce high current income. Over time, the cost of leverage is typically lower than the yield on the Fund's portfolio. The difference between what the Fund earns on its investments and pays on the money it borrows increases the income available to common shareholders.

The Fund began a process of transitioning from auction preferred leverage to bank debt leverage in early 2008. When it worked as intended, auction preferred stock was a very efficient form of leverage. However the breakdown of the auction process in late 2007 prompted us to seek alternative leverage. We determined that a borrowing facility was the best available option.

In addition to economic considerations there is a set of rules that govern leverage (most importantly, the terms and conditions of the leverage agreement, and all relevant securities laws). We take all of these factors into consideration as we manage the leverage *and* the assets of the Fund.

There are two useful measures of how much leverage the Fund has in place. The first is simply the total dollar amount of leverage. The other measure is the ratio of the Fund's assets financed by that leverage (in other words, the amount of leverage divided by total assets). The chart below presents both measures of leverage over the past three years.



When the leverage was comprised entirely of auction preferred stock, the *amount* of leverage rarely changed. As a result, the *percentage* of the Fund's leverage to total net assets varied as the value of the portfolio moved up or down. As can be seen in the chart, the leverage percentage climbed steadily as the financial crisis unfolded and the value of the Fund's investment portfolio fell.

As the leverage ratio rose to unsustainable levels, the Fund sold assets and used the proceeds to reduce leverage. While this meant that monthly distributions to shareholders had to be cut, it also served to reduce the NAV and market price risk to the Fund's common shareholders.

With debt leverage, it has been easier and less expensive to *increase* the amount borrowed by the Fund (within certain limits!). This is important because the dramatic recovery in asset prices meant the Fund could comfortably borrow more and use the money to purchase additional securities.

The "right" amount of leverage is never a simple matter to determine. Type of borrowing, the cost of funds and market conditions will all be factors to consider. At present, we are comfortable with the amount of the leverage. We continuously monitor these factors and try to use leverage in a manner most consistent with the Fund's objectives.

Monthly Distributions to Fund Shareholders

The monthly distribution paid to shareholders is intended to reflect current market conditions, but we also must make assumptions about the future. We begin with an estimate of the sustainable income generated from the investment portfolio, and end with a forecast of expenses, including the cost of leverage. While it sounds simple, in periods of rapid change, forecasting income and expenses becomes more art than science. There are always a lot of moving parts when the Fund sets the monthly distribution, and the present is no different.

With regard to income earned by the Fund, the financial crisis has claimed many victims and there are a few Fund portfolio holdings that are not currently making dividend or interest payments (noted as "non-

income producing" in the portfolio listing that follows). This obviously has a direct impact on our forecasted income.

Historically, the Fund's use of auction preferred stock as leverage encouraged it to invest in tax-advantaged (DRD-eligible) securities. As the Fund has transitioned away from auction preferred stock, its portfolio has also shifted to much greater percentages of fully-taxable securities. On a pre-tax basis, this has had a positive impact on the amount of income earned by the Fund, since fully-taxable securities typically yield more than tax-advantaged ones. Of course, as detailed in the Supplementary Tax Information below, the amount of income eligible for the corporate dividends received deduction (DRD) has accordingly decreased.

The primary variables on the expense forecast are the cost and amount of leverage employed by the Fund. During the year, we saw two different trends. Late in 2008, the reduction in the *amount* of leverage (and the amount of additional incremental income it provided) dwarfed the benefit the Fund would have seen from its declining *cost* of leverage. As a result, the Fund began its fiscal year with a dividend cut. In the second half of 2009, the Fund saw both variables trend positive: the cost of leverage continued to drop and the amount of leverage was increased. As we discussed in the shareholder letter, the additional income provided by that additional leverage consequently allowed the Fund to increase its dividend.

Impact of the Federal Reserve Raising Short-Term Rates

With the federal funds rate hovering near zero percent, it's fair to ask what will happen to the Fund when the Fed inevitably raises short-term rates. We have to start with the caveat that there is no comprehensive answer, since the Fund's performance depends on a lot more than the fed funds rate, which is the only interest rate that the Fed controls directly. Having said that, we believe there are several likely repercussions of Fed tightening.

Higher short-term rates are likely to reduce income available to the Fund's common stock shareholders. The Fund's cost of leverage would go up, whereas most of the Fund's assets pay fixed dividends or interest. The Fund could hedge this risk by fixing the cost of leverage for some period of time, but doing so would certainly increase the cost of leverage today in exchange for possibly lowering it in the future. Because the yield curve currently is steep, the market expects short rates will rise significantly and soon. As of December 31, 2009, the market was pricing-in 25-50 basis points (bp) of tightening by the Fed by June 2010, 100-125 bp of tightening by the end of 2010, and more than 250 bp of tightening by the end of 2011. Hedging the cost of leverage locks in those expected rate increases. Short-term interest rates may rise by more than that, but we currently think the economic outlook favors low rates for a longer period than the market expects. Nonetheless, when short-term rates eventually do rise, it probably will strain the Fund's dividend.

While the impact of higher short-term rates on income is fairly clear, their impact on preferred securities' prices is ambiguous. Higher short-term rates normally are associated with higher long-term rates and lower preferred prices. However, we don't think these are normal times! The Fed is not likely to raise short-term rates until the economy is stronger, which in turn should be positive for the credit outlook. With preferred valuations still being driven more by credit developments than by the general level of interest rates, Fed tightening – at least in moderate amounts – might actually be good news for preferred prices. In addition, if the Fed tightens by less than the market expects, long-term rates could fall, just as they did when the Fed tightened in 2004-05. In short, it's not obvious that long-term interest rates are set to rise, even though higher short-term rates are inevitable at some point – and it's even less clear that tighter monetary policy would be bad news for preferreds. (This is another reason why the Fund's hedging program is on hold.)

Implicit in this analysis is the view that the Fed will not have to raise short-term rates dramatically, which probably would push all rates higher. The only reason we could anticipate such high short-term rates is a breakout of inflation. Given soaring budget deficits and accommodative monetary policy, sharply higher inflation down the road cannot be ruled out. However, as we have discussed in recent Economic Updates, we do not think inflation will gain a foothold over the near to medium term. If we are right about that, we think the main impact of moderately tighter monetary policy on the Fund is likely to be somewhat reduced income.

Federal Tax Advantages of 2009 Calendar Year Distributions

In 2009, the Fund passed on a portion of its income to individuals in the form of qualified dividend income or QDI. Under federal law, QDI is taxed at a maximum 15% rate instead of an individual's ordinary income tax rate. In calendar year 2009, approximately 48.9% of distributions made by the Fund was eligible for QDI treatment. For an individual in the 28% tax bracket, this means that the Fund's total distributions will only be taxed at a blended 21.6% rate versus the 28% rate which would apply to distributions by a fund containing traditional corporate bonds. This tax advantage means that, all other things being equal, an individual in the 28% tax bracket who held 100 shares of Common Stock of the Fund for the calendar year would have had to receive approximately $66 in distributions from a traditional corporate bond fund to net the same after-tax amount as the $61 in distributions paid by the Fund.

For detailed information about the tax treatment of the particular distributions received from the Fund, please see the Form 1099 you receive from either the Fund or your broker.

Corporate shareholders also receive a federal tax benefit from the 35.1% of distributions that were eligible for the inter-corporate dividends received deduction or DRD.

It is important to remember that the composition of the portfolio and the income distributions can change from one year to the next, and that the QDI or DRD portions of 2010's distributions may not be the same (or even similar) to 2009.

As previously discussed, the Fund redeemed all of its outstanding auction preferred stock during the past year and began using debt for leverage. The following describes risks associated with leveraging the Fund through the use of borrowing, which do not materially differ from the risks the Fund formerly faced through leveraging using auction preferred stock.

Because the investment risk associated with investment assets purchased with funds obtained through leveraging is borne solely by each Fund's Common Stock shareholders, adverse movements in the price of the Fund's portfolio holdings would have a more severe effect on the Fund's net asset value than if the Fund were not leveraged. Leverage creates risks for the Fund's Common Stock shareholders, including the likelihood of greater volatility of the Fund's net asset value and the market price of its shares, and the risk that fluctuations in interest rates on borrowings may affect the return to Common Stock shareholders. If income from the securities purchased with such funds is not sufficient to cover the cost of leverage, net income of the Fund would be less than if leverage had not been used, and therefore the amount available for distribution to Common Stock shareholders as dividends will be reduced. In such an event, the Fund may nevertheless determine to maintain its leveraged position in order to avoid capital losses on securities purchased with the leverage. Further, all expenses associated with borrowing, such as interest expenses and transaction costs, will be borne solely by the Fund's Common Stock shareholders.

If the asset coverage for borrowing declines below the limits specified in the Investment Company Act of 1940 (the "1940 Act") or in the terms of the financing arrangement, the Fund might be required to sell a

portion of its investments when it is not advantageous to do so. In the extreme, sales of investments required to meet asset coverage tests imposed by the 1940 Act could also cause a Fund to lose its status as a regulated investment company under the Internal Revenue Code of 1986, as amended (the "Code"). If a Fund were unable to make adequate distributions to shareholders because of asset coverage or other restrictions, it could fail to qualify as a regulated investment company for federal income tax purposes, and, even if it did not fail to so qualify, it could become liable for income and excise tax on the portion of its earnings which are not distributed on a timely basis in accordance with applicable provisions of the Code.

On April 21, 2009, the Fund's shareholders approved a change in its concentration policy so that it will invest at least 25% of its total assets in each of the utilities industry and the financial services sector under normal market conditions. Formerly, the Fund invested more than 25% of its total assets in the utilities industry under normal market conditions and limited its investments in any other industry to 25%. The following describes risks associated with investing in the financial services sector.

U.S. and foreign laws and regulations require commercial banks and bank holding companies to maintain minimum levels of capital and liquidity, and to establish loan loss reserves. A bank's failure to maintain specified capital ratios may trigger dividend restrictions, suspensions on payments on subordinated debt, and limitations on growth. Bank regulators have broad authority in these instances and can ultimately impose sanctions, including conservatorship or receivership, on such non-complying banks even when these banks continue to be solvent, thereby possibly resulting in the elimination of stockholders' equity. Unless a bank holding company has subsidiaries other than banks that generate substantial revenues, the holding company's cash flow and ability to declare dividends may be impaired severely by restrictions on the ability of its bank subsidiaries to declare dividends.

Similarly, U.S. and foreign laws and regulations require insurance companies to maintain minimum levels of capital and liquidity. An insurance company's failure to maintain these capital ratios may also trigger dividend restrictions, suspensions on payments of subordinated debt, and limitations on growth. Insurance regulators (at the state-level in the United States) have broad authority in these instances and can ultimately impose sanctions, including conservatorship or receivership, on such non-complying insurance companies even when these companies continue to be solvent, thereby possibly resulting in the elimination of shareholders' equity. In addition, insurance regulators have extensive authority in some categories of insurance of approving premium levels and setting required levels of underwriting.

Governmental fiscal and monetary policies and general economic and political conditions can affect the availability and cost of funds to financial services companies, loan demand and asset quality and thereby impact the earnings and financial condition of financial services companies. In addition, the enactment of new legislation and regulation, as well as changes in the interpretation and enforcement of existing laws and regulations, may directly affect the manner of operations and profitability of participants in the financial services sector. Downturns in a national, regional or local economy or in the general business cycle or depressed conditions in an industry, for example, may adversely affect the quality or volume of a bank's loan portfolio or an insurance company's investment portfolio, particularly if the portfolio is concentrated in the affected region, industry or market sector. From time to time, general economic conditions have adversely affected financial institutions' energy, agricultural, commercial and/or residential real estate, less-developed country, venture capital, technology, telecommunications, and highly-leveraged loan portfolios.

Since September 2008, the financial services sector has experienced unprecedented turbulence. The U.S. economy's recession, led by the downturn in the housing industry, adversely affected the quality of most financial services companies' loan and securities portfolios. Loan charge-offs and mark-to-market losses have caused the capital ratios and overall financial condition of most financial services companies to deteriorate. In response, U.S. and foreign governments purchased significant equity capital positions in many banks and some insurance companies. Governments held a greater amount of preferred stock in some issuers than the total outstanding public preferred stock of that issuer. The full impact of government actions and deteriorating economic conditions is still unknown and could continue to adversely affect financial services companies. The impact of a deteriorating economy or industry upon institutions depends, in part, on the size of the institutions, the extent to which they are involved in the type of lending or market affected, the duration of the softening in the affected area and the managerial and capital resources of the financial institutions. In addition, changes in accounting rules applicable to loans and investment securities also may adversely impact the financial condition of these institutions.