PREFERRED INCOME STRATEGIES FUND INC
Form 497
March 26, 2003

PROSPECTUS

36,000,000 Shares
Preferred Income Strategies Fund, Inc.
Common Stock

Preferred Income Strategies Fund, Inc. is a newly organized, diversified, closed-end management investment company. The primary investment objective of the Fund is to provide stockholders with current income. The secondary investment objective of the Fund is to provide stockholders with capital appreciation. Under normal market conditions, at least 80% of the Fund s assets will be invested in a portfolio of preferred securities, including convertible preferred securities. The Fund intends to invest at least 80% of its total assets in preferred securities or debt securities that are rated investment grade or, if unrated, are considered by the Fund s investment adviser to be of comparable quality. The Fund may invest up to 20% of its total assets in preferred securities or debt securities that are rated below investment grade or, if unrated, are considered by the Fund s investment adviser to be of comparable quality. The Fund allocates its investments among various industries and among issuers in such industries. The Fund will invest at least 25% of its total assets in the industries comprising the financial services sector. The Fund also will emphasize investments in the industries comprising the utilities sector; however, the Fund will not invest 25% or more of its total assets in any one of the industries comprising

(continued on following page)

Investing in the Fund s common stock involves certain risks that are described in the Risk Factors and Special Considerations section beginning on page 7 of this prospectus.

	Per Share	Total
Public offering price	$25.00	$900,000,000
Underwriting discount	$1.125	$40,500,000
Proceeds, before expenses, to the Fund	$23.875	$859,500,000

The underwriters may also purchase up to an additional 5,400,000 shares at the public offering price, less the underwriting discount, within 45 days from the date of this prospectus to cover overallotments.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The shares will be ready for delivery on or about March 28, 2003.

Merrill Lynch & Co.

Advest, Inc.
Fahnestock & Co., Inc.
Morgan Keegan & Company, Inc.
Stifel, Nicolaus & Company
Incorporated

BB&T Capital Markets
a division of Scott & Stringfellow, Inc.
Janney Montgomery Scott LLC
Raymond James
Wells Fargo Securities, LLC

The date of this prospectus is March 25, 2003.

(continued from previous page)

the utilities sector. Emphasis on these sectors may subject the Fund to certain risks. Under current market conditions, the Fund expects to invest primarily in fully taxable preferred securities. The Fund may invest without limitation in U.S. dollar denominated securities of issuers domiciled outside the United States. There can be no assurance that the Fund s investment objectives will be realized.

Because the Fund is newly organized, its shares have no history of public trading. Shares of closed-end investment companies frequently trade at a price lower than (at a discount to) their net asset value. The risk may be greater for investors expecting to sell their shares in a relatively short period after completion of the public offering. The Fund s shares have been approved for listing on the New York Stock Exchange under the symbol PSY, subject to official notice of issuance.

The Fund may leverage through borrowings or the issuance of preferred stock or debt securities. Within approximately three to six months after completion of this offering of common stock, the Fund intends to offer shares of preferred stock representing approximately 36% of the Fund s capital, or approximately 56% of the Fund s common stock equity, immediately after the issuance of such preferred stock. There can be no assurance, however, that preferred stock representing such percentage of the Fund s capital will actually be issued. The use of preferred stock to leverage the common stock can create special risks. There can be no assurance that a leveraging strategy will be successful during any period in which it is employed.

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference.

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Information about the Fund can be reviewed and copied at the SEC s Public Reference Room in Washington, D.C. Call 1-202-942-8090 for information on the operation of the public reference room. This information is also available on the SEC s Internet site at http://www.sec.gov and copies may be obtained upon payment of a duplicating fee by writing the Public Reference Section of the SEC, Washington, D.C. 20549-0102.

You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

PROSPECTUS SUMMARY

This summary is qualified in its entirety by reference to the detailed information included in this prospectus.

The Fund Preferred Income Strategies Fund, Inc. is a newly organized, diversified, closed-end management investment company.

The Offering

The Fund is offering 36,000,000 shares of common stock at an initial offering price of $25.00 per share through a group of underwriters led by Merril Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch). You must purchase at least 100 shares of common stock. The underwriters may purchase up to an additional 5,400,000 shares of common stock within 45 days from the date of this prospectus to cover overallotments, if any.

Investment Objectives and Policies

The primary investment objective of the Fund is to provide stockholders with current income. The secondary investment objective of the Fund is to provide stockholders with capital appreciation. The Fund seeks to achieve its objectives by investing primarily in a portfolio of preferred securities, including convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer (preferred securities). The Fund may invest in fixed rate and adjustable rate securities. The Fund may invest in securities of any maturity. There can be no assurance that the Fund s investment objectives will be realized.

Preferred Securities. Under normal market conditions and after the initial investment period following this offering, the Fund will invest at least 80% of its assets in a portfolio of preferred securities. Based on the current market for preferred securities, the Fund expects to invest primarily in taxable preferred securities. Pursuant to Section 243 of the Internal Revenue Code of 1986, as amended (the Code), payments on taxable preferred securities do not qualify for the dividends received deduction (the Dividends Received Deduction). The Dividends Received Deduction generally allows corporations to deduct 70% of dividends received from their income. Since the Fund currently expects to invest primarily in taxable preferred securities, most of the Fund s distributions to stockholders will not qualify for the Dividends Received Deduction. In addition, it is expected that Fund distributions derived from income on taxable preferred securities will not be excludable from taxable income under certain proposals currently being discussed by federal government officials. Discussion of these proposals is ongoing, so their impact on the Fund and its stockholders cannot be predicted. Changes in the tax treatment of preferred securities and payments thereon may result in an increase in the supply of and demand for preferred securities making payments eligible for the Dividends Received Deduction. If such changes in the preferred securities market were to occur, the Fund may invest a greater percentage of its assets in preferred securities making payments eligible for the Dividends Received Deduction than is currently anticipated.

Debt Securities and Common Stock. The Fund may invest up to 20% of its total assets in debt securities, including convertible debt securities (debt securities). The Fund also may invest up to 20% of its total assets in common stocks. The Fund does not currently intend to invest directly in common stocks but may acquire and hold

common stock pursuant to a convertible feature in a security, in unit offerings, in an exchange offer, or in connection with a restructuring or bankruptcy of a portfolio security or similar transaction.

The allocation of the Fund s assets in various types of preferred, debt and equity securities may vary from time to time depending on the Investment Adviser s assessment of market conditions.

Credit Quality. Under normal market conditions and after the initial investment period following this offering, the Fund will invest at least 80% of its total assets in preferred securities and debt securities that are rated investment grade by the established rating services (Baa or higher by Moody s Investors Service, Inc. (Moody s), BBB or higher by Standard & Poor s (Standard & Poor s) or BBB or higher by Fitch, Inc. (Fitch)) or, if unrated, are considered by the Investment Adviser to be of comparable quality.

The Fund may invest up to 20% of its total assets in preferred securities or debt securities that are rated below investment grade (Ba or lower by Moody s, BB or lower by Standard & Poor s or BB or lower by Fitch) or, if unrated, are considered by the Investment Adviser to be of comparable quality, provided that such securities are issued by an issuer having outstanding a class of senior debt rated investment grade.

Foreign Securities. The Fund may invest without limitation in securities of issuers domiciled outside the United States, provided that the securities are U.S. dollar denominated investments or otherwise provide for payment to the Fund in U.S. dollars.

Portfolio Management Techniques. The Fund may use a variety of portfolio strategies both to increase the return of the Fund and to hedge, or protect, its exposure to interest rate movements and movements in the securities markets. These strategies include the use of derivatives, such as indexed securities, inverse securities, options, futures, options on futures, interest rate transactions, credit default swaps and short sales.

The Fund s hedging transactions are designed to reduce volatility but may come at some cost. For example, the Fund may try to limit its risk of loss from a decline in price of a portfolio security by purchasing a put option. However, the Fund must pay for the option, and the price of the security may not in fact drop. In large part, the success of the Fund s hedging activities depends on the Investment Adviser s ability to forecast movements in securities prices and interest rates. The strategies the Fund uses to enhance its return may be riskier and have more speculative aspects than its hedging strategies. The Fund is not required to use derivatives to enhance income or hedge its portfolio and may choose not to do so. The Fund cannot guarantee that any strategies it uses will work.

Investment Emphasis. The Fund will allocate its investments among industries and among issuers in such industries, based on the Investment Adviser s evaluation of market and economic conditions. The Fund expects to have significant exposure to the financial services sector and will invest at least 25% of its total assets in the industries

comprising the financial services sector. The Fund also will emphasize investments in the utilities sector; however, the Fund will not invest 25% or more of its total assets in any one of the industries comprising the utilities sector. Such emphasis may subject the Fund to certain risks.

Use of Leverage by the Fund

Issuance of Preferred Stock. The Fund may borrow money, issue debt securities or issue shares of preferred stock. The Fund may borrow money and issue debt securities in amounts up to 33$^{1}/3$%, and may issue shares of preferred stock in amounts up to 50%, of the value of its total assets to finance additional investments. Currently, the Fund intends to offer shares of preferred stock within approximately three to six months after completion of this offering. Under current market conditions it is anticipated that the preferred stock will represent approximately 36% of the Fund s capital, including the capital raised by issuing the preferred stock, or approximately 56% of the Fund s common stock equity. There can be no assurance, however, that preferred stock will actually be issued or if issued what percentage of the Fund s capital it will represent. Issuing preferred stock will result in the leveraging of the common stock. Although the Board of Directors has not yet determined the terms of the preferred stock offering, the Fund expects that the preferred stock will pay dividends that will be adjusted over either relatively short term periods (generally seven to 28 days) or medium term periods (up to five years). The preferred stock dividend rate will be based upon prevailing interest rates for debt obligations of comparable maturity. The money raised by the preferred stock offering will be invested in preferred securities and longer term obligations in accordance with the Fund s investment objectives. The expenses of the preferred stock, which will be borne by the Fund, will reduce the net asset value of the common stock. During periods when the Fund has preferred stock outstanding, the Fund will pay fees to the Investment Adviser for its services that are higher than if the Fund did not issue preferred stock, because the fees will be calculated on the basis of the Fund s average weekly net assets, including proceeds from the sale of preferred stock.

Potential Benefits of Leverage. Under normal market conditions, the Investment Adviser believes that the dividend and interest income on the Fund s portfolio should exceed the dividend rate the Fund must pay to the preferred stockholders. Thus, the Fund s use of preferred stock should provide common stockholders with a higher yield than they would receive if the Fund were not leveraged, although no assurance can be given that the issuance of preferred stock will result in a higher yield to common stockholders.

Risks of Leverage. The use of leverage creates certain risks for common stockholders, including higher volatility of both the net asset value and the market value of the common stock. Since any decline in the value of the Fund s investments will affect only the common stockholders, in a declining market the use of leverage will cause the Fund s net asset value to decrease more than it would if the Fund were not leveraged. This decrease in net asset value will likely also cause a decline in the market price for shares of common stock. In addition, fluctuations in the dividend rates paid on, and the amount of income allocable to, the preferred stock will affect

the yield to common stockholders. There can be no assurance that the dividend and interest income earned on the Fund s investments will be greater than the then current dividend rate the Fund pays on the preferred stock. Under certain conditions, the benefits of leverage to common stockholders will be reduced, and the Fund s leveraged capital structure could result in a lower yield to common stockholders than if the Fund were not leveraged.

During times of rising interest rates, the market value of the Fund s portfolio investments and, consequently, the net asset value of its shares may decline. The Fund s leveraging of its portfolio by issuing preferred stock may accentuate the potential decline. The Fund also may invest in inverse floating obligations and similar securities that create investment leverage, which may further accentuate any decline. Any investor who purchases shares with borrowed funds may experience an even greater decline.

Distributions. When the Fund issues preferred stock, common stockholders will receive all of the Fund s net income that remains after it pays dividends on the preferred stock and generally will be entitled to a pro rata share of net realized capital gains. If the Fund is liquidated, preferred stockholders will be entitled to receive liquidating distributions before any distribution is made to common stockholders. These liquidating distributions are expected to equal the original purchase price per share of the preferred stock plus any accumulated and unpaid dividends.

Redemption of Preferred Stock. The Fund may redeem the preferred stock for any reason. For example, the Fund may redeem all or part of the preferred stock if it believes that the Fund s leveraged capital structure will cause common stockholders to obtain a lower yield than they would if the common stock were unleveraged for any significant amount of time.

Voting Rights. Preferred stockholders, voting as a separate class, will be entitled to elect two of the Fund s Directors. Common and preferred stockholders, voting together as a single class, will be entitled to elect the remaining Directors. If the Fund fails to pay dividends to the preferred stockholders for two full years, the holders of all outstanding shares of preferred stock, voting as a separate class, would then be entitled to elect a majority of the Fund s Directors. The preferred stockholders also will vote separately on certain other matters as required under the Fund s Articles of Incorporation, the Investment Company Act of 1940, as amended, and Maryland law. Otherwise, common and preferred stockholders will have equal voting rights (one vote per share) and will vote together as a single class.

Ratings. Before it offers the preferred stock, the Fund intends to apply to one or more nationally recognized statistical rating organizations for ratings on the preferred stock. The Fund believes that a rating for the preferred stock will make it easier to market the stock, which should reduce the dividend rate.

Listing

Currently, there is no public market for the Fund s common stock. However, the Fund s shares of common stock have been approved for listing on the New York Stock Exchange under the symbol PSY, subject to official notice of issuance.

Investment Adviser

Fund Asset Management, L.P., the Investment Adviser, provides investment advisory and administrative services to the Fund. For its services, the Fund pays the Investment Adviser a monthly fee at the annual rate of 0.60% of the Fund s average weekly net assets (including assets acquired from the sale of any preferred stock), plus the proceeds of any outstanding borrowings used for leverage.

Dividends and Distributions

The Fund intends to distribute all or a portion of its net investment income monthly, and net realized capital gains, if any, at least annually. The Fund expects that it will commence paying dividends within 90 days of the date of this prospectus. Once the Fund issues preferred stock, the monthly dividends to common stockholders will consist of all or a portion of net investment income that remains after the Fund pays dividends on the preferred stock. At times, in order to maintain a stable level of monthly dividends to common stockholders, the Fund may, but is not required to, pay out less than all of its net investment income or pay out accumulated undistributed income in addition to net investment income. The Fund will distribute net capital gains, if any, at least annually to common stockholders and, after it issues the preferred stock, on a pro rata basis to common and preferred stockholders. The Fund may not declare any cash dividend or other distribution on its common stock unless the preferred stock has asset coverage of at least 200%. If the Fund issues preferred stock representing 36% of its total capital, the preferred stock s asset coverage will be approximately 278%. If the Fund s ability to make distributions on its common stock is limited, the Fund may not be able to qualify for taxation as a regulated investment company. This would have adverse tax consequences for stockholders.

Yield Considerations	The yield on the Fund s common stock will vary from period to period depending on factors including, but not limited to, the length of the initial investment period, market conditions, the timing of the Fund s investment in portfolio securities, the securities comprising the Fund s portfolio, the ability of the issuers of the portfolio securities to pay dividends or interest on such securities, changes in interest rates, including changes in the relationship between short term rates and long term rates, the amount and timing of borrowings and the issuance of the Fund s preferred stock or debt securities, the effects of leverage on the common stock discussed above under Leverage, the timing of the investment of leverage proceeds in portfolio securities, the Fund s net assets and its operating expenses. Consequently, the Fund cannot guarantee any particular yield on its shares, and the yield for any given period is not an indication or representation of future yields on Fund shares. The Fund s ability to achieve any particular yield level after it commences operations depends on future dividend and interest rates and other factors mentioned above, and the initial yield and later yields may be lower. Any statements as to the estimated yield are as of the date made, and no guarantee can be given that the Fund will achieve or maintain any particular yield level.

Automatic Dividend Reinvestment Plan	Dividend and capital gains distributions generally are used to purchase additional shares of the Fund s common stock. However, an investor can choose to receive distributions in cash. Since not all investors can participate in the automatic dividend reinvestment plan, you should call your broker or nominee to confirm that you are eligible to participate in the plan.
Mutual Fund Investment Option	Investors who purchase shares through Merrill Lynch in this offering and later sell their shares have the option, subject to certain conditions, to purchase Class D shares (to be re-designated Class A shares on or about April 14, 2003) of certain funds advised by the Investment Adviser or its affiliates with the proceeds from such sale.

RISK FACTORS AND SPECIAL CONSIDERATIONS

An investment in the Fund s common stock should not constitute a complete investment program.

Liquidity and Market Price of Shares. The Fund is newly organized and has no operating history or history of public trading.

Shares of closed-end management investment companies that trade in a secondary market frequently trade at a market price that is below their net asset value. This is commonly referred to as trading at a discount. Investors who sell their shares within a relatively short period after completion of the public offering are likely to be exposed to this risk. Accordingly, the Fund is designed primarily for long term investors and should not be considered a vehicle for trading purposes. Net asset value will be reduced following the offering by the underwriting discount and the amount of offering expenses paid by the Fund.

Market Risk and Selection Risk. Market risk is the risk that the market will go down in value, including the possibility that the market will go down sharply and unpredictably. Selection risk is the risk that the securities that Fund management selects will underperform the relevant market indices, or other funds with similar investment objectives and investment strategies.

Preferred Securities. The Fund invests primarily in a portfolio of preferred securities, including convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer. There are special risks associated with investing in preferred securities:

Subordination. Investments in preferred securities entail a higher level of credit risk than more senior debt instruments because preferred securities are subordinated to bonds and other debt instruments in an issuer s capital structure in terms of priority to corporate income and liquidation payments.

Limited Voting Rights. Holders of preferred securities usually have no voting rights with respect to the issuing company, although certain types of preferred securities provide their holders with the right to elect directors if preferred dividends have been in arrears for a specified number of periods. When those voting rights apply, once the issuer pays all the arrearages, the preferred security holders no longer have voting rights.

Redemption Rights. Certain preferred securities may contain special redemption features that grant the issuer of the preferred securities a right to redeem the securities prior to a specified date. As with all call provisions, a special redemption by the issuer may negatively impact the return of the security held by the Fund.

Deferral. Preferred securities also may include provisions that require or permit the issuer, at its discretion, to defer dividend distributions for a stated period or periods without any adverse consequences to the issuer. If the Fund owns a preferred security that is deferring its dividend distributions, the Fund may be required to report and possibly distribute income for tax purposes although it has not yet received such income.

Liquidity. Preferred securities may be substantially less liquid than many other securities, such as common stocks.

Non-Cumulative Preferred Securities. Dividends on non-cumulative preferred securities do not accrue. Unlike cumulative preferred securities, if a dividend on a share of non-cumulative preferred stock is not paid on the dividend payment date, that dividend ordinarily will never be paid.

Auction Rate or Remarketed Preferred Securities. Auction rate or remarketed preferred securities are adjustable preferred securities the dividends on which are determined at periodically held auctions or through remarketings. If sufficient bids do not exist at an auction (in case of auction rate preferred securities) or if a failed remarketing occurs (in the case of remarketed preferred securities), the Fund may not be able to sell all, and may not be able to sell any, of its auction rate or remarketed preferred securities through the auction or remarketing process. As a result, the Fund s investment in such stock may be illiquid.

Dividends Received Deduction. Based on the current market for preferred securities, the Fund expects to invest primarily in taxable preferred securities the income from which does not qualify for the Dividends Received Deduction under Section 243 of the Code. The Dividends Received Deduction generally allows corporations to deduct 70% of dividends received from domestic corporations from their income. Since, the Fund currently expects to invest primarily in taxable preferred securities, most of the Fund s distributions will not qualify for the Dividends Received Deduction. In addition, it is expected that Fund distributions derived from income on taxable preferred securities will not be excludable from taxable income under certain proposals currently being discussed by federal government officials. Discussion of these proposals is ongoing, so their impact on the Fund and its stockholders cannot be predicted. Changes in the tax treatment of preferred securities and payments thereon may result in an increase in the supply of and demand for preferred securities making payments eligible for the Dividends Received Deduction. If such changes in the preferred securities market were to occur, the Fund may invest a greater percentage of its assets in preferred securities making payments eligible for the Dividends Received Deduction than is currently anticipated.

Tax and Accounting Risk. The Fund may invest in preferred securities or other securities the federal income tax treatment of which may not be clear or may be subject to recharacterization by the Internal Revenue Service. It could be more difficult for the Fund to comply with the tax requirements applicable to regulated investment companies if the tax characterization of the Fund s investments or the tax treatment of the income from such investments were successfully challenged by the Internal Revenue Service. Additionally, the Financial Accounting Standards Board currently is reviewing accounting guidelines relating to taxable preferred securities. To the extent that a change in the guidelines could adversely affect the market for, and availability of, these securities, the Fund may be adversely affected.

Investment Emphasis. Under normal market conditions, the Fund will invest at least 25% of its total assets in the industries comprising the financial services sector. The Fund also will emphasize investments in the utilities sector; however, the Fund will not invest 25% or more of its total assets in any one of the industries comprising the utilities sector. The Fund is expected to have significant exposure to the companies comprising the financial services industries and, to a lesser extent, to the utilities industries. As a result, the Fund s investments may be subject to greater risk and market fluctuation than a fund that invests in securities representing a broader range of investment alternatives. These policies also make the Fund more susceptible to adverse economic or regulatory occurrences affecting the financial services and utilities industries.

Financial Services Sector Risk. The Fund s emphasis on securities of financial services companies makes it more susceptible to adverse conditions affecting such industries than a fund that does not have its assets invested to a similar degree in such issuers. Issuers in the financial services sector are subject to a variety of factors that may adversely affect their business or operations, including extensive regulation at the federal and/or state level and, to the extent that they operate internationally, in other countries, changes in prevailing interest rates, general economic conditions and other industry specific risks. See Other Investment Policies--Investment Emphasis.

Utilities Sector Risk. The Fund s emphasis on securities of utilities issuers makes it more susceptible to adverse conditions affecting such industries than a fund that does not have its assets invested to a similar degree in such issuers. Issuers in the utilities sector are subject to a variety of factors that may adversely affect their business or operations, including high interest costs in connection with capital construction programs, governmental regulations, the effects of economic slowdowns and surplus capacity, increased competition from other providers of utility services, technological innovations that may render existing plants, equipment or products obsolete, inexperience with and potential losses resulting from a developing deregulatory environment, increased costs and reduced availability of certain types of fuel, occasionally reduced availability and high costs of natural gas for resale, the effects of energy conservation, the effects of a national energy policy and lengthy delays and greatly increased costs and other problems associated with the design, construction, licensing, regulation and operation of nuclear facilities for electric generation See Other Investment Policies--Investment Emphasis.

Net Asset Value; Interest Rate Sensitivity; Credit Quality and Other Market Conditions. Generally, when interest rates go up, the value of fixed income securities, such as preferred and debt securities, goes down. Therefore, the net asset value of a fund that invests in fixed income securities changes as interest rates fluctuate. During periods of declining interest rates, an issuer may exercise its option to redeem preferred securities or prepay principal of debt securities earlier than scheduled, forcing the Fund to reinvest in lower yielding securities. During periods of rising interest rates, the average life of certain types of securities may be extended because of slower than expected principal payments. This may lock in a below market interest rate, increase the duration and reduce the value of the security. A decline in the credit quality or financial condition of issuers of fixed income securities in which the Fund invests may result in the value of such securities held by the Fund, and hence the Fund s net asset value, going down. A serious deterioration in the credit quality or financial condition of an issuer could cause a permanent decrease in the Fund s net asset value. Furthermore, volatility in the capital markets and other adverse market conditions may result in a decrease in the value of the securities held by the Fund. Given that the Fund uses market prices to value many of its investments, any decrease in the market value of the fixed income securities held by the Fund will result in a decrease in the Fund s net asset value.

Leverage. The Fund may borrow money, issue debt securities or issue preferred stock. The Fund may borrow money and issue debt securities in amounts up to $33^1/3$%, and may issue shares of preferred stock in amounts up to 50%, of the value of its total assets to finance additional investments. The Fund currently plans to issue preferred stock within approximately three to six months after the completion of this offering. Under current market conditions it is anticipated that the preferred stock will represent approximately 36% of the Fund s capital, including capital raised by issuing the preferred stock. There can be no assurance, however, that preferred stock will actually be issued, or if issued what percentage of the Fund s capital it will represent. Leverage creates certain risks for common stockholders, including higher volatility of both the net asset value and the market value of the common stock, because common stockholders bear the effects of changes in the value of the Fund s investments. Leverage also creates the risk that the investment return on shares of the Fund s common stock will be reduced to the extent the dividends paid on preferred stock and other expenses of the preferred stock exceed the dividend and interest income earned by the Fund on its investments. If the Fund is liquidated, preferred stockholders will be entitled to receive liquidating distributions before any distribution is made to common stockholders.

Portfolio Management Techniques. The Fund may engage in various portfolio strategies both to increase the return of the Fund and to hedge its portfolio against adverse effects from movements in interest rates and in the securities markets. These strategies include the use of derivatives, such as indexed securities, inverse securities, options, futures, options on futures, interest rate transactions, credit default swaps and short sales. Such strategies subject the Fund to the risk that, if the Investment Adviser incorrectly forecasts market values, interest rates or other applicable factors, the Fund s performance could suffer. Certain of these strategies such as inverse securites, credit default swaps and short sales may provide investment leverage to the Fund s portfolio and result in many of the same risks of leverage to holders of the Fund s common stock as discussed above under Leverage. The Fund is not required to use derivatives or other portfolio strategies to enhance income or to hedge its portfolio and may not do so. There can be no assurance that the Fund s portfolio strategies will be effective. Some of the derivative strategies that the Fund may use to enhance its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Fund s risk of loss.

Short Sales. The Fund may make short sales of securities. A short sale is a transaction in which the Fund sells a security it does not own in anticipation that the market price of that security will decline. When the Fund makes a short sale, it must borrow the security sold short and deliver it to the broker dealer through which it made the short sale as collateral for its obligation to deliver the security upon conclusion of the sale. The Fund s obligation to replace the borrowed security will be secured by collateral deposited with the broker dealer, usually cash, U.S. government securities or other liquid securities similar to those borrowed. The Fund will also be required to deposit similar collateral with its custodian. If the price of the security sold short increases between the time of the short sale and the time the Fund replaces the borrowed security, the Fund will incur a loss. The Fund also may make a short sale (against the box) by selling a security that the Fund owns or has the right to acquire without the payment of further consideration. The Fund s potential for loss is greater if it does not own the security that it is short selling.

Options and Futures Transactions. The Fund may engage in options and futures transactions to reduce its exposure to interest rate movements or to enhance its return. If the Fund incorrectly forecasts market values, interest rates or other factors, the Fund s performance could suffer. The Fund also may suffer a loss if the other party to the transaction fails to meet its obligations. The Fund is not required to enter into options and futures transactions for hedging purposes or to enhance its return and may choose not to do so.

Interest Rate Swaps. In order to hedge the value of the Fund s portfolio against interest rate fluctuations or to enhance the Fund s return the Fund may enter into interest rate swap transactions. In swap transactions, there is a risk that yields will move in the direction opposite of the direction anticipated by the Fund, which would cause the Fund to make payments to its counterparty in the transaction that could adversely affect Fund performance. The Fund is not required to enter into interest rate swaps for hedging purposes or to enhance its return and may choose not to do so.

Foreign Securities. The Fund may invest without limitation in securities of issuers domiciled outside the United States, provided that the securities are U.S. dollar denominated or otherwise provide for payment to the Fund in U.S. dollars. The Fund s investments in such issuers involve certain risks that are not involved in domestic investments, including fluctuation in foreign interest rates, future foreign political and economic developments and the possible imposition of exchange controls or other governmental laws or regulations.

Liquidity of Investments. Certain fixed income securities, including preferred and debt securities, in which the Fund invests may lack an established secondary trading market or are otherwise considered illiquid. Liquidity of a security relates to the ability to easily dispose of the security and the price to be obtained and does not generally relate to the credit risk or likelihood of receipt of cash at maturity. Illiquid securities may trade at a discount from comparable, more liquid investments.

Debt Securities. The Fund may invest up to 20% of its total assets in debt securities. Debt securities, such as bonds, involve credit risk. This is the risk that the borrower will not make timely payments of principal and interest. The degree of credit risk depends on the issuer s financial condition and on the terms of the bonds. These securities are also subject to interest rate risk. This is the risk that the value of the security may fall when interest rates rise. In general, the market price of debt securities with longer maturities will go up or down more in response to changes in interest rates than the market price of shorter term securities.

High Yield Securities. The Fund may invest up to 20% of its total assets in preferred securities or debt securities that are rated below investment grade or, if unrated, are considered by the Investment Adviser to be of comparable quality. Non-investment grade securities are often referred to as high yield securities, or in the case of non-investment grade debt securities, junk bonds. Investments in high yield securities entail a higher level of credit risk (loss of income and/or principal) than investments in higher rated securities. Securities rated in the lower rating categories are considered to be predominantly speculative with respect to capacity to pay interest and repay principal. Issuers of high yield securities may be highly leveraged and may not have available to them more traditional methods of financing. New issuers also may be inexperienced in managing their debt burden. The issuer s ability to service its debt obligations may be adversely affected by business developments unique to the issuer, the issuer s inability to meet specific projected business forecasts or the inability of the issuer to obtain additional financing. High yield securities are often unsecured and subordinated to other creditors of the issuer.

Convertible Securities and Common Stock. The preferred securities and debt securities in which the Fund invests may be convertible into the issuer s or a related party s common shares. Convertible securities generally offer lower dividend yields or interest rates than non-convertible securities of similar quality. As with all fixed income securities, the market values of the fixed convertible securities that the Fund may invest in tend to decline as interest rates increase and, conversely, to increase as interest rates decline. However, when the market price of the common stock underlying a convertible security exceeds the conversion price, the convertible security tends to reflect the market price of the underlying common stock. As the market price of the underlying common stock declines, the convertible security tends to trade increasingly on a yield basis and thus may not decline in price to the same extent as the underlying common stock.

The Fund may invest up to 20% of its total assets in common stocks. The Fund does not currently intend to invest directly in common stocks but may acquire and hold common stocks pursuant to a convertible feature in a security, in unit offerings, in an exchange offer, or in connection with a restructuring or bankruptcy of the security or similar transactions. Common stocks may be more susceptible to adverse changes in market value due to issuer specific events or general movements in the equities markets.

Rating Agencies. The Fund may be subject to guidelines of one or more nationally recognized statistical ratings organizations that may issue ratings for its preferred stock. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act and may prohibit or limit the use by the Fund of certain portfolio management techniques or investments. The Fund does not expect these guidelines to prevent the Investment Adviser from managing the Fund s portfolio in accordance with the Fund s investment objectives and policies.

Market Disruption. The terrorist attacks in the United States on September 11, 2001 have had a disruptive effect on the securities markets, some of which were closed for a four-day period. These terrorist attacks and related events, including current U.S. military actions in Iraq, have led to increased short term market volatility and may have long term effects on U.S. and world economies and markets. Similar disruptions of the financial markets could impact interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the Fund s common stock.

Antitakeover Provisions. The Fund s Articles of Incorporation and By-laws and the General Corporation Law of the State of Maryland include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Directors. Such provisions could limit the ability of stockholders to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund.

FEE TABLE

Stockholder Transaction Fees:	
Maximum Sales Load (as a percentage of offering price)	4.50%
Offering Expenses Borne by the Fund (as a percentage of offering price)(a)	0.06%
Dividend Reinvestment Plan Fees	None
Annual Expenses (as a percentage of net assets attributable to common stock):	
Investment Advisory Fee(b)(c)	0.94%
Interest Payments on Borrowed Funds	None
Other Expenses(b)(c)	0.23%
Total Annual Expenses(b)(c)	1.17%

(a) The Investment Adviser has agreed to pay all of the Fund s organizational expenses. Offering costs will be paid by the Fund. The offering costs to be paid by the Fund are not included in the annual expenses shown in the table. Offering costs borne by common stockholders will result in a reduction of capital of the Fund attributable to common stock. If the Fund offers preferred stock in an amount equal to approximately 36% of the Fund s capital, the costs of that offering, estimated to be approximately 1.11% of the total dollar amount of the preferred stock offering, will be effectively borne by the common stockholders and result in a reduction of the net asset value of the shares of common stock. These preferred stock offering costs are estimated to be approximately $0.16 per share of common stock (0.64% of the offering price).

(b) See Investment Advisory and Management Arrangements page 43.

(c) Assumes leverage by issuing preferred stock in an amount equal to approximately 36% of the Fund s capital at a dividend rate of 1.20%. The Fund intends to use leverage only if the Investment Adviser believes that it would result in a higher yield to common stockholders over time. See Risk Factors and Special Considerations Leverage and Risks and Special Considerations of Leverage. If the Fund does not use leverage, it is estimated that, as a percentage of net assets attributable to common stock, the Investment Advisory Fee would be 0.60%, Interest Payments on Borrowed Funds would be 0.00%, Other Expenses would be 0.09% and Total Annual Expenses would be 0.69%.

EXAMPLE:

	1 Year	3 Years	5 Years	10 Years
An investor would pay the following expenses (including the sales load of $45, estimated offering expenses of this offering of $0.60 and the estimated preferred stock offering costs assuming the Fund offers preferred stock in an amount equal to approximately 36% of the Fund s capital (after issuance) of $6.40) on a $1,000 investment, assuming total annual expenses of 1.17% and a 5% annual return throughout the periods	$63	$87	$113	$187

The Fee Table is intended to assist investors in understanding the costs and expenses that a stockholder in the Fund will bear directly or indirectly. The expenses set forth under Other Expenses are based on estimated amounts through the end of the Fund s first fiscal year. The Example set forth above assumes reinvestment of all dividends and distributions and utilizes a 5% annual rate of return as mandated by Securities and Exchange Commission (the Commission) regulations. **The Example should not be considered a representation of future expenses or annual rate of return, and actual expenses, leverage amount or annual rate of return may be more or less than those assumed for purposes of the Example.**

THE FUND

Preferred Income Strategies Fund, Inc. (the Fund) is a newly organized, diversified, closed-end management investment company. The Fund was incorporated under the laws of the State of Maryland on January 23, 2003, and has registered under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund s principal office is located at 800 Scudders Mill Road, Plainsboro, New Jersey 08536, and its telephone number is (609) 282-2800.

The Fund is organized as a closed-end investment company. Closed-end investment companies differ from open-end investment companies (commonly referred to as mutual funds) in that closed-end investment companies do not redeem their securities at the option of the stockholder, whereas open-end investment companies issue securities redeemable at net asset value at any time at the option of the stockholder and typically engage in a continuous offering of their shares. Accordingly, open-end investment companies are subject to continuous asset in-flows and out-flows that can complicate portfolio management. However, shares of closed-end investment companies frequently trade at a discount from net asset value. This risk may be greater for investors expecting to sell their shares in a relatively short period after completion of the public offering.

The Board of Directors of the Fund may at any time consider a merger, consolidation or other form of reorganization of the Fund with one or more other closed-end investment companies advised by the Fund s Investment Adviser with similar investment objectives and policies as the Fund. Any such merger, consolidation or other form of reorganization would require the prior approval of the Board of Directors and the stockholders of the Fund. See Description of Capital Stock Certain Provisions of the Articles of Incorporation and By-Laws.

USE OF PROCEEDS

The net proceeds of this offering will be approximately $858,890,000 (or approximately $987,815,000 assuming the underwriters exercise the overallotment option in full) after payment of offering costs estimated to be approximately $610,000 and the deduction of the underwriting discount.

Due to current illiquidity and scarcity of available securities in the preferred securities markets, investments that in the judgment of the Investment Adviser are appropriate investments for the Fund may not be immediately available. Therefore, the Fund expects that there will be an initial investment period of between three and six months following the completion of its common stock offering, depending on market conditions and the availability of appropriate securities, before it is invested in accordance with its investment objectives and policies. Pending such investment, it is anticipated that all or a portion of the proceeds will be invested in U.S. Government securities or high grade, short term money market instruments. A relatively long initial investment period may have a negative impact on the yield on the Fund s common stock and return to stockholders. See Investment Objectives and Policies.

INVESTMENT OBJECTIVES AND POLICIES

The primary investment objective of the Fund is to provide stockholders with current income. The secondary investment objective of the Fund is to provide stockholders with capital appreciation. The Fund s investment objectives are fundamental policies and may not be changed without the approval of a majority of the outstanding voting securities of the Fund (as defined in the 1940 Act).

The Fund seeks to achieve its objectives by investing primarily in a portfolio of preferred securities, including convertible preferred securities that may be converted into common stock or other securities of the same or a different issuer (preferred securities). Under normal market conditions and often the initial investment period following the offering, the Fund will invest at least 80% of its assets in preferred securities. For this purpose, assets means net assets, including assets acquired from the sale of preferred stock, plus the amount of any borrowings for investment purposes. This is a non-fundamental policy and may be changed by the Board of Directors of the Fund provided that stockholders are provided with at least 60 days prior notice of any change as required by the rules under the 1940 Act. Under normal market conditions, the Fund intends to invest primarily in fully taxable preferred securities. The Fund s portfolio of preferred securities may include both fixed and adjustable rate securities. There can be no assurance that the Fund s investment objectives will be realized.

The Fund may invest without limitation in securities of issuers domiciled outside the United States that are U.S. dollar denominated investments or otherwise provide for payment to the Fund in U.S. dollars.

The Fund allocates its investments among various industries and among issuers in such industries based on the Investment Adviser s evaluation of market and economic conditions. Under normal circumstances, the Fund will invest at least 25% of its total assets in the industries comprising the financial services sector. The Fund also will emphasize investments in the utilities sector; however, the Fund will not invest 25% or more of its total assets in any one of the industries comprising the utilities sector. Emphasis on these sectors may subject the Fund to certain risks.

Under normal market conditions, and after the initial investment period following this offering the Fund will invest at least 80% of its total assets in preferred securities or debt securities that are rated investment grade by the established rating services (Baa or higher by Moody s Investors Service, Inc. (Moody s), BBB or higher by Standard & Poor s (Standard & Poor s) or BBB or higher by Fitch, Inc. (Fitch)) or, if unrated, are considered by Fund Asset Management, L.P. (the Investment Adviser) to be of comparable quality. The Fund may invest up to 20% of its total assets in securities rated below investment grade (Ba or lower by Moody s, BB or lower by Standard & Poor s or BB or lower by Fitch) or, if unrated, are considered by the Investment Adviser to be of comparable quality, provided that such securities are issued by an issuer having outstanding a class of senior debt rated investment grade.

Securities rated Baa by Moody s, BBB by Standard & Poor s or BBB by Fitch, although investment grade, are considered to have speculative characteristics. Securities rated Baa by Moody s are considered by Moody s as medium to lower medium grade securities; they are neither highly protected nor poorly secured; dividend or interest payments and capital or principal security, as the case may be, appear to Moody s to be adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over time; and in the opinion of Moody s, securities in this rating category lack outstanding investment characteristics. Standard & Poor s regards such securities as having an adequate capacity to pay dividends or interest and repay capital or principal, as the case may be; whereas such securities normally exhibit adequate protection parameters, adverse economic conditions or changing circumstances are more likely, in the opinion of Standard & Poor s, to lead to a weakened capacity to pay dividends or interest and repay capital or principal for securities in this category than in higher rating categories. Securities rated BBB by Fitch are considered by Fitch to have adequate capacity for timely payment of financial commitments, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. Securities rated Ba by Moody s, BB by Standard & Poor s and BB by Fitch are considered to have speculative elements and a greater vulnerability to default than higher rated securities. Below investment grade securities and comparable unrated securities involve substantial risk of loss, are considered speculative with respect to the issuer s ability to pay interest and any required redemption or principal payments and are susceptible to default or decline in market value due to adverse economic and business

developments. The descriptions of the investment grade rating categories by Moody s, Standard & Poor s and Fitch, including a description of their speculative characteristics, are set forth in Appendix A. All references to securities ratings by Moody s, Standard & Poor s and Fitch in this prospectus shall, unless otherwise indicated, include all securities within each such rating category (*i.e.*, Baa1, Baa2 and Baa3 in the case of Moody s, BBB+ and BBB- in the case of Standard & Poor s and BBB+ and BBB- in the case of Fitch). All percentage and ratings limitations on securities in which the Fund may invest apply at the time of making an investment and shall not be considered violated if an investment rating is subsequently downgraded to a rating that would have precluded the Fund s initial investment in such security. In the event that the Fund disposes of a portfolio security subsequent to its being downgraded, the Fund may experience a greater risk of loss than if such security had been sold prior to such downgrade.

The Fund also may invest up to 20% of its total assets in common stocks. The Fund does not currently intend to invest directly in common stocks but may acquire and hold common stocks pursuant to a convertible feature in a security, in unit offerings, in an exchange offer, or in connection with a restructuring or bankruptcy of the security or similar transactions.

The allocation of the Fund s assets in various types of preferred, debt and equity securities may vary from time to time depending on the Investment Adviser s assessment of market conditions.

Investment in the common stock of the Fund offers the individual investor several potential benefits. The Fund offers investors the opportunity to receive current income by investing in a professionally managed portfolio comprised primarily of preferred securities, some of which are a type of investment typically not offered to individual investors. The Investment Adviser provides professional management, which includes the extensive credit analysis needed to invest in preferred securities, foreign securities, junk bonds and convertible securities. In addition to using the credit rating provided by independent rating agencies, the Investment Adviser independently evaluates the creditworthiness of the portfolio securities held by the Fund. The Fund also relieves the investor of the burdensome administrative details involved in managing a portfolio of such investments. Additionally, the Investment Adviser may seek to enhance the yield of the Fund s common stock by leveraging the Fund s capital structure through borrowings or the issuance of short term debt securities or shares of preferred stock. These benefits are at least partially offset by the expenses involved in running an investment company. Such expenses primarily consist of advisory fees and operational costs. The use of leverage also involves certain expenses and risk considerations. See Risks and Special Considerations of Leverage Effects of Leverage.

The Fund may engage in various portfolio strategies to seek to enhance its return or to hedge its portfolio against movements in interest rates through the use of derivatives, such as indexed and inverse securities, options, futures, options on futures, interest rate transactions, credit default swaps and short selling. Each of these portfolio strategies is described below. There can be no assurance that the Fund will employ these strategies or that, if employed, they will be effective.

The Fund may vary its investment policies for temporary defensive purposes during periods in which the Investment Adviser believes that conditions in the securities markets or other economic, financial or political conditions warrant. Under such conditions, the Fund for temporary defensive purposes may invest up to 100% of its total assets in securities issued or guaranteed by the United States Government or its instrumentalities or agencies, certificates of deposit, bankers acceptances and other bank obligations, commercial paper rated in the highest category by an established rating agency, or other debt securities deemed by the Investment Adviser to be consistent with a defensive posture, or may hold its assets in cash.

The Fund may invest in, among other things, the types of instruments described below:

Description of Preferred Securities

General. Under normal market conditions the Fund will invest at least 80% of its total assets in preferred securities. Generally, preferred securities receive dividends in priority to distributions on common stock and usually have a priority of claim over common stockholders if the issuer of the stock is liquidated. Preferred securities include hybrid or taxable preferred securities and traditional preferred stocks whose dividends qualify for the Dividends Received Deduction as described below. Preferred securities have certain characteristics of both debt and equity securities. Like debt securities, preferred securities rate of income is generally contractually fixed. Like equity securities, preferred securities do not have rights to precipitate bankruptcy filings or collection activities in the event of missed payments. Furthermore, preferred securities are generally in a subordinated position in an issuer s capital structure and their values are heavily dependent on the profitability of the issuer rather than on any legal claims to specific assets or cash flows.

Taxable Preferred Securities. Based on current market conditions, the Fund intends to invest primarily in taxable preferred securities (often referred to as hybrid preferred securities), the payments on which are not eligible for the dividends received deduction allowed to corporate shareholders (Dividends Received Deduction) pursuant to Section 243 of the Internal Revenue Code of 1986, as amended (the Code). Such payments constitute deductible interest expense for issuers thereof rather than dividends eligible for the Dividends Received Deduction. Pursuant to Section 243 of the Code, corporations generally may deduct 70% of the dividend income they receive from domestic corporations. Corporate stockholders of a regulated investment company, for which status the Fund intends to qualify, generally are permitted to claim a deduction with respect to that portion of their dividend distributions attributable to amounts received by the regulated investment company that qualify for the Dividends Received Deduction. However, many preferred securities pay dividends that are not eligible for the Dividends Received Deduction. The taxable preferred securities in which the Fund intends to invest typically offer additional yield spread versus other types of preferred securities due to the fact that payments made with respect to such preferred securities do not qualify for the Dividends Received Deduction. Accordingly, any corporate stockholder should assume that none of the distributions it receives from the Fund will qualify for the Dividends Received Deduction. In addition, it is expected that Fund distributions derived from income on taxable preferred securities will not be excludable from taxable income under certain proposals currently being discussed by federal government officials. Discussion of these proposals is ongoing, so their impact on the Fund and its stockholders cannot be predicted. Changes in the tax treatment of preferred securities and payments thereon may result in an increase in the supply of and demand for preferred securities making payments eligible for the Dividends Received Deduction. If such changes in the preferred securities market were to occur, the Fund may invest a greater percentage of its assets in preferred securities making payments eligible for the Dividends Received Deduction than is currently anticipated. Taxable preferred securities are a comparatively new asset class. Taxable preferred securities include but are not limited to: trust originated preferred securities, monthly income preferred securities, quarterly income bond securities, quarterly income debt securities, quarterly income preferred securities, corporate trust securities, public income notes and other trust preferred securities.

Taxable preferred securities are typically issued by an affiliated business trust of a corporation, generally in the form of beneficial interests in subordinated debentures or similarly structured securities. The taxable preferred securities market consists of both fixed and adjustable coupon rate securities that are either perpetual in nature or have stated maturity dates. The taxable preferred securities market is generally divided into the $25 par and the institutional segments. The $25 par segment is typified by securities that are listed on the New York Stock Exchange (the NYSE), which trade and are quoted flat (*i.e.*, without accrued dividend income

that is not included in the trading price) and which are typically callable at par value five years after their original issuance date. The institutional segment is typified by $1,000 par value securities that are not exchange listed, which trade and are quoted on an accrued income basis, and which typically have a minimum of 10 years of call protection (at premium prices) from the date of their original issuance.

Taxable preferred securities normally constitute junior and fully subordinated liabilities of an issuer or the beneficiary of a guarantee that is junior and fully subordinated to the other liabilities of the guarantor. In addition, taxable preferred securities often permit the issuer to defer the payment of income for a specified period, which may be eighteen months or more, without triggering an event of default. Because of their subordinated position in the capital structure of an issuer, the ability to defer payments for extended periods of time without adverse consequence to the issuer, and certain other features (such as restrictions on common dividend payments by the issuer or ultimate guarantor when cumulative payments on the taxable preferred securities have not been made), issuers and investors generally treat taxable preferred securities as close substitutes for traditional preferred securities. Taxable preferred securities have many of the key characteristics of equity due to their subordinated position in an issuer s capital structure and because their quality and value are heavily dependent on the profitability of the issuer rather than on any legal claims to specific assets or cash flows.

Taxable preferred securities are often issued with a final maturity date, although some are perpetual in nature. In certain instances, the final maturity date may be extended and/or the final payment of principal may be deferred at the issuer s option for a specified time without any adverse consequence to the issuer. No redemption can typically take place unless all cumulative payment obligations have been met, although issuers may be able to engage in open-market repurchases without regard to any cumulative dividends payable. A portion of the portfolio may include investments in non-cumulative preferred securities, whereby the issuer does not have an obligation to make up any arrearages to its stockholders. Should an issuer default on its obligations under such a security, the amount of dividends the Fund pays to stockholders may be adversely affected.

Many taxable preferred securities are issued by trusts or other special purpose entities established by operating companies, and are not direct obligations of the operating company. At the time a trust or special purpose entity sells its preferred securities to investors, the trust or special purpose entity purchases debt of the operating company (with terms comparable to those of the securities issued by the trust or special purpose entity), which enables the operating company to deduct for federal income tax purposes the interest paid on the debt held by the trust or special purpose entity. The trust or special purpose entity is generally required to be treated as transparent for federal income tax purposes such that the holders of the taxable preferred securities are treated as owning beneficial interests in the underlying debt of the operating company.

Accordingly, dividend payments made with respect to such taxable preferred securities are treated as interest rather than dividends for federal income tax purposes and, as such, are not eligible for the Dividends Received Deduction. The trust or special purpose entity in turn would be a holder of the operating company s debt and would have priority with respect to the operating company s assets over the operating company s common stockholders, but would typically be subordinated to other classes of the operating company s debt. Typically a taxable preferred security has a rating that is slightly below that of its corresponding operating company s senior debt securities. As a result of their subordinated position in an issuer s capital structure, taxable preferred securities typically offer investors a higher interest payment compared to the senior debt securities of the operating company.

Traditional Fixed Rate Preferred Securities. Unlike taxable preferred securities, traditional fixed rate preferred securities generally have fixed dividend rates for the life of the issue and typically, unless issued by a foreign corporation, pay dividends that qualify for the Dividends Received Deduction. They can be perpetual, with no

mandatory redemption date, or issued with a fixed mandatory redemption date. Certain issues of preferred securities are convertible into other equity securities. Perpetual preferred securities provide a fixed dividend throughout the life of the issue, with no mandatory retirement provisions, but may be callable. Sinking fund preferred securities provide for the redemption of a portion of the issue on a regularly scheduled basis with, in most cases, the entire issue being retired at a future date. The value of fixed rate preferred securities can be expected to vary inversely with interest rates. Certain fixed rate preferred securities have features intended to provide some degree of price stability. These features may include an auction mechanism at some specified future date. The auction feature is normally intended to enhance the probability that a preferred securities stockholder will be able to dispose of its holdings close to a pre-specified price, typically equal to par or a stated value. Other price stability mechanisms include convertibility into an amount of common equity of the same issuer at some specified future date, typically in amounts not greater than par value of the underlying preferred securities. Another common form of fixed rate preferred securities is the traditional convertible preferred security, which permits the holder to convert into a specified number of shares at the holder s option at any time prior to a specified date. Innovative preferred securities and convertible preferred securities are less liquid than the traditional fixed rate preferred security.

Dividends on any series of preferred stock may be cumulative or non-cumulative. Cumulative dividends accumulate until paid out, so if on the dividend payment date no dividend is declared such obligation will exist and take precedence over any common stock dividends until paid out. Non-cumulative dividends do not accrue and any omitted dividends will never be paid.

Adjustable Rate Preferred Securities. Unlike traditional fixed rate preferred securities, adjustable rate preferred securities are preferred securities that have a dividend rate that adjusts periodically to reflect changes in the general level of interest rates. Adjustable rate preferred securities generally pay dividends that qualify for the Dividends Received Deduction. The adjustable feature is intended to make the market value of these securities less sensitive to changes in interest rates than similar securities with fixed dividend rates.

The dividend rate on adjustable rate preferred securities typically is determined quarterly according to an adjustment formula established at the time of issuance of such securities that cannot be changed without approval of the holders thereof. Although adjustment formulas vary among issues, they typically involve a fixed relationship either to: (1) rates on specific classes of debt securities issued by the U.S. Treasury, such as the highest base rate yield of the 90-day Treasury bill, the 10-year Treasury note, or either the 20-year or 30-year Treasury bond or (2) London Interbank Offered Rate, with limits (known as collars) on the minimum dividend rate that may be paid. As the maximum dividend rate is approached, any further increase in interest rates may adversely affect the market value of the stock. As the minimum dividend rate is approached, any further decrease in interest rates may positively affect the market value of the preferred securities.

The market values of outstanding issues of adjustable rate preferred securities may fluctuate in response to changing market conditions. In the event that market participants in a particular issue demand a different yield than the adjustment formulas produce, the market price will change to produce the desired yield. The dividend yield demanded by market participants may vary with changing perceptions of credit quality and the relative levels of short term and long term interest rates, as well as other factors. Most of the adjustable rate preferred securities currently outstanding are perpetual.

Auction Rate Preferred Securities. Auction rate preferred securities pay dividends that adjust based upon periodic auctions. Such preferred securities are similar to short term corporate money market instruments in that an auction rate preferred stockholder has the opportunity to sell the preferred securities at par in an auction, through which buyers set the dividend rate in a bidding process for the next pre-determined dividend period. The dividend rate set in the auction depends upon market conditions and the credit quality of the particular issuer.

Typically, the auction rate preferred securities dividend rate is limited to a specified maximum percentage of an external commercial paper index as of the auction date. Further, the terms of auction rate preferred securities generally provide that they are redeemable by the issuer at certain times or under certain conditions.

Remarketed Preferred Securities. Like buyers of auction rate preferred securities, buyers of shares of a series of remarketed preferred securities receive a uniform dividend rate. In a remarketing, however, unlike an auction, the dividend rate and dividend period are set by remarketing agents, taking into account sell and hold orders from existing holders, the rates and number of shares sought by potential buyers and prevailing market conditions. During the remarketing process, remarketing agents use their reasonable best efforts to remarket the remarketed preferred securities tendered for sale in the remarketing. The dividend rate for each dividend period will be the rate per annum that the remarketing agents determine, in their sole discretion, to be the lowest rate, giving effect to the allocation of shares of remarketed preferred stock among dividend periods of different lengths, that will enable the remarketing agents to sell at par all shares tendered for sale in the remarketing.

From time to time, preferred