

PIMCO Floating Rate Strategy Fund  
Form 497  
December 17, 2004  
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File Nos. 333-120227 and 811-21601

PROSPECTUS

**\$480,000,000**

**PIMCO Floating Rate Strategy Fund**

**Auction Market Preferred Shares ( AMPS )**

**3,840 Shares, Series M**

**3,840 Shares, Series T**

**3,840 Shares, Series W**

**3,840 Shares, Series TH**

**3,840 Shares, Series F**

**Liquidation Preference \$25,000 per Share**

*Investment Objective.* PIMCO Floating Rate Strategy Fund (the Fund ) is a recently organized, diversified, closed-end management investment company. The Fund's investment objective is to seek high current income, consistent with the preservation of capital.

*The Offering.* The Fund is simultaneously offering 3,840 Series M Auction Market Preferred Shares ( Series M AMPS ), 3,840 Series T Auction Market Preferred Shares ( Series T AMPS ), 3,840 Series W Auction Market Preferred Shares ( Series W AMPS ), 3,840 Series TH Auction Market Preferred Shares ( Series TH AMPS ) and 3,840 Series F Auction Market Preferred Shares ( Series F AMPS ). These shares are referred to together in this prospectus as AMPS or the AMPS. The AMPS will not be listed on any exchange. Generally, investors may only buy and sell the AMPS through an order placed at an auction with or through a broker-dealer that has entered into an agreement with the auction agent or in a secondary market that certain broker-dealers may maintain. These broker-dealers are not required to maintain a market in the AMPS, and a secondary market, if one develops, may not provide investors with liquidity.

*Portfolio Management Strategies.* The Fund is actively managed in accordance with the portfolio manager's top down short-term (cyclical) and longer-term (secular) economic outlook, using strategies that focus on credit quality analysis, broad market diversification among industries and sectors and other risk

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management techniques. The portfolio manager attempts to identify investments that provide high current income through fundamental research, driven by independent credit analysis and proprietary analytical tools, and also uses a variety of techniques designed to control risk and minimize exposure to issues that the portfolio manager believes are more likely to default or otherwise depreciate in value over time. Under normal market conditions, the Fund seeks to achieve its investment objective by investing at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, a substantial portion of which will be senior floating rate loans, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments. Senior floating rate loans generally hold the most senior position in the capital structure of a borrower and are often secured with collateral. The Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in senior floating rate loans and other debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's Investors Service, Inc. (Moody's)), below BBB- by either Standard & Poor's (S&P) or Fitch, Inc. (Fitch Ratings), or below a comparable rating by Dominion Bond Rating Service Limited (Dominion), or unrated but judged by the portfolio manager to be of comparable quality. The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC+/Caa1 or lower by each agency rating the security or that are unrated but judged by the portfolio manager to be of comparable quality. **Debt securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as high yield securities or junk bonds. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.**

*(continued on following page)*

**Investing in the AMPS involves certain risks. You should read the discussion of material risks of investing in the Fund in Risks beginning on page 39 of this prospectus. Certain of these risks are summarized in Prospectus Summary Special Risk Considerations beginning on page 9. The minimum purchase amount of the AMPS is \$25,000.**

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|                         | <u>Per Share</u> | <u>Total</u>   |
|-------------------------|------------------|----------------|
| Public offering price   | \$ 25,000        | \$ 480,000,000 |
| Sales load              | \$250            | \$4,800,000    |
| Proceeds to the Fund(1) | \$ 24,750        | \$ 475,200,000 |

(1) Not including offering expenses payable by the Fund estimated to be \$585,000, or \$30.47 per share.

The public offering price per share will be increased by the amount of dividends, if any, that have accumulated from the date the AMPS are first issued.

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 Underwriters are offering the AMPS subject to the condition that the AMPS be rated Aaa by Moody's and AAA by Fitch Ratings as of the time of delivery of the AMPS to the broker-dealers and subject to certain other conditions. The Underwriters expect to deliver the AMPS to an investor's broker-dealer, in book-entry form through the facilities of The Depository Trust Company, on or about December 20, 2004.

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**Merrill Lynch & Co.**

**UBS Investment Bank**

**A.G. Edwards**

**Oppenheimer & Co.**

**Wachovia Securities**



The date of this prospectus is December 16, 2004.

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*(continued from previous page)*

Because most of the investments held by the Fund will be floating rate assets (as defined below), the Fund's portfolio is generally expected to have less interest rate risk (*i.e.*, sensitivity to fluctuations in market interest rates) and a more stable net asset value than funds with portfolios that invest in longer-term fixed rate securities, although the net asset value will vary due to fluctuations in interest rates and other factors such as changes in the credit quality of securities in the portfolio. Due to its focus on variable rate securities, the amounts of the Fund's monthly distributions to common shareholders are expected to vary with fluctuations in market interest rates.

*Limited Operating History.* The Fund is a recently organized, diversified, closed-end management investment company which has been operational for less than two months. The common shares are listed on the New York Stock Exchange ( NYSE ) under the symbol PFN.

*Portfolio Contents.* As noted above, a substantial portion of the Fund's investment assets will ordinarily consist of senior floating rate debt securities and interests in senior floating rate loans ( Senior Loans ) made to or issued by U.S. or non-U.S. banks or other corporations. Senior Loans typically pay interest at rates which are re-determined periodically on the basis of a floating base lending rate (such as the London Inter-Bank Offered Rate, LIBOR ) plus a premium. Although Senior Loans are typically of below investment grade quality, they tend to have more favorable recovery rates than those of other types of below investment grade quality debt obligations. Other floating rate debt instruments in which the Fund may invest include catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities that pay interest at rates which adjust whenever a specified interest rate changes and/or reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund may also invest without limit in securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments (together with floating rate debt instruments, floating rate assets ). The Fund believes that these securities and investments have economic characteristics similar to the floating rate debt securities in which the Fund will invest. The Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in Senior Loans and other debt instruments that are, at the time of purchase, rated below investment grade or unrated but judged by the portfolio manager to be of comparable quality. To the extent consistent with the Fund's investment policy specified above, the Fund may invest a portion of its assets in securities and instruments other than floating rate assets, such as fixed rate convertible securities, high-yield bonds and mortgage-backed and other asset-backed securities issued on a public or private basis. The Fund expects to invest predominantly in U.S. dollar-denominated debt securities and will not invest more than 25% of its total assets in debt securities denominated in currencies other than the U.S. dollar. The Fund reserves the right to invest without limit in debt securities of non-U.S. issuers, although it will not invest more than 10% of its total assets in debt securities of issuers located in emerging markets. The Fund may make use of a variety of other instruments, including collateralized debt obligations, preferred shares, commercial paper, U.S. Government securities, zero-coupon and inflation-indexed bonds, real estate investment trusts (REITs), structured notes and other hybrid instruments, credit-linked trust certificates, total return swaps, credit default swaps and other derivative instruments. The Fund cannot assure you that it will achieve its investment objective.

Because of the floating rate or short-term features of most of the Fund's investments, it is expected that the Fund normally will have an average portfolio duration of zero to one year. The portfolio manager believes that this duration range and the Fund's exposure to lower-quality debt securities minimizes exposure to interest rate risk while still offering the potential for higher current income than would be expected from a higher quality portfolio.

You should read this prospectus, which contains important information about the Fund, before deciding whether to invest, and retain it for future reference. A Statement of Additional Information, dated December 16, 2004 (the SAI ), containing additional information about the Fund and the AMPS, has been filed with the Securities and Exchange Commission and is incorporated by reference in its entirety into this prospectus, which means that it is part of this prospectus for legal purposes. You can review the table of contents of the SAI on page 76 of this prospectus. You may request a free copy of the SAI by calling (877) 819-2224 or by writing to the Fund, or obtain a copy (and other information regarding the Fund) from the Securities and Exchange Commission's web site (<http://www.sec.gov>).

Investors in the AMPS will be entitled to receive cash dividends at an annual rate that may vary for the successive rate periods for the AMPS. The dividend rate for the initial rate period will be 2.40% for Series M AMPS, 2.40% for Series T AMPS, 2.40% for Series W AMPS, 2.40% for Series TH AMPS and 2.40% for Series F AMPS. The initial rate period for the AMPS is from the date of issuance through January 3, 2005 for Series M AMPS, through January 4, 2005 for Series T AMPS, through January 5, 2005 for Series W AMPS, through January 6, 2005 for Series TH AMPS and through January 9, 2005 for Series F AMPS. For subsequent rate periods, the AMPS will pay dividends based on a rate generally set at auctions held every seven days for each series of AMPS. Generally, investors may only buy or sell AMPS through an order placed at an auction with or through a broker-dealer in accordance with the procedures specified in this prospectus. Prospective purchasers should carefully review the auction procedures described in this prospectus, and should note:

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- r a buy order (called a bid ) or sell order is a commitment to buy or sell the AMPS based on the results of an auction; and
- r purchases and sales will be settled on the next business day after the auction.

The AMPS, which have no history of public trading, are not listed on an exchange. Broker-dealers may maintain a secondary trading market in the AMPS outside of the auctions; however, they have no obligation to do so, and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market (*i.e.*, trading will depend on the presence of willing buyers and sellers, and the trading price will be subject to variables to be determined at the time of the trade by such broker dealers). A general increase in the level of interest rates may have an adverse effect on the secondary market price of the AMPS, and an investor that sells AMPS between auctions may receive a price per share of less than \$25,000.

The AMPS will be senior to the Fund's outstanding common shares of beneficial interest ( Common Shares ), which are traded on the New York Stock Exchange under the symbol PFN. The AMPS have a liquidation preference of \$25,000 per share, plus any accumulated, unpaid dividends. The AMPS also have priority over the Fund's Common Shares as to distribution of assets. See Description of AMPS. The Fund may redeem AMPS as described under Description of AMPS Redemption. It is a condition of closing this offering that the AMPS be offered with a rating of Aaa from Moody's and AAA from Fitch Ratings.

The AMPS do not represent a deposit or obligation of, and are not guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

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You should rely only on the information contained or incorporated by reference in this prospectus. The Fund has not, and the Underwriters have not, authorized anyone to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. The Fund is not, and the Underwriters are not, making an offer of the AMPS in any state where the offer is not permitted. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus. The Fund's business, financial condition, results of operations and prospects may have changed since that date.

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**PROSPECTUS SUMMARY**

*This is only a summary. This summary may not contain all of the information that you should consider before investing in the AMPS. Certain of the capitalized terms used herein are defined in Article 11 of the Amended Bylaws (as defined below under *Special Risk Considerations* *Anti-Takeover Provisions* ), which is attached as Appendix A to the SAI. You should review the more detailed information contained in this prospectus and in the SAI, especially the information set forth under the heading *Risks*.*

**The Fund**

PIMCO Floating Rate Strategy Fund (the *Fund* ) is a recently organized, diversified, closed-end management investment company. The Fund commenced investment operations on October 29, 2004, upon the closing of an initial public offering of 37,000,000 Common Shares. As of December 14, 2004, the Fund had 41,305,236 Common Shares outstanding and total net assets of approximately \$794,614,762. The Fund's Common Shares are traded on the New York Stock Exchange under the symbol *PFN*. See *The Fund*. The Fund's principal office is located at 1345 Avenue of the Americas, New York, New York 10105, and its telephone number is (800) 331-1710.

**The Offering**

The Fund is offering 3,840 Series M AMPS, 3,840 Series T AMPS, 3,840 Series W AMPS, 3,840 Series TH AMPS and 3,840 Series F AMPS, each share of each series having a par value of \$.00001 and a liquidation preference of \$25,000 per share plus accumulated dividends, if any, that have accumulated from the date the Fund first issued the AMPS. The purchase price of the AMPS is \$25,000 per share plus dividends, if any, that have accumulated from the date the Fund first issues the AMPS. The AMPS are being offered by a group of underwriters (the *Underwriters* ) led by Merrill Lynch, Pierce, Fenner & Smith Incorporated.

The AMPS entitle their holders to receive cash dividends at an annual rate that may vary for the successive rate periods (also referred to as *dividend periods* ) for the AMPS. In general, except as described under *Dividends on AMPS* below and *Description of AMPS Dividends and Rate Periods*, the rate period for each series of AMPS will be seven days. The auction agent will determine the dividend rate for a particular rate period by an auction conducted on the Business Day immediately prior to the start of that rate period. See *Description of AMPS The Auction*.

The AMPS are not listed on an exchange. Instead, investors will generally buy or sell AMPS in an auction by submitting orders to broker-dealers that have entered into an agreement with the auction agent.

Generally, investors in the AMPS will not receive certificates representing ownership of their shares. The securities depository (The Depository Trust Company or any successor) (the *Securities Depository* ) or its nominee for the account of the investor's broker-dealer will maintain record ownership of the AMPS in book-entry form. An investor's broker-dealer, in turn, will maintain records of that investor's beneficial ownership of the AMPS.

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**Investment Objective and Strategies**

*Investment Objective.* The Fund's investment objective is to seek high current income, consistent with the preservation of capital. The Fund attempts to achieve this objective by normally investing at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, a substantial portion of which will be Senior Loans, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments (collectively, floating rate assets). See Portfolio Contents below. The Fund may invest without limit, and ordinarily expects to invest a substantial portion of its assets, in Senior Loans and other debt instruments that are, at the time of purchase, rated below investment grade (or unrated but judged by the portfolio manager to be of comparable quality) as described under Credit Quality below. The Fund cannot assure you that it will achieve its investment objective.

*Portfolio Management Strategies.* In selecting investments for the Fund, Pacific Investment Management Company LLC (PIMCO or the Sub-Adviser), the Fund's portfolio manager, attempts to identify floating rate and other debt instruments that provide high current income through fundamental research, driven by independent credit analysis and proprietary analytical tools. Investment decisions are based primarily on PIMCO's assessment of the issuer's credit characteristics and the position of the security in the issuer's capital structure in light of PIMCO's outlook for particular industries, the economy and the market generally. At the same time, PIMCO uses a variety of techniques, such as credit default swaps, designed to control risk and minimize the Fund's exposure to debt instruments that PIMCO believes are more likely to default or otherwise depreciate in value over time and detract from the Fund's overall return to investors. Because most of the investments held by the Fund will be floating rate assets, the Fund's portfolio is generally expected to have less interest rate risk (i.e., sensitivity to fluctuations in market interest rates) and a more stable net asset value than portfolios of funds that invest in longer-term fixed rate securities, although the net asset value will vary due to fluctuations in interest rates and other factors such as changes in the credit quality of securities in the portfolio. The Fund also attempts to preserve capital based on PIMCO's assessment of the issuer's credit characteristics and macro-economic factors. Subject to the guidelines under Credit Quality below, the Fund has the flexibility to invest in debt obligations of any credit quality based on its assessment of the particular issuer.

The Fund does not invest its assets according to predetermined weightings in particular issuers, industries or sectors. Instead, PIMCO attempts to identify quality investments in any industry or sector through fundamental research, driven by independent credit analysis and proprietary analytical tools.



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*Credit Quality.* Under normal market conditions, the Fund may invest without limit, and ordinarily expects to invest a substantial portion of its assets, in Senior Loans and other debt instruments that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's, below BBB- by either S&P or Fitch Ratings, or below a comparable rating by Dominion), or unrated but judged by PIMCO to be of comparable quality. The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC+/Caa1 or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. Debt securities of below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal and are commonly referred to as high yield securities or junk bonds. Debt securities in the lowest investment grade category may also be considered to possess some speculative characteristics.

*Independent Credit Analysis.* PIMCO relies heavily on its own analysis of the credit quality and risks associated with individual debt obligations considered for the Fund, rather than relying exclusively on rating agencies or third-party research. In the case of Senior Loans, PIMCO analyzes and takes into account the legal/protective features associated with the securities (such as their position in the borrower's capital structure and any security through collateral) in assessing their credit characteristics. The individuals managing the Fund utilize this information in an attempt to manage credit risk and identify issuers, industries or sectors that offer attractive yields relative to PIMCO's assessment of their credit characteristics. This aspect of PIMCO's capabilities will be particularly important because of the Fund's emphasis on Senior Loans and other below investment grade debt securities.

*Duration.* The average portfolio duration of the Fund will normally be within a short range (*i.e.*, a zero to one-year time frame) due to the Fund's predominant investment in floating rate assets, although it may be longer at any time and from time to time to the extent that the Fund invests in longer-term fixed rate securities. Duration is a measure of the expected life of a debt security that is used to determine the sensitivity of the security's price to changes in interest rates. PIMCO believes that the Fund's short duration range minimizes exposure to price changes of its portfolio securities due to interest rate volatility and related risk while still offering the potential opportunity for high current income.

*Diversification.* Subject to the availability of suitable investment opportunities, PIMCO will attempt to diversify the Fund's investments broadly in an attempt to minimize the portfolio's sensitivity to credit and other risks associated with a particular issuer, industry or sector, or to the impact of a single economic, political, corporate or regulatory occurrence.

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*Portfolio Contents.* Under normal market conditions, the Fund seeks to achieve its investment objective by investing at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, a substantial portion of which will be Senior Loans, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments (collectively, floating rate assets). Senior Loans are typically originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other financial institution for a lending syndicate of financial institutions. Senior Loans are normally accessible only to financial institutions and large corporate and institutional investors and are not widely available to individual investors. Floating rate debt instruments are debt instruments that pay interest at rates which adjust whenever a specified interest rate changes and/or reset on predetermined dates (such as the last day of a month or calendar quarter). These floating rate debt instruments may include, in addition to Senior Loans, instruments such as catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities. As noted above, the Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in Senior Loans and other debt instruments that are, at the time of purchase, rated below investment grade or unrated but judged by PIMCO to be of comparable quality. The Fund may invest the remainder of its assets in securities and instruments other than floating rate assets, such as fixed rate convertible securities, high-yield bonds and mortgage-backed and other asset-backed securities issued on a public or private basis. The Fund expects to invest predominantly in U.S. dollar-denominated debt securities and will not invest more than 25% of its total assets in debt securities denominated in currencies other than the U.S. dollar. The Fund reserves the right to invest without limit in debt securities of non-U.S. issuers, although it will not invest more than 10% of its total assets in debt securities of issuers located in emerging markets. The Fund may make use of a variety of other instruments, including preferred shares, commercial paper, U.S. Government securities, zero-coupon and inflation-indexed bonds, structured notes and other hybrid instruments, credit-linked trust certificates, real estate investment trusts (REITs), total return swaps, credit default swaps and other derivative instruments. The Fund may invest in securities of companies with small market capitalizations. The Fund may invest without limit in illiquid securities. As a diversified fund, the Fund generally may not, with respect to 75% of its total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities of other investment companies, if, as a result, (i) more than 5% of the Fund's total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of

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that issuer. The Fund will not concentrate its investments in a particular industry by investing more than 25% of its total assets in that industry. The Fund's industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities).

**Investment Manager**

PA Fund Management LLC (the "Manager") serves as the investment manager of the Fund. Subject to the supervision of the Fund's Board of Trustees, the Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund's business affairs and other administrative matters. The Manager will receive an annual fee, payable monthly, in an amount equal to .75% of the Fund's average weekly total managed assets. "Total managed assets" means the total assets of the Fund (including any assets attributable to any AMPS and borrowings that may be outstanding) minus accrued liabilities (other than liabilities representing borrowings). The Manager is located at 1345 Avenue of the Americas, New York, New York 10105. Organized in 2000 as a subsidiary successor of a business originally organized in 1987, the Manager provides investment management and advisory services to a number of closed-end and open-end investment company clients. As of September 30, 2004, the Manager had approximately \$33.6 billion in assets under management. Allianz Global Investors of America L.P. is the direct parent company of PA Retail Holdings LLC, of which the Manager is a wholly-owned subsidiary. As of September 30, 2004, Allianz Global Investors of America L.P. and its subsidiaries, including PIMCO, had approximately \$502 billion in assets under management.

The Manager has retained its affiliate, PIMCO, as a sub-adviser to manage the Fund's portfolio investments. See "Portfolio Manager" below.

**Portfolio Manager**

PIMCO serves as the Fund's sub-adviser responsible for managing the Fund's portfolio investments, and is sometimes referred to herein as the "portfolio manager" and the "Sub-Adviser." Subject to the supervision of the Manager, PIMCO has full investment discretion and makes all determinations with respect to the investment of the Fund's assets.

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. Organized in 1971, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to mutual funds. As of September 30, 2004, PIMCO had approximately \$415 billion in assets under management.

The Manager (and not the Fund) will pay a portion of the fees it receives to PIMCO in return for PIMCO's services.

**Leverage**

The Fund expects to utilize financial leverage on an ongoing basis for investment purposes. After completion of the offering of the AMPS, the Fund anticipates its total leverage from the issuance of the AMPS

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will be approximately 38%. Although the Fund may in the future offer other AMPS, the Fund does not currently intend to offer AMPS other than Series M AMPS, Series T AMPS, Series W AMPS, Series TH AMPS and Series F AMPS. The Fund may also use a variety of additional strategies to leverage the portfolio, including borrowing money, issuing debt securities or using reverse repurchase agreements, loans of portfolio securities, credit default swap contracts and other derivatives, as well as when-issued, delayed delivery or forward commitment transactions. However, these forms of leverage will only be used, if at all, as a substitute for, rather than in addition to, the leverage obtained through the issuance of the AMPS.

The Fund generally will not utilize leverage if it anticipates that it would result in a lower return to holders of the Fund's Common Shares (Common Shareholders) over time than if leverage were not used. Use of financial leverage creates an opportunity for increased income for Common Shareholders, but, at the same time, creates the possibility for greater loss (including the likelihood of greater volatility of net asset value and market price of the Common Shares and of dividends), and there can be no assurance that a leveraging strategy will be used or that it will be successful during any period in which it is employed. Because the fees received by the Manager are based on the total managed assets of the Fund (including assets attributable to the AMPS and borrowings that may be outstanding), the fees will be higher when leverage is utilized. The Manager therefore has a financial incentive for the Fund to issue AMPS or utilize borrowings. See Risks General Risks of Investing in the Fund Leverage Risk.

**Special Risk Considerations**

The following describes various principal risks of investing in the Fund. A more detailed description of these and other risks of investing in the Fund are described under Risks in this prospectus and under Investment Objective and Policies in the SAI.

*Risks of Investing in the AMPS.* Before investing in the AMPS, you should consider certain risks carefully. The primary risks of investing in the AMPS are:

- r the Fund will generally not be permitted to declare dividends or other distributions with respect to your AMPS or redeem your AMPS unless the Fund meets certain asset coverage requirements, as discussed in Description of AMPS Rating Agency Guidelines and Asset Coverage ;
- r if you try to sell your AMPS between auctions, you may not be able to sell any or all of your shares, or you may receive a purchase price of less than \$25,000 per share plus any accumulated or unpaid dividends. An increase in the level of interest rates, particularly during any Long Term Special Rate Period (as defined below), likely would have an adverse effect on the secondary market price of the AMPS. You may transfer shares outside of an auction only to or through certain broker-dealers, as

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discussed in Description of AMPS The Auction Secondary Market Trading and Transfer of AMPS ;

- r if an auction fails, you may not be able to sell any or all of your AMPS;
- r a rating agency could downgrade the rating assigned to the AMPS, which could affect the liquidity of your investment;
- r the Fund may be forced to redeem your AMPS to meet regulatory or rating agency requirements, and may voluntarily redeem your shares in certain circumstances;
- r in certain extraordinary circumstances the Fund may not earn sufficient income from its investments to pay dividends on AMPS;
- r the value of the Fund's investment portfolio may decline, reducing the asset coverage for the AMPS; and
- r if an issuer of a security in which the Fund invests experiences financial difficulties or defaults, or if an issuer in which the Fund invests is affected by other adverse market factors, there may be a negative impact on the income and/or asset value of the Fund's investment portfolio, which will reduce asset coverage for the AMPS, making it more difficult for the Fund to pay dividends on the AMPS.

*Risks of Investing in the Fund.* In addition to the risks described above, certain general risks relating to an investment in the Fund may under certain circumstances reduce the Fund's ability to pay dividends and meet its asset coverage requirements on the AMPS. These risks include:

*Limited Operating History.* The Fund is a recently organized, diversified, closed-end management investment company which has been operational for approximately seven weeks.

*Credit Risk/High Yield Risk.* Credit risk is the risk that one or more debt obligations in the Fund's portfolio will decline in price, or fail to pay interest or principal when due, because the issuer of the obligation or borrower experiences an actual or perceived decline in its financial status. The Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in debt instruments that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's, below BBB- by either S&P or Fitch Ratings or below a comparable rating by Dominion) or that are unrated but judged by PIMCO to be of comparable quality, including debt securities that are in default or the issuers of which are in bankruptcy. Debt obligations of below investment grade quality are commonly referred to as high yield securities or junk bonds and are predominantly speculative with respect to the issuer's capacity to pay interest and repay principal when due, and therefore involve a greater risk of default. Debt securities in the lowest investment grade category may also be

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considered to possess some speculative characteristics. The prices of these lower grade obligations are generally more volatile and sensitive to actual or perceived negative developments, such as a decline in the revenues of the borrowers underlying Senior Loans or a general economic downturn, than are the prices of higher grade securities.

Although Senior Loans in which the Fund will invest will often be secured by collateral, there can be no assurance that liquidation of any such collateral would satisfy the borrower's obligation in the event of default or that such collateral could be readily liquidated. However, PIMCO believes that Senior Loans generally tend to have more favorable recovery rates than most other types of loans. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations in its ability to realize the benefits of any collateral securing a Senior Loan. Because of the Fund's emphasis on Senior Loans and other below investment grade debt securities, PIMCO's capabilities in analyzing credit quality and associated risks will be particularly important, and there can be no assurance that PIMCO will be successful in this regard. See Investment Objective and Strategies High Yield Securities ( Junk Bonds ) and Risks General Risks of Investing in the Fund Credit Risk/High Yield Risk for additional information. Due to the risks involved in investing in high yield securities, an investment in the Fund should be considered speculative.

*Liquidity Risk.* The Fund may invest without limit in securities which are illiquid at the time of investment (generally determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, *i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Illiquid securities may trade at a discount from comparable, more liquid investments, and may be subject to wide fluctuations in market value. Also, the Fund may not be able to dispose of illiquid securities when that would be beneficial at a favorable time or price. Below investment grade debt securities tend to be less liquid than higher-rated securities. The Senior Loans in which the Fund invests will likely not be registered with the Securities and Exchange Commission or any state securities commission and generally will not be listed on a national securities exchange. PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

*Leverage Risk.* The Fund utilizes financial leverage for investment purposes. Leverage risk includes the risk associated with the issuance of AMPS to leverage the Fund's Common Shares. The Fund may also leverage the portfolio by borrowing money, issuing debt securities or using reverse repurchase agreements, loans of portfolio securities, credit default swap contracts and other derivatives, as well as when-issued, delayed delivery or forward commitment transactions.

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However, these forms of leverage will only be used, if at all, as a substitute for, rather than in addition to, the leverage obtained through the issuance of the AMPS. If the dividend rate on the AMPS and interest rates (if applicable) on other forms of leverage, as reset periodically, exceeds the net rate of return on the Fund's portfolio, the leverage will result in a lower net asset value than if the Fund were not leveraged, and the Fund's ability to pay dividends and to meet its asset coverage requirements on the AMPS would be reduced. It is expected that this risk should be partially mitigated because the dividend rates on the AMPS and the interest rates on the Fund's portfolio of Senior Loans and other debt instruments are expected to vary in a similar manner.

Because the fees received by the Manager are based on the total managed assets of the Fund (including assets attributable to any AMPS and borrowings that may be outstanding), the fees will be higher when leverage is utilized and the Manager has a financial incentive for the Fund to issue AMPS or utilize borrowings.

*Issuer Risk.* The value of floating rate and other debt instruments may decline for a number of reasons which directly relate to the issuer or borrower, such as management performance, financial leverage and reduced demand for the issuer's or borrower's goods and services.

*Smaller Company Risk.* The general risks associated with floating rate and other debt instruments are particularly pronounced for securities issued by companies with smaller market capitalizations. These companies may have limited product lines, markets or financial resources or they may depend on a few key employees. As a result, they may be subject to greater levels of credit, market and issuer risk.

*Management Risk.* The Fund is subject to management risk because it is an actively managed portfolio. PIMCO and the individual portfolio managers will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that these will produce the desired results.

*Foreign (Non-U.S.) Investment Risk.* The Fund expects to invest predominantly in U.S. dollar-denominated debt securities and will not invest more than 25% of its total assets in debt securities denominated in currencies other than the U.S. dollar. The Fund reserves the right to invest without limit in debt securities of foreign (non-U.S.) issuers, although it will not invest more than 10% of its total assets in debt securities of issuers located in emerging markets. The Fund's investments in foreign issuers and in securities denominated in foreign currencies involve special risks. For example, the value of these investments may decline in response to unfavorable political and legal developments, unreliable or untimely information or economic and financial instability. The value of securities denominated in foreign currencies may fluctuate based on changes in the value of those currencies relative to the U.S. dollar, and a decline in applicable foreign exchange rates could reduce the value of such securities held by the Fund. Foreign settlement procedures also may involve additional risks.

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*Emerging Markets Risk.* The Fund may invest up to 10% of its total assets in debt securities of issuers located in emerging markets. Foreign investment risk may be particularly high to the extent that the Fund invests in securities of issuers based in or securities denominated in the currencies of emerging market countries. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of foreign issuers to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation, nationalization and less social, political and economic stability; (ii) the smaller size of the market for such securities and a lower volume of trading, resulting in lack of liquidity and in price volatility; and (iii) certain national policies which may restrict the Fund's investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests.

*Derivatives Risk.* The Fund may utilize a variety of derivative instruments for hedging, investment, or risk management purposes. As part of its strategy to invest in floating rate assets, the Fund may enter into derivatives in connection with investments in fixed rate securities to effectively convert the fixed rate interest payments into floating rate payments. The Fund may also use derivatives to gain exposure to securities markets in which it will invest (*e.g.*, pending investment of the proceeds of this offering and the Fund's Common Share offering in individual securities) or to add leverage to the portfolio (but only as a substitute for the leverage obtained from AMPS). The types of derivative instruments the Fund may utilize include, but are not limited to, option contracts, futures contracts, options on future contracts, swap agreements (including total return and credit default swaps) and short sales. The Fund may also have exposure to derivatives, such as interest rate or credit-default swaps, through investment in credit linked trust certificates and other securities issued by special purpose or structured vehicles. Derivatives are subject to a number of risks described elsewhere in this prospectus, such as liquidity risk, issuer risk, interest rate risk, credit risk, leverage risk, counterparty risk, management risk and, if applicable, smaller company risk. They also involve the risk of mispricing or improper valuation, the risk of ambiguous documentation and the risk that changes in the value of a derivative may not correlate perfectly with an underlying asset, interest rate or index. Suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial.

*Counterparty Risk.* In addition to credit risk with respect to the counterparties to the Senior Loans in which the Fund invests, the Fund will also be subject to credit risk with respect to derivative contracts entered into directly by the Fund or held by special purpose or structured vehicles in which the Fund invests. If a counterparty becomes bankrupt or otherwise fails to perform its obligations due to financial difficulties, the Fund may experience significant delays in obtaining any recovery in a bankruptcy or other reorganization



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proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

*Mortgage-Related and Asset-Backed Risk.* The Fund may invest in a variety of mortgage-related and other asset-backed securities, including both commercial and residential mortgage securities and other mortgage-backed instruments (public or private). Asset-backed securities are subject to a number of risks described elsewhere in this prospectus, such as credit risk and liquidity risk. Generally, rising interest rates tend to extend the duration of fixed rate mortgage-related securities, making them more sensitive to changes in interest rates, and may reduce the market value of the securities. PIMCO expects that the Fund will focus its mortgage-related investments principally in adjustable rate mortgage-related and other asset-backed securities, which should minimize the Fund's overall sensitivity to interest rate volatility with respect to these investments. However, because interest rates on most adjustable rate mortgage- and asset-backed securities typically only reset periodically (*e.g.*, monthly or quarterly), changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuation in the market value of these securities, including declines in value as market interest rates rise. In addition, adjustable and fixed rate mortgage-related securities are subject to prepayment risk—the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. This can reduce the Fund's returns because the Fund may have to reinvest that money at lower prevailing interest rates. The Fund's investments in other asset-backed securities, such as collateralized debt obligations, are subject to risks similar to those associated with mortgage-backed securities, as well as additional risks associated with the nature of the assets and the servicing of those assets.

*Risk of Investing in REITs.* Investing in REITs involves certain unique risks in addition to investing in the real estate industry in general. REITs are subject to interest rate risks (especially mortgage REITs) and the risk of default by lessees or borrowers. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A mortgage REIT may be affected by the ability of the issuers of its portfolio mortgages to repay their obligations. REITs whose underlying assets are concentrated in properties used by a particular industry are also subject to risks associated with such industry. REITs may have limited financial resources, and their securities may trade less frequently and in a limited volume and be subject to more abrupt or erratic price movements than larger company securities.

*Interest Rate Risk.* Generally, when market interest rates rise, the prices of debt obligations (and particularly longer-term fixed rate debt obligations) fall, and vice versa. This interest rate risk is the risk that the debt obligations in the Fund's portfolio will decline in value because of increases in market interest rates. The prices of short-term floating rate and other debt obligations generally fluctuate less than prices of long-term debt obligations as interest rates change. Because

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the Fund will normally have a short portfolio duration (*i.e.*, a zero to one-year time frame), the Fund's net asset value will tend to fluctuate less in response to changes in market interest rates than if the Fund invested mainly in long-term debt securities. Although the Fund's net asset value will vary, PIMCO expects the Fund's policy of investing principally in floating rate assets will minimize the Fund's overall sensitivity to market interest rate fluctuations. However, because rates on certain floating rate debt instruments typically only reset periodically (*e.g.*, monthly or quarterly), changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuation in the Fund's net asset value. Moreover, a portion of the Fund's assets may be invested in debt instruments with fixed rates of interest (including up to 20% of its assets in longer duration fixed rate instruments), which will generally lose value in direct response to rising interest rates. The Fund's use of leverage through the issuance of AMPS or the use of borrowings will tend to increase interest rate risk.

*Reinvestment Risk.* Income from the Fund's portfolio will decline if and when the Fund invests the proceeds from prepaid, matured, traded or called debt obligations at market interest rates that are below the current earnings rate on those obligations. This could impact the Fund's net asset value and reduce asset coverage on the AMPS.

*Inflation/Deflation Risk.* Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of payments at future dates. As inflation increases, the real, or inflation-adjusted, value of the AMPS and distributions, as well as the real value of the Fund's portfolio, could decline. Deflation risk is the risk that prices throughout the economy decline over time—the opposite of inflation. Deflation may have an adverse effect on the creditworthiness of issuers and may make issuer default more likely, which may result in a decline in the value of the Fund's portfolio. Deflation may also result in a decline in the dividend rate of the AMPS.

*Regulatory Changes.* To the extent that legislation or state or federal bank or other regulators impose additional requirements or restrictions on the ability of certain financial institutions to make loans, particularly in connection with highly leverage transactions, the availability of Senior Loans and other related investments sought after by the Fund may be reduced. Further, such legislation or regulation could depress the market value of Senior Loans and other instruments held by the Fund.

*Confidential Information Access Risk.* In managing the Fund, PIMCO normally will seek to avoid the receipt by portfolio managers and analysts of material, non-public information ( Confidential Information ) about the issuers of Senior Loans and related investments being considered for acquisition by the Fund or held in the Fund's portfolio. In many instances, issuers offer to furnish Confidential Information to prospective purchasers or holders of the issuer's Senior Loans. In circumstances where PIMCO's portfolio

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managers and analysts do not receive Confidential Information from these issuers, the Fund may be disadvantaged in comparison to other Senior Loan investors, including with respect to the price the Fund pays or receives when it buys or sells a Senior Loan. Further, in situations where the Fund is asked, for example, to grant consents, waivers or amendments with respect to Senior Loans, PIMCO's ability to assess the desirability of such consents, waivers and amendments may be compromised.

*Market Disruption and Geopolitical Risk.* The war with Iraq, its aftermath and the continuing occupation of Iraq are likely to have a substantial impact on the U.S. and world economies and securities markets. The nature, scope and duration of the war and occupation and the potential costs of rebuilding the Iraqi infrastructure cannot be predicted with any certainty. Terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001 closed some of the U.S. securities markets for a four-day period and similar future events cannot be ruled out. The war and occupation, terrorism and related geopolitical risks have led, and may in the future lead, to increased short-term market volatility and may have adverse long-term effects on U.S. and world economies and markets generally. Those events could also have an acute effect on individual issuers or related groups of issuers. These risks could also adversely affect individual issuers and securities markets, interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the AMPS.

*Certain Affiliations.* Certain broker-dealers may be considered to be affiliated persons of the Fund, the Manager and/or PIMCO due to their possible affiliations with Allianz AG, the ultimate parent of the Manager and PIMCO. Absent an exemption from the Securities and Exchange Commission or other regulatory relief, the Fund is generally precluded from effecting certain principal transactions with affiliated brokers, and its ability to purchase securities being underwritten by an affiliated broker or a syndicate including an affiliated broker, or to utilize affiliated brokers for agency transactions, is subject to restrictions. This could limit the Fund's ability to engage in securities transactions and take advantage of market opportunities. In addition, unless and until the underwriting syndicate is broken in connection with the initial public offering of AMPS, the Fund will be precluded from effecting principal transactions with brokers who are members of the syndicate.

*Anti-Takeover Provisions.* The Fund's Amended and Restated Agreement and Declaration of Trust (the Declaration) and Second Amended and Restated Bylaws (the Amended Bylaws) include provisions that could limit the ability of other entities or persons to acquire control of the Fund or convert the Fund to open-end status. See Anti-Takeover and Other Provisions in the Declaration of Trust.

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**Trading Market**

The AMPS will not be listed on a stock exchange. Instead, you may buy or sell AMPS at a periodic auction by submitting orders to a broker-dealer that has entered into a separate agreement with the auction agent (a Broker-Dealer) or to a broker-dealer that has entered into an agreement with a Broker-Dealer. In addition to the auctions, Broker-Dealers and other broker-dealers may (but are not required to) maintain a separate secondary trading market in AMPS, but may discontinue this activity at any time. You may transfer shares outside of auctions only to or through a Broker-Dealer, a broker-dealer that has entered into a separate agreement with a Broker-Dealer, or other persons as the Fund permits. There can be no assurance that a secondary trading market for the AMPS will develop or, if it does develop, that it will provide holders of AMPS with liquidity of investment. See Description of AMPS The Auction.

**Ratings**

The Fund will issue the AMPS only if the AMPS have received a credit quality rating of Aaa from Moody's and AAA from Fitch Ratings. These ratings are an assessment of the capacity and the willingness of an issuer to pay preferred share obligations, and is not a recommendation to purchase, hold or sell those shares inasmuch as the ratings do not comment as to the market price or suitability for a particular investor. Ratings issued by nationally recognized statistical rating agencies such as Moody's and Fitch Ratings do not eliminate or mitigate the risks of investing in the AMPS. These ratings may be changed, suspended or withdrawn in each rating agency's discretion. See Description of AMPS Rating Agency Guidelines and Asset Coverage.

**Dividends on AMPS**

The table below shows the dividend rates, the dividend payment dates and the number of days for the initial rate periods on each series of AMPS offered in this prospectus. For subsequent rate periods, AMPS will pay dividends based on a rate set at auctions normally held every seven days. In most instances, dividends are payable on the first Business Day following the end of the rate period. The rate set at auction will not exceed the maximum applicable rate. See Description of AMPS Dividends and Rate Periods.

Dividends on AMPS will be cumulative from the date the shares are first issued and will be paid out of legally available funds.

| AMPS      | Initial<br>Dividend<br>Rate | Date of<br>Accumulation<br>at Initial Rate* | Dividend   |  | Number<br>of Days<br>in<br>Initial<br>Rate<br>Period |
|-----------|-----------------------------|---|--|--|--|
|           |                             |   | Payment<br>Date for<br>Initial<br>Rate<br>Period** | Subsequent<br>Dividend<br>Payment<br>Day |  |
| Series M  | 2.40%                       | December 20                                 | January 4  | Tuesday                                  | 15   |
| Series T  | 2.40%                       | December 20                                 | January 5  | Wednesday                                | 16   |
| Series W  | 2.40%                       | December 20                                 | January 6  | Thursday                                 | 17   |
| Series TH | 2.40%                       | December 20                                 | January 7  | Friday                                   | 18   |
| Series F  | 2.40%                       | December 20                                 | January 10   | Monday                                   | 21   |

\* All dates 2004.

\*\* All dates 2005.

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Notwithstanding the schedule above, the Fund may, subject to certain conditions, designate special rate periods of more than seven days. The Fund may not designate a special rate period unless sufficient clearing bids were made in the most recent auction. In addition, full cumulative dividends and any amounts due with respect to mandatory redemptions or optional redemptions must be paid in full or deposited with the auction agent. The Fund also must have received confirmation from Moody's and Fitch Ratings or any substitute rating agency that the proposed special rate period will not adversely affect such agency's then-current rating on the AMPS. The dividend payment date for a special rate period will be set out in the notice designating the special rate period.

The Fund may declare a special rate period under circumstances in which it believes it has the opportunity to secure an advantageous dividend rate on the AMPS, although it may choose not to do so. These circumstances could include, among others (i) if the Manager believes that interest rates will rise more than market expectations over a particular period or (ii) if long-term interest and dividend rates are lower than short-term interest and dividend rates for a particular period.

**Determination of Maximum Applicable Rates**

Except during a non-payment period, the applicable rate for any rate period for AMPS will not be more than the maximum applicable rate attributable to such shares. The maximum applicable rate for each series of AMPS will depend on the credit rating assigned to such shares and on the duration of the rate period. The maximum applicable rate will be the higher of the applicable percentage of the reference rate or the applicable spread plus the reference rate. The reference rate is the applicable LIBOR Rate (for a rate period of fewer than 365 days) or the applicable Treasury Rate Index (for a rate period of 365 days or more). The applicable percentage or applicable spread as so determined is further subject to upward but not downward adjustment in the discretion of the Board of Trustees after consultation with the Broker-Dealers. The applicable percentage and spread is as follows:

| <b>Moody's Credit Rating</b> | <b>Fitch Credit Rating</b> | <b>Applicable Percentage</b> | <b>Applicable Spread</b> |
|------------------------------|----------------------------|------------------------------|--------------------------|
| Aaa                          | AAA                        | 125%                         | 125 bps                  |
| Aa3 to Aa1                   | AA- to AA+                 | 150%                         | 150 bps                  |
| A3 to A1                     | A- to A+                   | 200%                         | 200 bps                  |
| Baa3 to Baa1                 | BBB- to BBB+               | 250%                         | 250 bps                  |
| Ba1 and below                | BB+ and below              | 300%                         | 300 bps                  |

There is no minimum applicable rate in respect of any rate period. See Description of AMPS Dividends and Rate Periods.

**Liquidation Preference**

If the Fund is liquidated, the Fund must pay to holders of AMPS \$25,000 per share, plus accumulated but unpaid dividends, if any, whether or not earned or declared. See Description of AMPS General.

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**Asset Maintenance**

Under Article 11 of the Amended Bylaws attached as Appendix A to the SAI, which establishes and fixes the rights and preferences of each series of AMPS, the Fund must maintain:

- r asset coverage on the AMPS as required by the rating agency or agencies rating the AMPS; and
- r asset coverage of at least 200% with respect to senior securities that are stock, including the AMPS, as discussed in Description of AMPS Rating Agency Guidelines and Asset Coverage.

In the event that the Fund does not maintain (or cure a failure to maintain) these coverage tests, some or all of the AMPS will be subject to mandatory redemption. See Description of AMPS Redemption Mandatory Redemption.

Based on the composition of the Fund's portfolio as of December 14, 2004, the Fund estimates that the asset coverage of the AMPS, as measured pursuant to the Investment Company Act of 1940, as amended (the 1940 Act), would be approximately 264% if the Fund were to issue all of the AMPS offered in this prospectus, representing approximately 38% of the Fund's capital (including the capital attributable to the AMPS). This asset coverage will change from time to time.

**Mandatory Redemption**

If the Preferred Shares Basic Maintenance Amount or the 1940 Act Preferred Shares Asset Coverage (each as defined in the Amended Bylaws and discussed in Description of AMPS Rating Agency Guidelines and Asset Coverage) is not maintained or restored as specified in the Amended Bylaws, the AMPS will be subject to mandatory redemption, out of funds legally available therefor, at the redemption price of \$25,000 per share plus an amount equal to dividends thereon (whether or not earned or declared) accumulated but unpaid to (but not including) the date fixed for redemption. Any such redemption will be limited to the minimum number of AMPS necessary to restore the Preferred Shares Basic Maintenance Amount or the 1940 Act Preferred Shares Asset Coverage, as the case may be. The Fund's ability to make such a mandatory redemption may be restricted by the provisions of the 1940 Act. See Description of AMPS Redemption Mandatory Redemption.

**Optional Redemption**

The AMPS are redeemable at the option of the Fund, as a whole or in part, on any dividend payment date (except during the initial rate period or a non-call period) at the redemption price of \$25,000 per share, plus an amount equal to the accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption. See Description of AMPS Redemption Optional Redemption.

Although the AMPS are subject to redemption under certain circumstances as described above and under Description of AMPS Redemption, the AMPS may not be redeemed at a shareholder's option at net asset value, unlike the shares of an open-end mutual fund.

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### **Voting Rights**

The 1940 Act requires that the holders of any outstanding series of AMPS and any other outstanding preferred shares, voting as a class, have the right to elect at least two trustees at all times (in accordance with the timing of elections under the Fund's staggered Board structure) and to elect a majority of the trustees at any time when two years' dividends on the AMPS or any other preferred shares are unpaid. The holders of AMPS and any other preferred shares will vote as a separate class (and, in certain circumstances, the holders of each series of AMPS will vote as a separate class) on certain other matters as required under the Fund's Declaration and Amended Bylaws and under the 1940 Act. See Description of AMPS' Voting Rights, Description of Capital Structure and Anti-Takeover and Other Provisions in the Declaration of Trust.

### **Federal Income Taxation**

The distributions with respect to any series of AMPS (other than distributions in redemption of AMPS subject to Section 302(b) of the Internal Revenue Code of 1986, as amended (the Code)) will constitute dividends to the extent of the Fund's current or accumulated earnings and profits, as calculated for federal income tax purposes. Such dividends generally will be taxable as ordinary income to holders. For taxable years beginning on or before December 31, 2008, provided holding period and other requirements are met, the Fund may designate distributions of investment income derived from dividends of U.S. corporations and some foreign corporations as qualified dividend income. Qualified dividend income will be taxed in the hands of individuals at the rates applicable to long-term capital gain, provided these same holding period and other requirements are met by the shareholder. The Fund does not expect a significant portion of Fund distributions to be derived from qualified dividend income. Distributions of net capital gains (*i.e.*, the excess of net long-term capital gains over net short-term capital losses) that are designated by the Fund as capital gain dividends will be treated as long-term capital gains in the hands of holders receiving such distributions. In general, dividends (other than capital gain dividends) paid to a shareholder that is not a U.S. person within the meaning of the Code are subject to withholding of U.S. federal income tax at a rate of 30% (or lower applicable treaty rate). However, for taxable years of the Fund beginning after December 31, 2004 and before January 1, 2008, the Fund generally will not be required to withhold any amounts with respect to distributions of (i) U.S. source interest income that would not be subject to U.S. federal income tax if earned directly by an individual who is not a U.S. person within the meaning of the Code, and (ii) net short-term capital gains in excess of net long-term capital losses, in each case to the extent such distributions are properly designated by the Fund. The Internal Revenue Service (the IRS) currently requires that a regulated investment company that has two or more classes of stock allocate to each such class proportionate amounts of each type of its income (such as ordinary income and capital gains) based upon the percentage of total dividends distributed to each class for the tax year. Accordingly, the Fund intends each year to allocate capital gain dividends between and among its Common Shares and each series of the AMPS in proportion to the total dividends paid to each

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class during or with respect to such year. Dividends qualifying and not qualifying for (a) treatment as qualified dividend income and (b) the dividends received deduction, if any, will similarly be allocated between and among classes. See Tax Matters.

**Custodian, Auction Agent, Transfer Agent, Registrar, Dividend Paying Agent and Redemption Agent**, State Street Bank & Trust Co. ( State Street ) will act as the Fund's custodian. Deutsche Bank Trust Company Americas ( Deutsche Bank ) will act as auction agent, and as the transfer agent, registrar, dividend paying agent and redemption agent for the AMPS.



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The financial highlights table set forth below is intended to help you understand the Fund's recent financial performance. Information contained in the table below under the headings "Per Share Operating Performance" and "Ratios/Supplemental Data" shows the unaudited operating performance of the Fund from the commencement of the Fund's investment operations on October 29, 2004 through November 30, 2004. Because the Fund is recently organized and commenced investment operations on October 29, 2004, the table covers approximately four weeks of operations, during which a substantial portion of the Fund's portfolio was held in temporary investments pending investment in securities that meet the Fund's investment objective and policies. Accordingly, the information presented may not provide a meaningful representation of the Fund's operating performance.

|  | <b>For the Period October 29, 2004*<br/>through November 30, 2004<br/>(Unaudited)</b> |
|--|---|
| <b>Per Share Operating Performance</b>   |   |
| Net Asset Value, Beginning of Period**   | \$ 19.10  |
| <b>Investment Operations:</b>  |   |
| Net Investment Income  | 0.03  |
| Net Realized and Unrealized Gain on Investments, Swaps, Futures Contracts, Written Options, Unfunded Loan Commitment and Foreign Currency Transactions | 0.08  |
| Net Increase in Net Assets resulting from Investment Operations  | 0.11  |
| <b>Capital Share Transactions:</b>   |   |
| Common Stock Offering Costs Charged to Paid-in Capital in Excess of Par  | (0.03)  |
| Net Asset Value, End of Period   | \$ 19.18  |
| Market Price, End of Period  | \$ 20.00  |
| <b>Total Investment Return(1)</b>  | <b>0.00%</b>  |
| <b>Ratios/Supplemental Data:</b>   |   |
| Net Assets, End of Period (in thousands)   | \$ 747,953  |
| Ratio of Expenses to Average Net Assets(2)   | 0.82%   |
| Ratio of Net Investment Income to Average Net Assets(2)  | 1.78%   |
| Portfolio Turnover   | 5.00%   |

\* Date of commencement of operations.

\*\* Initial public offering price of \$20.00 per share less underwriting discount of \$.90 per share.

(1) Total Investment Return is calculated assuming a purchase of common stock at the current market price on the first day of the period and a sale at the current market price on the last day of the period reported. Total Investment Return does not reflect brokerage commissions or sales charges. Total Investment Return for a period less than one year is not annualized.

(2) Annualized.

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**THE FUND**

The Fund is a recently organized, diversified, closed-end management investment company registered under the 1940 Act. The Fund was organized as a Massachusetts business trust on June 30, 2004 and is registered as an investment company under the 1940 Act. As a recently-organized entity, the Fund has a limited operating history. The Fund's principal office is located at 1345 Avenue of the Americas, New York, New York 10105, and its telephone number is (800) 331-1710.

The Fund commenced operations on October 29, 2004, upon the closing of an initial public offering of 37,000,000 of its Common Shares. The proceeds of such offering were approximately \$705,220,000 after the payment of organizational and offering expenses. In connection with the initial public offering of the Fund's Common Shares, the Underwriters were granted an option to purchase up to an additional 5,550,000 Common Shares to cover over allotments. On November 16, 2004 and December 14, 2004, the Underwriters purchased an additional 2,000,000 and 2,300,000 Common Shares of the Fund, respectively, pursuant to the over allotment option. These purchases yielded net proceeds to the Fund of approximately \$82,130,000. The Fund's Common Shares are traded on the New York Stock Exchange under the symbol PFN.

**USE OF PROCEEDS**

The net proceeds of the offering of AMPS will be approximately \$474,615,000 after payment of the estimated offering costs and sales load. The Fund will invest the net proceeds of the offering in accordance with the Fund's investment objective and policies as stated below. It is presently anticipated that the Fund will be able to invest substantially all of the net proceeds in floating rate debt instruments and other securities that meet its investment objective and policies within six months after the completion of the offering. The Fund anticipates that it may take up to six months to complete this initial investment process due to potential limited availability of suitable Senior Loans in the marketplace as well as additional time required for PIMCO to analyze and assess counterparties and contractual and other features associated with Senior Loans, which are typically more detailed and complex than those associated with more traditional debt instruments. Pending such investment, it is anticipated that the proceeds will be invested in high grade, short-term securities, credit linked trust certificates, and/or index futures contracts or similar derivative instruments designed to give the Fund exposure to the markets in which it intends to invest while PIMCO selects specific securities. During the period in which the Fund is investing the net proceeds of the offering, it may not be in a position to achieve its investment objective.

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**CAPITALIZATION**

The following table sets forth the unaudited capitalization of the Fund as of December 14, 2004, and as adjusted to give effect to the issuance of the AMPS offered hereby (including estimated offering expenses and sales load of \$5,385,000).

|   | <u>Actual</u>         | <u>As Adjusted</u>    |
|---|-----------------------|-----------------------|
| Series M AMPS, \$.00001 par value<br>(no shares issued; 3,840 shares issued, as adjusted,<br>at \$25,000 per share liquidation preference)  | \$ 0                  | \$ 96,000,000         |
| Series T AMPS, \$.00001 par value<br>(no shares issued; 3,840 shares issued, as adjusted,<br>at \$25,000 per share liquidation preference)  | \$ 0                  | \$ 96,000,000         |
| Series W AMPS, \$.00001 par value<br>(no shares issued; 3,840 shares issued, as adjusted,<br>at \$25,000 per share liquidation preference)  | \$ 0                  | \$ 96,000,000         |
| Series TH AMPS, \$.00001 par value<br>(no shares issued; 3,840 shares issued, as adjusted,<br>at \$25,000 per share liquidation preference) | \$ 0                  | \$ 96,000,000         |
| Series F AMPS, \$.00001 par value<br>(no shares issued; 3,840 shares issued; as adjusted,<br>at \$25,000 per share liquidation preference)  | \$ 0                  | \$ 96,000,000         |
| <b>Total AMPS</b>   | <b>\$ 0</b>           | <b>\$ 480,000,000</b> |
| Common Shares, \$.00001 par value, 41,305,236 shares outstanding  | \$ 787,730,008        | \$ 782,345,008        |
| Undistributed net investment income   | \$ 2,481,127          | \$ 2,481,127          |
| Accumulated net realized loss on investments  | \$ (170,173)          | \$ (170,173)          |
| Net unrealized appreciation of investments  | \$ 4,573,800          | \$ 4,573,800          |
| <b>Net assets applicable to Common Shares</b>   | <b>\$ 794,614,762</b> | <b>\$ 789,229,762</b> |

**Table of Contents****PORTFOLIO COMPOSITION**

The following table sets forth certain information with respect to the composition of the Fund's investment portfolio as of November 30, 2004, based on the highest rating assigned.

| <b>S&amp;P#134</b>             | <b>Moody s#134</b>             | <b>Number of Issues</b> | <b>Value</b>   | <b>Percent</b> |
|--------------------------------|--------------------------------|-------------------------|----------------|----------------|
| AAA                            | Aaa                            | 23                      | \$ 327,345,915 | 35.8%          |
| AA                             | Aa                             | 1                       | 2,347,832      | .3             |
| A                              | A                              | 1                       | 6,162,672      | .7             |
| BBB                            | Baa                            | 1                       | 4,955,505      | .5             |
| BB                             | Ba                             | 10                      | 43,706,847     | 4.8            |
| B                              | B                              | 11                      | 77,815,087     | 8.5            |
| CCC                            | Caa                            | 0                       | 0              | 0              |
| CC                             | Ca                             | 0                       | 0              | 0              |
| C                              | C                              | 0                       | 0              | 0              |
| NR*                            | NR*                            | 114                     | 342,840,440    | 37.4           |
|                                | P-1                            | 1                       | 22,437,528     | 2.4            |
| Cash and Repurchase Agreements | Cash and Repurchase Agreements |                         | 87,912,713     | 9.6            |
|                                |                                | 162                     | \$ 915,524,539 | 100%           |

#134Ratings using the higher of S&P's or Moody's ratings on the Fund's portfolio securities. S&P rating categories may be further modified by a plus (+) or minus (-) in AA, A, BBB, BB, B and CCC ratings. Moody's rating categories may be further modified by a 1, 2 or 3 in Aa, A, Baa, Ba, B and Caa ratings.

\* Refers to securities that have not been rated by Moody's or S&P but that have been assessed by PIMCO as being of comparable credit quality to rated securities in which the Fund may invest. See Investment Objective and Strategies.

**INVESTMENT OBJECTIVE AND STRATEGIES****Investment Objective**

The Fund's investment objective is to seek high current income, consistent with the preservation of capital. Under normal market conditions, the Fund seeks to achieve its investment objective by investing at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, a substantial portion of which will be Senior Loans, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments (collectively, "floating rate assets"). The Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's, below BBB- by either S&P or Fitch Ratings, or below a comparable rating by Dominion) or that are unrated but judged by PIMCO to be of comparable quality. Various types of securities and other instruments in which the Fund may invest in are described under Portfolio Contents and Other Information below. The Fund cannot assure you that it will achieve its investment objective.

**Portfolio Management Strategies**

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The Fund is actively managed in accordance with PIMCO's top down short-term (cyclical) and longer-term (secular) economic outlook, using strategies that focus on credit quality analysis, broad market diversification among industries and sectors and other risk management techniques. In selecting investments for the Fund, PIMCO attempts to identify Senior Loans and other floating rate assets that provide high current

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income through fundamental research, driven by independent credit analysis and proprietary analytical tools. Investment decisions are based primarily on PIMCO's assessment of the issuer's credit characteristics and the position of the particular security in the issuer's capital structure, in light of PIMCO's outlook for particular industries, the economy and the market generally. At the same time, PIMCO uses a variety of techniques, such as credit default swaps, designed to control risk and minimize the Fund's exposure to issues that PIMCO believes are more likely to default or otherwise depreciate in value over time and detract from the Fund's overall return to investors. The Fund cannot assure you that such securities will ultimately continue to pay current income or be paid in full at maturity.

Because most of the investments held by the Fund will be floating rate assets, the Fund's portfolio is generally expected to have less interest rate risk (*i.e.*, sensitivity to fluctuations in market interest rates) and a more stable net asset value than funds with portfolios that invest in longer-term fixed rate securities, although the net asset value will vary due to fluctuations in interest rates and other factors such as changes in the credit quality of securities in the portfolio.

**Credit Quality.** The Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in debt securities that are, at the time of purchase, rated below investment grade or that are unrated but judged by PIMCO to be of comparable quality. The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC+/Caa1 or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality. The Fund may invest in issuers of any credit quality (including bonds in the lowest ratings categories and debt securities that are in default or the issuers of which are in bankruptcy) if PIMCO determines that the particular obligation offers an attractive yield relative to its risk profile. As described under High Yield Securities ( Junk Bonds ) below, debt securities of below investment grade quality (including many Senior Loans) are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as high yield securities or junk bonds. The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue.

**Independent Credit Analysis.** PIMCO relies heavily on its own analysis of the credit quality and risks associated with individual debt obligations considered for the Fund, rather than relying exclusively on rating agencies or third-party research. In the case of Senior Loans, PIMCO analyzes and takes into account the legal/protective features associated with the securities (such as their position in the borrower's capital structure and any security through collateral) in assessing their credit characteristics. PIMCO has a devoted team of professionals that conducts fundamental credit research and analysis of individual issuers, industries and sectors and uses proprietary analytical tools (such as computer databases and Web-based applications) to assess and monitor credit risk. The individuals managing the Fund utilize this information in an attempt to manage credit risk and identify issuers, industries or sectors that offer attractive yields relative to PIMCO's assessment of their credit characteristics. This aspect of PIMCO's capabilities will be particularly important because of the Fund's emphasis on Senior Loans and other below investment grade securities. PIMCO's ability to analyze Senior Loans may be limited to the extent that portfolio managers and analysts avoid the receipt of material, non-public information about the issuers of Senior Loans. See Risks General Risks of Investing in the Fund Confidential Information Access Risk.

**Duration.** The average portfolio duration of the Fund will normally be within a short range (*i.e.*, a zero to one-year time frame) due to the Fund's predominant investment in floating rate assets, although it may be longer at any time and from time to time to the extent that the Fund invests in longer-term fixed-income securities. PIMCO believes that the Fund's short duration range minimizes exposure to price changes of its portfolio securities due to interest rate volatility and related risk while still offering the potential opportunity for high current income.

Duration is a measure of the expected life of a debt security that is used to determine the sensitivity of the security's price to changes in interest rates. The longer a security's duration, the more sensitive it will be to

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changes in interest rates. For example, the market price of a bond with a duration of two years would be expected to decline 2% if interest rates were to rise 1%. Conversely, the market price of the same bond would be expected to increase 2% if interest rates were to fall 1%. The market price of a bond with a duration of one year would be expected to increase or decline half as much as the market price of a bond with a two-year duration. The maturity of a security measures only the time until final payment is due. Duration, on the other hand, takes into account the pattern of all payments of interest and principal on a security over time, including how these payments are affected by prepayments and by changes in interest rates, as well as the time until an interest rate on a security is reset (in the case of variable rate securities).

## **Portfolio Contents and Other Information**

Under normal market conditions, the Fund seeks to achieve its investment objective by investing at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, a substantial portion of which will be Senior Loans, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments (collectively, floating rate assets). In addition to Senior Loans, other floating rate debt instruments in which the Fund may invest include catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities that pay interest at rates which adjust whenever a specified interest rate changes and/or reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund may invest the remainder of its assets in securities and instruments other than floating rate assets, such as fixed rate convertible securities, high-yield bonds and mortgage-backed and other asset-backed securities issued on a public or private basis. The Fund may make use of a variety of other instruments, including collateralized debt obligations, preferred shares, commercial paper, U.S. Government securities, zero-coupon and inflation-indexed bonds, real estate investment trusts (REITs), structured notes and other hybrid instruments, credit-linked trust certificates, total return swaps, credit default swaps and other derivative instruments. Certain debt instruments, such as convertible bonds, also may include the right to participate in equity appreciation, and PIMCO will generally evaluate those instruments based primarily on their debt characteristics. The Fund may invest in securities of companies with small market capitalizations. The principal and/or interest rate on some debt instruments may be determined by reference to the performance of a benchmark asset or market, such as an index of securities, or the differential performance of two assets or markets, such as the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

The Fund may invest without limit, and ordinarily expects to invest a substantial portion of its assets, in debt securities that are, at the time of purchase, rated below investment grade. See High Yield Securities ( Junk Bonds ) below. The Fund may also invest in investment grade securities.

The Fund expects to invest predominantly in U.S. dollar-denominated debt securities, which may include those issued by foreign corporations or supra-national government agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund may invest up to 10% of its total assets in securities of issuers located in emerging markets.

The Fund may utilize a variety of derivative instruments for hedging, investment and risk management purposes. As noted above, as part of its strategy to invest in floating rate assets, the Fund may enter into derivatives in connection with investments in fixed rate securities to effectively convert the fixed rate interest payments into floating rate payments. The types of derivative instruments the Fund may utilize include, but are not limited to, option contracts (including options on futures contracts), futures contracts, swap agreements (including total return and credit default swaps) and short sales. The Fund may also seek to obtain market exposure to the securities in which it primarily invests by entering into a series of purchase and sales contracts. The Fund may also use derivatives to leverage the portfolio, but only as a substitute for leverage attained through the issuance of the AMPS and any other preferred shares.





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The Fund may invest without limit in illiquid securities (which are generally determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, *i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

The Fund cannot change its investment objective without the approval of the holders of a majority of the outstanding Common Shares and any preferred shares (including any AMPS) voting together as a single class, and of the holders of a majority of the outstanding preferred shares (including any AMPS) voting as a separate class. A majority of the outstanding shares (whether voting together as a single class or voting as a separate class) means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of those shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less. See Description of AMPS Voting Rights for additional information with respect to the voting rights of holders of AMPS. The Fund may not change its policy to normally invest at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate assets as specified above unless it provides shareholders with at least 60 days' written notice of such change.

Other than the issuance of AMPS the Fund may use a variety of strategies to add leverage to the portfolio. These include borrowing money, issuing debt securities or using reverse repurchase agreements, loans of portfolio securities, credit default swap contracts and other derivatives, as well as when-issued, delayed delivery and forward commitment transactions. However, these forms of leverage will only be used, if at all, as a substitute for, rather than in addition to, the leverage obtained through the issuance of the AMPS and any other preferred shares. See Risks General Risks of Investing in the Fund Leverage Risk.

Upon PIMCO's recommendation, for temporary defensive purposes and in order to keep the Fund's cash fully invested, including during the period in which the net proceeds of this offering are being invested, the Fund may deviate from its investment objective and policies and invest some or all of its total assets in other than floating rate assets, including longer-term fixed rate investment grade debt securities, credit-linked trust certificates and/or index futures contracts or similar derivative instruments. The Fund may not achieve its investment objective when it does so.

The following provides additional information regarding the types of securities and other instruments in which the Fund will ordinarily invest. A more detailed discussion of these and other instruments and investment techniques that may be used by the Fund is provided under Investment Objective and Policies in the SAI. The ability of the Fund to use some of the strategies discussed below and in the SAI, such as derivatives, is limited by the rating agency guidelines. See Description of AMPS Rating Agency Guidelines and Asset Coverage below.

### **Floating Rate Debt Instruments**

Floating rate debt instruments are debt instruments that pay interest at rates which adjust whenever a specified interest rate changes and/or which reset on predetermined dates (such as the last day of a month or calendar quarter). In addition to Senior Loans, floating rate debt instruments in which the Fund may invest may include, without limitation, instruments such as catastrophe and other event-linked bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities. Due to their floating rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt instrument is generally expected to have less sensitivity to fluctuations in market interest rates than a comparable fixed rate debt instrument, although the value of a floating rate instrument may nonetheless decline as interest rates rise and due to other factors, such as changes in credit quality.



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### Senior Loans

The Fund expects to ordinarily invest a substantial portion of its assets in Senior Loans. Senior Loans include senior floating rate loans and institutionally traded senior floating rate debt obligations issued by an asset-backed pool or other issuers, as well as interests therein. Loan interests generally take the form of direct interests acquired during a primary distribution and may also take the form of assignments of, novations of, or participations in a Senior Loan acquired in secondary markets.

Senior Loans typically pay interest at rates which are re-determined periodically on the basis of a floating base lending rate (such as the LIBOR Rate) plus a premium. Although Senior Loans are typically of below investment grade quality, they tend to have more favorable recovery rates than other types of below investment grade quality debt obligations. Senior Loans generally (but not always) hold the most senior position in the capital structure of a borrower and are often secured with collateral. A Senior Loan is typically originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other financial institution (the Agent) for a lending syndicate of financial institutions (Lenders). The Agent typically administers and enforces the Senior Loan on behalf of the other Lenders in the syndicate. In addition, an institution, typically but not always the Agent, holds any collateral on behalf of the Lenders. A financial institution's employment as an Agent might be terminated in the event that it fails to observe a requisite standard of care or becomes insolvent. A successor Agent would generally be appointed to replace the terminated Agent, and assets held by the Agent under the loan agreement would likely remain available to holders of such indebtedness. However, if assets held by the Agent for the benefit of the Fund were determined to be subject to the claims of the Agent's general creditors, the Fund might incur certain costs and delays in realizing payment on a loan or loan participation and could suffer a loss of principal and/or interest. In situations involving other interposed financial institutions (e.g., an insurance company or government agency) similar risks may arise.

The Fund may purchase assignments of Senior Loans from Lenders. The purchaser of an assignment typically succeeds to all the rights and obligations under the loan agreement with the same rights and obligations as the assigning Lender. Assignments may, however, be arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning Lender.

The Fund may also invest in participations in Senior Loans, although it expects to do so on a limited basis. Participations by the Fund in a Lender's portion of a Senior Loan typically will result in the Fund having a contractual relationship only with such Lender, not with the borrower. As a result, the Fund may have the right to receive payments of principal, interest and any fees to which it is entitled only from the Lender selling the participation and only upon receipt by such Lender of such payments from the borrower. In connection with purchasing participations, the Fund generally will have no right to enforce compliance by the borrower with the terms of the loan agreement, nor any rights with respect to any funds acquired by other Lenders through set-off against the borrower, and the Fund may not directly benefit from any collateral supporting the Senior Loan in which it has purchased the participation. As a result, the Fund may assume the credit risk of both the borrower and the Lender selling the participation.

Purchasers of Senior Loans and other forms of direct indebtedness depend primarily upon the creditworthiness of the corporate or other borrower for payment of principal and interest. If the Fund does not receive scheduled interest or principal payments on such indebtedness, the Fund's share price and yield could be adversely affected. Senior Loans that are fully secured may offer the Fund more protection than an unsecured loan in the event of non-payment of scheduled interest or principal. However, there is no assurance that the liquidation of any collateral from a secured Senior Loan would satisfy the borrower's obligation, or that such collateral could be liquidated. Also, the Fund may invest in Senior Loans that are unsecured.

Senior Loans may not be readily marketable and may be subject to restrictions on resale. In some cases, negotiations involved in disposing of indebtedness may require weeks to complete. Consequently, some indebtedness may be difficult or impossible to dispose of readily at what

PIMCO believes to be a fair price.

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Senior Loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the Senior Loan from free cash flow. The degree to which borrowers prepay Senior Loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among others. As such, prepayments cannot be predicted with accuracy. Upon a prepayment, either in part or in full, the actual outstanding debt on which the Fund derives interest income will be reduced. However, the Fund may receive both a prepayment penalty fee from the prepaying borrower and a facility fee upon the purchase of a new Senior Loan with the proceeds from the prepayment of the former. The effect of prepayments on the Fund's performance may or may not be mitigated by the receipt of prepayment fees and/or the Fund's reinvestment of prepayments in other Senior Loans that have similar or identical yields.

## **High Yield Securities ( Junk Bonds )**

As noted above, the Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in Senior Loans and other debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's, below BBB- by either S&P or Fitch Ratings, or below a comparable rating by Dominion) or that are unrated but judged by PIMCO to be of comparable quality. These securities are sometimes referred to as high yield securities or junk bonds. Investing in high yield securities involves greater risks (in particular, greater risk of default) and special risks in addition to the risks associated with investments in investment grade debt obligations. While offering a greater potential opportunity for capital appreciation and higher yields, high yield securities typically entail greater potential price volatility and may be less liquid than higher-rated securities. High yield securities may be regarded as predominantly speculative with respect to the issuer's continuing ability to meet principal and interest payments. They also may be more susceptible to real or perceived adverse economic and competitive industry conditions than higher-rated securities. Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics.

The market values of high yield securities tend to reflect individual developments of the issuer to a greater extent than do higher-quality securities, which tend to react mainly to fluctuations in the general level of interest rates. In addition, lower-quality debt securities tend to be more sensitive to economic conditions. Certain emerging market governments that issue high yield securities are among the largest debtors to commercial banks, foreign governments and supra-national organizations such as the World Bank, and may not be able or willing to make principal and/or interest payments as they come due.

Senior Loans generally tend to have more favorable recovery rates than most other types of loans. Although Senior Loans in which the Fund will invest will often be secured by collateral, there can be no assurance that liquidation of such collateral would satisfy the borrower's obligation in the event of default or that such collateral could be readily liquidated.

*Credit Ratings and Unrated Securities.* Rating agencies are private services that provide ratings of the credit quality of debt obligations, including convertible securities. Appendix A to this prospectus describes the various ratings assigned to debt obligations by Moody's, S&P, Fitch Ratings and Dominion. Ratings assigned by a rating agency are not absolute standards of credit quality and do not evaluate market risks. Rating agencies may fail to make timely changes in credit ratings and an issuer's current financial condition may be better or worse than a rating indicates. PIMCO relies heavily on its own analysis of the credit quality and risks associated with individual debt obligations considered for the Fund, rather than relying exclusively on rating agencies or third-party research. See *Portfolio Management Strategies Independent Credit Analysis*. In the case of Senior Loans, PIMCO analyzes and takes into account the legal/protective features associated with the securities (such as their position in the borrower's capital structure and any security through collateral) in assessing their credit characteristics. The Fund will not necessarily sell a security when its rating is reduced below its rating at the time of purchase. The ratings of a debt security may change over time. Moody's, S&P, Fitch Ratings and Dominion

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monitor and evaluate the ratings assigned to securities on an ongoing basis. As a result, debt instruments held by the Fund could receive a higher rating (which would tend to increase their value) or a lower rating (which would tend to decrease their value) during the period in which they are held.

The Fund may purchase unrated securities (which are not rated by a rating agency) if PIMCO determines that the securities are of comparable quality to rated securities that the Fund may purchase. Many of the Senior Loans and other debt instruments in which the Fund invests may be unrated. Unrated securities may be less liquid than comparable rated securities and involve the risk that PIMCO may not accurately evaluate the security's comparative credit rating. Analysis of the creditworthiness of issuers of high yield securities may be more complex than for issuers of higher-quality debt obligations. The Fund's success in achieving its investment objective may depend more heavily on PIMCO's credit analysis than if the Fund invested primarily in higher-quality and rated securities.

## **Bonds**

The Fund may invest in bonds of varying maturities (with predominantly low durations) issued by U.S. and foreign corporations, domestic and foreign banks and other business entities. Bonds can be variable or fixed rate debt obligations, including bills, notes, debentures, money market instruments and similar instruments and securities. Bonds generally are used by corporations as well as governments and other issuers to borrow money from investors. The issuer pays the investor a variable or fixed rate of interest and normally must repay the amount borrowed on or before maturity. Certain bonds are perpetual in that they have no maturity date. The Fund may also invest in catastrophe or other event-linked bonds. Although the Fund will ordinarily invest in floating rate assets, it may invest a portion of its assets in longer-term fixed rate bonds.

## **Commercial Paper**

Commercial paper represents short-term unsecured promissory notes issued in bearer form by corporations such as banks or bank holding companies and finance companies. The rate of return on commercial paper may be linked or indexed to the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

## **Preferred Stocks**

Preferred stock represents an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from liquidation of the company. Some preferred stocks also entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company's common stock, and thus also represent an ownership interest in the company. The preferred stocks in which the Fund invests will ordinarily have a variable dividend, generally determined on a quarterly or other periodic basis, either according to a formula based upon a specified premium or discount to the yield on particular U.S. Treasury securities or based on an auction process, involving bids submitted by holders and prospective purchasers of such stocks. Some preferred stocks offer a fixed rate of return with no maturity date. Because they never mature, these preferred stocks act like long-term bonds and can be more volatile than other types of preferred stocks and may have heightened sensitivity to changes in interest rates. Because preferred stocks represent an equity ownership interest in a company, their value usually will react more strongly than bonds and other debt instruments to actual or perceived changes in a company's financial condition or prospects, or to fluctuations in the equity markets.

## **Convertible Securities and Synthetic Convertible Securities**

The Fund may invest in convertible securities, which are debt securities that may be converted at either a stated price or stated rate into underlying shares of common stock. Convertible securities have general characteristics similar to both debt securities and equity securities. PIMCO will generally evaluate these

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instruments based primarily on their debt characteristics. Because most convertible securities are fixed rate instruments, the market value of convertible securities tends to decline as interest rates increase and, conversely, tends to increase as interest rates decline. In addition, because of the conversion feature, the market value of convertible securities tends to vary with fluctuations in the market value of the underlying common stocks and, therefore, also will react to variations in the general market for equity securities.

The Fund may also invest in synthetic convertible securities, which differ from convertible securities in certain respects. Unlike a true convertible security, which is a single security having a unitary market value, a synthetic convertible comprises two or more separate securities, each with its own market value. Therefore, the market value of a synthetic convertible security is the sum of the values of its debt component and its convertibility component. Synthetic convertible securities can be variable or fixed rate instruments. For these reasons, the values of a synthetic convertible and a true convertible security may respond differently to market fluctuations.

Convertible securities generally have higher yields than common stocks. There can be no assurance of current income because the issuers of the convertible securities may default on their obligations. A convertible security, in addition to providing current income, offers the potential for capital appreciation through the conversion feature, which enables the holder to benefit from increases in the market price of the underlying common stock.

## **Bank Capital Securities and Obligations**

The Fund may invest in bank capital securities. Bank capital securities are issued by banks to help fulfill their regulatory capital requirements. There are three common types of bank capital: Lower Tier II, Upper Tier II and Tier I. To the extent that the Fund invests in bank capital, it expects to primarily invest in floating rate Upper Tier II and Tier I bank capital. Bank capital is generally, but not always, of investment grade quality. Upper Tier II securities are commonly thought of as hybrids of debt and preferred stock. Upper Tier II securities are often perpetual (with no maturity date), callable and have a cumulative interest deferral feature. This means that under certain conditions, the issuer bank can withhold payment of interest until a later date. However, such deferred interest payments generally earn interest. Tier I securities often take the form of trust preferred securities.

The Fund may also invest in other bank obligations, including certificates of deposit, bankers' acceptances and fixed time deposits. Certificates of deposit are negotiable certificates issued against funds deposited in a commercial bank for a definite period of time and earning a specified return. Bankers' acceptances are negotiable drafts or bills of exchange, normally drawn by an importer or exporter to pay for specific merchandise, which are accepted by a bank, meaning, in effect, that the bank unconditionally agrees to pay the face value of the instrument on maturity. Fixed time deposits are bank obligations payable at a stated maturity date and bearing interest at a fixed rate. Fixed time deposits may be withdrawn on demand by the investor, but may be subject to early withdrawal penalties which vary depending upon market conditions and the remaining maturity of the obligation.

## **Zero-Coupon Bonds, Step-Ups and Payment-In-Kind Securities**

Zero-coupon bonds pay interest only at maturity rather than at intervals during the life of the security. Like zero-coupon bonds, step up bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security. Payment-in-kind securities (PIKs) are debt obligations that pay interest in the form of other debt obligations, instead of in cash. Each of these instruments is normally issued and traded at a deep discount from face value. Zero-coupon bonds, step-ups and PIKs allow an issuer to avoid or delay the need to generate cash to meet current interest payments and, as a result, may involve greater credit risk than bonds that pay interest currently or in cash. The Fund would be required to distribute the income on these instruments as it accrues, even though the



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Fund will not receive the income on a current basis or in cash. Thus, the Fund may have to sell other investments, including when it may not be advisable to do so, to make income distributions to its shareholders.

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### **Foreign (Non-U.S.) Investments and Currencies**

The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of foreign issuers and of supra-national government entities. Supra-national entities include international organizations that are organized or supported by one or more government entities to promote economic reconstruction or development and by international banking institutions and related governmental agencies. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. Up to 10% of the Fund's total assets may be invested in debt securities of issuers located in emerging markets. Investing in foreign securities involves special risks and considerations not typically associated with investing in U.S. securities. See *Risks* General Risks of Investing in the Fund Foreign (Non-U.S.) Investment Risk.

Most of the foreign investments of the Fund will consist of Senior Loans originated in a foreign jurisdiction or to which a foreign lender or borrower is a party, or other floating rate debt instruments of non-U.S. corporate issuers.

The U.S. dollar-denominated foreign securities in which the Fund may invest include Eurodollar obligations and Yankee Dollar obligations. Eurodollar obligations are U.S. dollar-denominated certificates of deposit and time deposits issued outside the U.S. capital markets by foreign branches of U.S. banks and by foreign banks. Yankee Dollar obligations are U.S. dollar-denominated obligations issued in the U.S. capital markets by foreign banks. Eurodollar and Yankee Dollar obligations are generally subject to the same risks that apply to domestic debt issues, notably credit risk, market risk and liquidity risk. Additionally, Eurodollar (and to a limited extent, Yankee Dollar) obligations are subject to certain sovereign risks. One such risk is the possibility that a sovereign country might prevent capital, in the form of U.S. dollars, from flowing across its borders. Other risks include adverse political and economic developments; the extent and quality of government regulation of financial markets and institutions; the imposition of foreign withholding taxes; and the expropriation or nationalization of foreign issuers.

The Fund also may invest in sovereign debt issued by foreign governments, their agencies or instrumentalities, or other government-related entities. As a holder of sovereign debt, the Fund may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. In addition, there are generally no bankruptcy proceedings similar to those in the United States by which defaulted sovereign debt may be collected. The Fund also may invest in Brady Bonds, which are securities created through the exchange of existing commercial bank loans to sovereign entities for new obligations in connection with a debt restructuring. Investments in Brady Bonds may be viewed as speculative. Brady Bonds acquired by the Fund may be subject to restructuring arrangements or to requests for new credit, which may cause the Fund to realize a loss of interest or principal on any of its portfolio holdings.

*Foreign Currencies and Related Transactions.* The Fund's investments in securities that trade in, or receive revenues in, foreign currencies will be subject to currency risk, which is the risk that fluctuations in the exchange rates between the U.S. dollar and foreign currencies may negatively affect any investment. The Fund may engage in a variety of transactions involving foreign currencies in order to hedge against foreign currency risk, to increase exposure to a foreign currency or to shift exposure to foreign currency fluctuations from one currency to another. For instance, the Fund may purchase foreign currencies on a spot (cash) basis and enter into forward foreign currency exchange contracts, foreign currency futures contracts and options on foreign currencies and futures. Suitable hedging transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in such transactions at any given time or from time to time. Also, these transactions may not be successful and may eliminate any chance for the Fund to benefit from favorable fluctuations in relevant foreign currencies.

Please see *Investment Objective and Policies Foreign (Non-U.S.) Securities*, *Investment Objective and Policies Foreign Currency Transactions* and *Investment Objective and Policies Foreign Currency Exchange-Related Securities* in the SAI for a more detailed description of the types of foreign investments and foreign currency transactions in which the Fund may invest and their related risks.



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### **Derivatives**

The Fund may, but is not required to, use a variety of derivative instruments for hedging or risk management purposes or as part of its investment strategies. Generally, derivatives are financial contracts whose value depends upon, or is derived from, the value of an underlying asset, reference rate or index, and may relate to individual debt instruments, interest rates, currencies or currency exchange rates, and related indexes. As part of its strategy to invest in floating rate assets, the Fund may enter into derivatives in connection with investments in fixed rate securities to effectively convert the fixed rate interest payments into floating rate payments. The Fund may also use derivatives to gain exposure to floating rate or high yield securities and other securities in which the Fund may invest (including pending investment of the proceeds of this offering). Examples of derivative instruments that the Fund may use include, but are not limited to, options, futures contracts, options on futures contracts, swap agreements (including total return and credit default swaps) and short sales. The Fund may also engage in credit spread trades. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities, where the value of the investment position is determined by changes in the difference between such prices or interest rates, as the case may be, of the respective securities. The Fund may also have exposure to derivatives, such as interest rate or credit-default swaps, through investment in credit-linked trust certificates and other securities issued by special purpose or structured vehicles. The Fund may also use derivatives to add leverage to the portfolio, but only as a substitute for leverage obtained through preferred shares. The Fund's use of derivative instruments involves risks different from, or possibly greater than, the risks associated with investment directly in securities and other more traditional investments. See **Risks** General Risks of Investing in the Fund **Derivatives Risk**. Certain types of derivative instruments that the Fund may utilize with some frequency are described elsewhere in this section, including those described under **Credit Default Swaps**, **Certain Interest Rate Transactions**, **Structured Notes and Related Instruments** and **Credit-Linked Trust Certificates**. Please see **Investment Objective and Policies** **Derivative Instruments** in the SAI for additional information about these and other derivative instruments that the Fund may use and the risks associated with such instruments. There is no assurance that these derivative strategies will be available at any time or that PIMCO will determine to use them for the Fund or, if used, that the strategies will be successful. In addition, the Fund will be subject to certain restrictions on its use of derivative strategies imposed by Moody's and Fitch Ratings (and may be subject to these and/or other restrictions by any rating agency that may in the future rate the AMPS) in connection with their expected issuance of ratings for issued by the Fund. See **Description of AMPS** **Rating Agency Guidelines and Asset Coverage**.

### **Credit Default Swaps**

The Fund may enter into credit default swap contracts for hedging purposes, to add leverage to the portfolio or for general investment purposes. When used for hedging purposes, the Fund would be the buyer of a credit default swap contract. In that case, the Fund would be entitled to receive the par (or other agreed-upon) value of a referenced debt obligation from the counterparty to the contract in the event of a default by a third party, such as a U.S. or foreign issuer, on the debt obligation. In return, the Fund would pay to the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would have spent the stream of payments and received no benefit from the contract. When the Fund is the seller of a credit default swap contract, it receives the stream of payments but is obligated to pay upon default of the referenced debt obligation. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total assets, the Fund would be subject to investment exposure on the notional amount of the swap.

### **Commercial and Other Mortgage-Related and Asset-Backed Securities**

Mortgage-related securities are debt instruments which provide periodic payments consisting of interest and/or principal that are derived from or related to payments of interest and/or principal on underlying mortgages. Additional payments on mortgage-related securities may be made out of unscheduled prepayments of

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principal resulting from the sale of the underlying property, or from refinancing or foreclosure, net of fees or costs that may be incurred. The mortgage-related securities in which the Fund invests will typically pay variable rates of interest, although the Fund may invest in fixed rate obligations as well.

The Fund may invest in commercial mortgage-related securities issued by corporations. These are securities that represent an interest in, or are secured by, mortgage loans secured by commercial property, such as industrial and warehouse properties, office buildings, retail space and shopping malls, multifamily properties and cooperative apartments, hotels and motels, nursing homes, hospitals and senior living centers. The commercial mortgage loans that underlie commercial mortgage-related securities have certain distinct risk characteristics. Commercial mortgage loans generally lack standardized terms, which may complicate their structure. Commercial properties themselves tend to be unique and difficult to value. Commercial mortgage loans tend to have shorter maturities than residential mortgage loans, and may not be fully amortizing, meaning that they may have a significant principal balance, or balloon payment, due on maturity. In addition, commercial properties, particularly industrial and warehouse properties, are subject to environmental risks and the burdens and costs of compliance with environmental laws and regulations.

Other mortgage-related securities in which the Fund may invest include mortgage pass-through securities, collateralized mortgage obligations ( CMOs ), mortgage dollar rolls, CMO residuals (other than residual interests in real estate mortgage investment conduits), stripped mortgage-backed securities ( SMBSs ) and other securities that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property.

The Fund may invest in other types of asset-backed securities that are offered in the marketplace, including Enhanced Equipment Trust Certificates ( EETCs ) and collateralized debt obligations ( CDOs ). Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. EETCs tend to be less liquid than bonds. CDOs include collateralized bond obligations ( CBOs ), collateralized loan obligations ( CLOs ) and other similarly structured securities. A CBO is a trust typically backed by a diversified pool of high-risk, below investment grade fixed income securities. A CLO is a trust typically collateralized by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans. While the trusts that issue CDOs may themselves be leveraged and may invest in lower-quality instruments, the Fund will generally purchase only senior CDOs, will not purchase residual CDOs and will only purchase CDOs that meet the Fund's credit policies.

Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence of, or defalcation by, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that utilize the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets. The issuers of certain asset-backed securities bear various expenses, including, without limitation, servicing and advisory fees.

Please see Investment Objective and Policies Mortgage-Related and Other Asset-Backed Securities in the SAI and Risks General Risks of Investing in the Fund Mortgage-Related and Asset-Backed Risk in this prospectus for a more detailed description of the types of mortgage-related and other asset-backed securities in which the Fund may invest and their related risks.

## **Real Estate Investment Trusts (REITs)**

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The Fund may invest in REITs. REITs primarily invest in income-producing real estate or real estate related loans or interests. REITs are generally classified as equity REITs, mortgage REITs or a combination of

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equity and mortgage REITs. Equity REITs invest the majority of their assets directly in real property and derive income primarily from the collection of rents. Equity REITs can also realize capital gains by selling properties that have appreciated in value. Mortgage REITs invest the majority of their assets in real estate mortgages and derive income from the collection of interest payments. REITs are not taxed on income distributed to shareholders provided they comply with the applicable requirements of the Code. The Fund will indirectly bear its proportionate share of any management and other expenses paid by REITs in which it invests in addition to the expenses paid by the Fund. Debt securities issued by REITs are, for the most part, general and unsecured obligations and are subject to risks associated with REITs. Please see Investment Objective and Policies Real Estate Investment Trusts ( REITs ) in the SAI for a more detailed description of these instruments and their related risks.

## **Delayed Funding Loans and Revolving Credit Facilities**

The Fund may enter into, or acquire participations in, delayed funding loans and revolving credit facilities, in which a lender agrees to make loans up to a maximum amount upon demand by the borrower during a specified term. These commitments may have the effect of requiring the Fund to increase its investment in a company at a time when it might not be desirable to do so (including at a time when the company's financial condition makes it unlikely that such amounts will be repaid). Delayed funding loans and revolving credit facilities are subject to credit, interest rate and liquidity risk and the risks of being a lender.

## **Certain Interest Rate Transactions**

The Fund may enter into long and short interest rate swap, cap or floor transactions. One possible use of interest rate swaps involves the Fund's agreement with the swap counterparty to pay a fixed rate payment in exchange for the counterparty paying the Fund a variable rate payment. The payment obligation would be based on the notional amount of the swap. The Fund may use an interest rate cap or floor, which would require the Fund to pay a premium to the cap or floor counterparty and would entitle the Fund, to the extent that a specified variable rate index exceeds a predetermined fixed rate, to receive from the counterparty payment of the difference based on the notional amount. The Fund may use interest rate swaps, caps and floors for hedging or general investment purposes. The Fund may choose or be required to redeem some or all of the AMPS. This redemption may result in the Fund seeking to terminate early all or a portion of any swap, cap or floor transaction. Any termination of a cap, swap or floor could result in a termination payment by or to the Fund.

## **Structured Notes and Related Instruments**

The Fund may invest in structured notes and other related instruments, which are privately negotiated debt obligations where the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest rate (an embedded index), such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets, such as indexes reflecting bonds. Structured instruments may be issued by corporations, including banks, as well as by governmental agencies. The terms of such structured instruments normally provide that their principal and/or interest payments are to be adjusted upwards or downwards (but ordinarily not below zero) to reflect changes in the embedded

index while the structured instruments are outstanding. As a result, the interest and/or principal payments that may be made on a structured product may vary widely, depending on a variety of factors, including the volatility of the embedded index and the effect of changes in the embedded index on principal and/or interest payments. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index(es) or other asset(s). Application of a multiplier involves leverage that will serve to magnify the potential for gain and the risk of loss.

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PIMCO may utilize structured instruments for investment purposes and also for risk management purposes. While structured instruments may offer the potential for a favorable rate of return from time to time, they also entail certain risks. Structured instruments may be less liquid than other debt securities, and the price of



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structured instruments may be more volatile. In some cases, depending on the terms of the embedded index, a structured instrument may provide that the principal and/or interest payments may be adjusted below zero. Structured instruments also may involve significant credit risk and risk of default by the counterparty. Although structured instruments are not necessarily illiquid, PIMCO believes that currently most structured instruments are illiquid. Like other sophisticated strategies, the Fund's use of structured instruments may not work as intended. If the value of the embedded index changes in a manner other than that expected by PIMCO, principal and/or interest payments received on the structured instrument may be substantially less than expected.

## **Reverse Repurchase Agreements**

The Fund may utilize reverse repurchase agreements in order to add leverage to the portfolio as a substitute for, rather than in addition to, leverage obtained through the issuance of preferred shares. In a reverse repurchase agreement, the Fund sells securities to a bank or broker-dealer and agrees to repurchase the securities at a mutually agreed date and price. Generally, the effect of such a transaction is that the Fund can recover and reinvest all or most of the cash invested in the portfolio securities involved during the term of the reverse repurchase agreement and still be entitled to the returns associated with those portfolio securities. Such transactions are advantageous if the interest cost to the Fund of the reverse repurchase transaction is less than the returns it obtains on investments purchased with the cash.

Unless the Fund covers its positions in reverse repurchase agreements (by segregating liquid assets at least equal in amount to the forward purchase commitment), its obligations under the agreements will be subject to the Fund's limitations on borrowings. Reverse repurchase agreements involve leverage risk and also the risk that the market value of the securities that the Fund is obligated to repurchase under the agreement may decline below the repurchase price. In the event the buyer of securities under a reverse repurchase agreement files for bankruptcy or becomes insolvent, the Fund's use of the proceeds of the agreement may be restricted pending a determination by the other party, or its trustee or receiver, whether to enforce the Fund's obligation to repurchase the securities.

## **Repurchase Agreements**

The Fund may enter into repurchase agreements, in which the Fund purchases a security from a bank or broker-dealer and the bank or broker-dealer agrees to repurchase the security at the Fund's cost plus interest within a specified time. If the party agreeing to repurchase should default, the Fund will seek to sell the securities which it holds. This could involve transaction costs or delays in addition to a loss on the securities if their value should fall below their repurchase price. Repurchase agreements maturing in more than seven days are considered to be illiquid securities.

## **U.S. Government Securities**

The Fund may invest in U.S. Government securities, which are obligations of, or guaranteed by, the U.S. Government, its agencies or government-sponsored enterprises. U.S. Government securities include a variety of securities that differ in their interest rates, maturities and dates of issue. Securities issued or guaranteed by agencies or instrumentalities of the U.S. Government may or may not be supported by the full faith and credit of the United States or by the right of the issuer to borrow from the U.S. Treasury.

## **Municipal Bonds**

Municipal bonds are generally issued by states, municipalities and other political subdivisions, agencies, authorities and instrumentalities of states and multi-state agencies or authorities. Like other debt obligations, municipal bonds are subject to interest rate, credit and market risk. The ability of a municipal issuer to make payments could be affected by litigation, legislation or other political events or the bankruptcy of the issuer. The types of municipal bonds in which the Fund may invest include municipal lease obligations. The Fund also may invest in securities issued by entities whose underlying assets are municipal bonds.

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### **When Issued, Delayed Delivery and Forward Commitment Transactions**

The Fund may purchase securities which it is eligible to purchase on a when-issued basis, may purchase and sell such securities for delayed delivery and may make contracts to purchase such securities for a fixed price at a future date beyond normal settlement time (forward commitments). When-issued transactions, delayed delivery purchases and forward commitments involve a risk of loss if the value of the securities declines prior to the settlement date. This risk is in addition to the risk that the Fund's other assets will decline in value. Therefore, these transactions may result in a form of leverage and increase the Fund's overall investment exposure. Typically, no income accrues on securities the Fund has committed to purchase prior to the time delivery of the securities is made, although the Fund may earn income on securities it has segregated to cover these positions.

### **Credit-Linked Trust Certificates**

Among the income-producing securities in which the Fund may invest are credit-linked trust certificates, which are investments in a limited purpose trust or other vehicle formed under state law which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to provide exposure to the high yield or another fixed income market. For instance, the Fund may invest in credit-linked trust certificates as a cash management tool in order to gain exposure to the high yield markets and/or to remain fully invested when more traditional income-producing securities are not available, including during the period when the net proceeds of this offering of AMPS are being invested.

Like an investment in a bond, investments in these credit-linked trust certificates represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the certificate. However, these payments are conditioned on the trust's receipt of payments from, and the trust's potential obligations to, the counterparties to the derivative instruments and other securities in which the trust invests. For instance, the trust may sell one or more credit default swaps, under which the trust would receive a stream of payments over the term of the swap agreements provided that no event of default has occurred with respect to the referenced debt obligation upon which the swap is based. If a default occurs, the stream of payments may stop and the trust would be obligated to pay to the counterparty the par (or other agreed upon value) of the referenced debt obligation. This, in turn, would reduce the amount of income and principal that the Fund would receive as an investor in the trust. Please see **Credit Default Swaps** above for additional information about credit default swaps. The Fund's investments in these instruments are indirectly subject to the risks associated with derivative instruments, including, among others, credit risk, default or similar event risk, counterparty risk, interest rate risk, leverage risk and management risk. It is expected that the trusts which issue credit-linked trust certificates will constitute private investment companies, exempt from registration under the 1940 Act. Therefore, the certificates will be subject to the risks described under **Other Investment Companies** in the SAI, and will not be subject to applicable investment limitations and other regulation imposed by the 1940 Act (although the Fund will remain subject to such limitations and regulation, including with respect to its investments in the certificates). Although the trusts are typically private investment companies, they are generally not actively managed such as a hedge fund might be. It is also expected that the certificates will be exempt from registration under the Securities Act of 1933. Accordingly, there may be no established trading market for the certificates and they may constitute illiquid investments. See **Risks General Risks of Investing in the Fund Liquidity Risk**. If market quotations are not readily available for the certificates, they will be valued by the Fund at fair value as determined by the Board of Trustees or persons acting at its direction. See **Net Asset Value**. The Fund may lose its entire investment in a credit-linked trust certificate.

### **Short Sales**

A short sale is a transaction in which the Fund sells an instrument that it does not own in anticipation that the market price will decline. The Fund may use short sales for investment and risk management purposes. When the Fund engages in a short sale, it must borrow the security sold short and deliver it to the counterparty. The Fund may have to pay a fee to borrow particular securities and would often be obligated to pay over

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payments received on such borrowed securities. The Fund's obligation to replace the borrowed security will be secured by collateral deposited with the lender, which is usually a broker-dealer, and/or with the Fund's custodian. The Fund may not receive any payments (including interest) on its collateral. Short sales expose the Fund to the risk that it will be required to cover its short position at a time when the securities have appreciated in value, thus resulting in a loss to the Fund. The Fund may engage in so-called "naked" short sales where it does not own or have the immediate right to acquire the security sold short at no additional cost, in which case the Fund's losses could theoretically be unlimited.

## **Lending of Portfolio Securities**

For the purpose of achieving income, the Fund may lend its portfolio securities to brokers, dealers, and other financial institutions provided a number of conditions are satisfied, including that the loan is fully collateralized. Please see "Investment Objective and Policies - Securities Loans" in the SAI for details. When the Fund lends portfolio securities, its investment performance will continue to reflect changes in the value of the securities loaned, and the Fund will also receive a fee or interest on the collateral. Securities lending involves the risk of loss of rights in the collateral or delay in recovery of the collateral if the borrower fails to return the security loaned or becomes insolvent. The Fund may pay lending fees to the party arranging the loan.

## **Rating Agency Requirements**

In connection with rating the AMPS, Moody's and Fitch Ratings will impose asset coverage tests and other restrictions that may limit the Fund's ability to engage in certain of the transactions described above. See "Description of AMPS - Rating Agency Guidelines and Asset Coverage."

*Please see "Investment Objective and Policies" in the SAI for additional information regarding the investments of the Fund and their related risks.*

## **RISKS**

Risk is inherent in all investing. Investing in any investment company security involves risk, including the risk that you may receive little or no return on your investment or even that you may lose part or all of your investment. Therefore, before purchasing AMPS, you should consider carefully the following risks that you assume when you invest in the Fund.

### **Risks of Investing in the AMPS**

**Auction Risk.** You may not be able to sell your AMPS at an auction if the auction fails; that is, if there are more AMPS offered for sale than there are buyers for those shares. If sufficient clearing bids do not exist in an auction, the Applicable Rate will be the maximum applicable rate, and in such event, owners of AMPS wishing to sell will not be able to sell all, and may not be able to sell any, of such shares in the auction. As a result, your investment in AMPS may be illiquid. Neither the Broker-Dealers nor the Fund is obligated to purchase AMPS in an auction or otherwise, nor is the Fund required to redeem AMPS in the event of a failed auction. Also, if you place bid orders (orders to retain AMPS) at an auction only at a specified rate, and that bid rate exceeds the Applicable Rate set at the auction, you will not retain your AMPS. If you elect to

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retain AMPS without specifying a rate below which you would not wish to continue to hold those AMPS, and the auction sets a below-market rate, you may receive a lower rate of return on your AMPS than the market rate. The rate period for the AMPS may be changed by the Fund, subject to certain conditions and with notice to the holders of the AMPS, which could also affect the liquidity of your investment. See Description of AMPS The Auction.

*Ratings and Asset Coverage Risk.* While it is a condition to the closing of the offering that Moody's assigns a rating of Aaa and Fitch Ratings assigns a rating of AAA to the AMPS, these ratings will not

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eliminate or necessarily mitigate the risks of investing in the AMPS. Moody's, Fitch Ratings or another rating agency then rating the AMPS could downgrade the AMPS, which may make your shares less liquid at an auction or in the secondary market. If a rating agency downgrades the AMPS, the Fund may (but is not required to) alter its portfolio in an effort to improve the rating, although there is no assurance that it will be able to do so to the extent necessary to restore the prior rating. In addition, the Fund may be forced to redeem your AMPS to meet regulatory or rating agency requirements. The Fund may also voluntarily redeem AMPS under certain circumstances. See Description of AMPS Redemption. The Fund may not redeem AMPS if such a redemption would cause the Fund to fail to meet regulatory or rating agency asset coverage requirements, and the Fund may not declare, pay or set apart for payment any dividend or other distribution if immediately thereafter the Fund would fail to meet regulatory asset coverage requirements. In addition, as a condition to its receipt of a Aaa rating (by Moody's) and a AAA rating (by Fitch Ratings) on the AMPS, the Fund has agreed to certain investment limitations, which may restrict the Fund from making investments that PIMCO believes would benefit the Fund. See Description of AMPS Rating Agency Guidelines and Asset Coverage for descriptions of the significance and limitations of the ratings on the AMPS and of the asset maintenance and other tests the Fund must meet.

*Secondary Market Risk.* If you try to sell your AMPS between auctions, you may not be able to sell any or all of your shares, or you may not be able to sell them for \$25,000 per share or \$25,000 per share plus accumulated dividends. Changes in interest rates could affect the price you would receive if you sold your shares in the secondary market, particularly if the Fund has designated a special rate period (a rate period of more than seven days). Broker-dealers that maintain a secondary trading market (if any) for the AMPS are not required to maintain this market, and the Fund is not required to redeem shares if either an auction or an attempted secondary market sale fails because of a lack of buyers. The AMPS are not listed on a stock exchange or the Nasdaq Stock Market, Inc. (NASDAQ). If you sell your AMPS to a broker-dealer between auctions, you may receive less than the price you paid for them, especially when market interest rates have risen since the last auction or during a special rate period. In addition, a Broker-Dealer may, in its own discretion, decide to sell the AMPS in the secondary market to investors at any time and at any price, including at prices equivalent to, below or above the par value of the AMPS.

*Securities and Exchange Commission Inquiries.* The Underwriters have advised the Fund that certain Broker-Dealers and other participants in the auction rate securities markets, including both taxable and tax exempt markets, have received letters from the Securities and Exchange Commission requesting that each of them voluntarily conduct an investigation regarding their respective practices and procedures in those markets. Those Broker-Dealers have indicated to the Fund that they are cooperating and expect to continue to cooperate with the Securities and Exchange Commission in providing the requested information. No assurance can be given as to whether the results of this process will affect the market for the AMPS or the auctions.

*Restrictions on Dividends and Other Distributions.* Restrictions imposed on the declaration and payment of dividends or other distributions to the holders of the Fund's Common Shares and AMPS, both by the 1940 Act and by requirements imposed by rating agencies, might impair the Fund's ability to maintain its qualification as a regulated investment company for federal income tax purposes. While the Fund intends to redeem AMPS to enable the Fund to distribute its income as required to maintain its qualification as a regulated investment company under the Code, there can be no assurance that such redemptions can be effected in time to meet the requirements of the Code. See Tax Matters.

## **General Risks of Investing in the Fund**

*Limited Operating History.* The Fund is a recently organized, diversified, closed-end management investment company which has been operational for approximately seven weeks.

*Credit Risk/High Yield Risk.* In general, lower rated debt securities (including many Senior Loans) carry a greater degree of risk that the issuer will lose its ability to make interest and principal payments, which could have a negative impact on the Fund's net asset value or dividends. The Fund may invest without limit and





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ordinarily expects to invest a substantial portion of its assets in debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's, below BBB- by either S&P or Fitch Ratings, or below a comparable rating by Dominion) or that are unrated but judged by PIMCO to be of comparable quality, including debt securities that are in default or the issuers of which are in bankruptcy. Debt securities rated below investment grade quality are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal, and are commonly referred to as high yield securities or junk bonds. The prices of these lower grade bonds are generally more volatile and sensitive to actual or perceived negative developments, such as a decline in the issuer's revenues or revenues of the borrowers underlying Senior Loans or a general economic downturn, than are the prices of higher grade securities. In addition, the secondary market on which high yield securities are traded may be less liquid than the market for investment grade securities, meaning these securities are subject to greater liquidity risk than investment grade securities. Bonds in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies.

High yield securities may be more susceptible to real or perceived adverse economic and competitive industry conditions than investment grade securities. A projection of an economic downturn or of a period of rising interest rates, for example, could cause a decline in high yield security prices because the advent of a recession could lessen the ability of an issuer to make principal and interest payments on its debt obligations. If an issuer of high yield securities defaults, in addition to risking non-payment of all or a portion of interest and principal, the Fund may incur additional expenses to seek recovery. Although Senior Loans in which the Fund will invest will often be secured by collateral, there can be no assurance that liquidation of such collateral would satisfy the borrower's obligation in the event of a default or that such collateral could be readily liquidated. In the event of bankruptcy of a borrower, the Fund could experience delays or limitations in its ability to realize the benefits of any collateral securing a Senior Loan. The Fund may also invest in Senior Loans that are not secured. In addition, the Fund may purchase interests in Senior Loans from financial intermediaries whereby the Fund depends on the intermediary for payment of principal and interest on the Senior Loan. A decline in the financial soundness of the intermediary may adversely affect the Fund. The market prices of high yield securities structured as zero-coupon, step-up or payment-in-kind securities will normally be affected to a greater extent by interest rate changes, and therefore tend to be more volatile than the prices of securities that pay interest currently and in cash. PIMCO seeks to reduce these risks through diversification, credit analysis and attention to current developments and trends in both the economy and financial markets.

The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue. In determining whether to retain or sell such a security, PIMCO may consider such factors as PIMCO's assessment of the credit quality of the issuer of such security, the price at which such security could be sold and the rating, if any, assigned to such security by other rating agencies. Analysis of creditworthiness may be more complex for issuers of high yield securities than for issuers of higher quality debt securities. Because of the Fund's emphasis on Senior Loans and other below investment grade debt obligations, PIMCO's capabilities in this area will be particularly important.

In addition to the credit risks associated with high yield securities, the Fund could also lose money if the issuer of other debt obligations, or the counterparty to a derivatives contract, repurchase agreement, loan of portfolio securities or other obligation, is, or is perceived to be, unable or unwilling to make timely principal and/or interest payments, or to otherwise honor its obligations. The downgrade of a security may further decrease its value.

*Liquidity Risk.* The Fund may invest without limit in securities which are illiquid at the time of investment. The term "illiquid securities" for this purpose is generally determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, *i.e.*, securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities. Illiquid securities may be subject to wide fluctuations in market value. The Fund may be subject to significant delays in disposing of illiquid securities. Accordingly, the Fund may be forced to sell

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these securities at less than fair market value or may not be able to sell them when PIMCO believes it is desirable to do so. Illiquid securities also may entail registration expenses and other transaction costs that are higher than those for liquid securities. Restricted securities, *i.e.*, securities subject to legal or contractual restrictions on resale, may also be illiquid. In general, below investment grade debt securities tend to be less liquid than higher-rated securities. PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

*Leverage Risk.* The Fund utilizes leverage on an ongoing basis for investment purposes. Leverage risk includes the risk associated with the issuance of the AMPS in order to leverage the Common Shares. As a substitute for AMPS or other preferred shares, the Fund may also leverage the Common Shares through the borrowing of money, the issuance of debt securities or the use of credit default swaps, reverse repurchase agreements and other derivatives, as well as when-issued, delayed delivery or forward commitment transactions. After completion of the offering of AMPS, the Fund anticipates that its total leverage from the issuance of AMPS will represent approximately 38% of the Fund's total assets. The precise amount of leverage used by the Fund may vary from time to time, but the Fund will not incur leverage (including preferred shares) in an amount exceeding 50% of its total assets. Although the Fund may in the future offer other preferred shares, the Fund does not currently intend to offer preferred shares other than the AMPS offered in this prospectus. Any preferred shares or borrowings will have seniority over the Common Shares.

If the dividend rate on the AMPS exceeds the net rate of return on the Fund's portfolio, the leverage will result in a lower net asset value than if the Fund were not leveraged, and the Fund's ability to pay dividends and meet its asset coverage requirements on the AMPS would be reduced. It is expected that this risk should be partially mitigated because the dividend rates on the AMPS and the interest rates on the Fund's portfolio of Senior Loans and other floating rate debt instruments are expected to vary in a similar manner. Any decline in the net asset value of the Fund's investments could result in the Fund being in danger of failing to meet its asset coverage requirements or of losing its expected Aaa rating (in the case of Moody's) or AAA rating (in the case of Fitch Ratings) on the AMPS. In an extreme case, the Fund's current investment income might not be sufficient to meet the dividend requirements on the AMPS. In order to counteract such an event, the Fund might need to liquidate investments in order to fund a redemption of some or all of the AMPS. Liquidation at times of adverse economic conditions may result in a capital loss to the Fund. There is no assurance that the Fund's leveraging strategy will be successful.

While the Fund may from time to time consider reducing leverage in response to actual or anticipated changes in interest rates in an effort to mitigate the increased volatility of current income and net asset value associated with leverage, there can be no assurance that the Fund will actually reduce leverage in the future or that any reduction, if undertaken, will be effective. Changes in the future direction of interest rates are very difficult to predict accurately. If the Fund were to reduce leverage based on a prediction about future changes to interest rates, and that prediction turned out to be incorrect, the reduction in leverage would likely operate to reduce the Fund's net asset value relative to the circumstance where the Fund had not reduced leverage. The Fund may decide that this risk outweighs the likelihood of achieving the desired reduction to volatility in income and net asset value if the prediction were to turn out to be correct, and determine not to reduce leverage as described above.

Because the fees received by the Manager are based on the total managed assets of the Fund (including assets attributable to any AMPS and borrowings that may be outstanding), the fees will be higher when AMPS are issued or borrowings are utilized; and the Manager therefore has a financial incentive for the Fund to issue AMPS or utilize borrowings.

*Issuer Risk.* The value of floating rate and other debt instruments may decline for a number of reasons which directly relate to the issuer or borrower, such as management performance, financial leverage and reduced demand for the issuer's or borrower's goods and services.

*Smaller Company Risk.* The Fund may invest in smaller companies. The general risks associated with floating rate and other debt instruments are particularly pronounced for securities issued by companies with



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smaller market capitalizations. These companies may have limited product lines, markets or financial resources or they may depend on a few key employees. As a result, they may be subject to greater levels of credit, market and issuer risk. Securities of smaller companies may trade less frequently and in lesser volume than more widely held securities and their values may fluctuate more sharply than other securities. Companies with medium-sized market capitalizations may have risks similar to those of smaller companies.

*Management Risk.* The Fund is subject to management risk because it is an actively managed investment portfolio. PIMCO and the individual portfolio managers will apply investment techniques and risk analyses in making investment decisions for the Fund, but there can be no guarantee that these will produce the desired results.

*Foreign (Non-U.S.) Investment Risk.* The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of foreign issuers. The Fund may invest up to 25% of its total assets in debt instruments denominated in foreign currencies, including obligations of non-U.S. governments and their respective sub-divisions, agencies and government-sponsored enterprises. The Fund's investments in foreign issuers and in securities denominated in foreign currencies involve special risks. There may be less information publicly available about a foreign issuer than about a U.S. issuer, and foreign issuers are not generally subject to accounting, auditing and financial reporting standards and practices comparable to those in the United States. The securities of some foreign issuers are less liquid and at times more volatile than securities of comparable U.S. issuers. Foreign brokerage costs, custodial expenses and other fees are also generally higher than for securities traded in the United States. With respect to certain foreign countries, there is also a possibility of expropriation of assets, confiscatory taxation, political or financial instability and diplomatic developments which could affect the value of investments in those countries. In addition, income received by the Fund from sources within foreign countries may be reduced by withholding and other taxes imposed by such countries.

The value of securities denominated in foreign currencies may fluctuate based on changes in the value of those currencies relative to the U.S. dollar, and a decline in applicable foreign exchange rates could reduce the value of such securities held by the Fund. The values of foreign investments and the investment income derived from them also may be affected unfavorably by changes in currency exchange control regulations. In addition, although a portion of the Fund's investment income may be received or realized in foreign currencies, the Fund will be required to compute and distribute its income in U.S. dollars. Therefore, if the exchange rate for any such currency declines after the Fund's income has been earned and translated into U.S. dollars but before payment, the Fund could be required to liquidate portfolio securities to make such distributions.

*Emerging Markets Risk.* The Fund may invest up to 10% of its total assets in debt securities of issuers located in emerging markets. Foreign investment risk may be particularly high to the extent that the Fund invests in securities of issuers based in or securities denominated in the currencies of emerging market countries. These securities may present market, credit, currency, liquidity, legal, political and other risks different from, and greater than, the risks of investing in developed foreign countries. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of foreign issuers to a heightened degree. These heightened risks include: (i) greater risks of expropriation, confiscatory taxation, nationalization and less social, political and economic stability; (ii) the smaller size of the market for such securities and a lower volume of trading, resulting in lack of liquidity and in price volatility; and (iii) certain national policies which may restrict the Fund's investment opportunities, including restrictions on investing in issuers or industries deemed sensitive to relevant national interests.

*Derivatives Risk.* Derivatives are financial contracts whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indexes). The Fund may invest in a variety of derivative instruments for hedging or risk management purposes or as part of its investment strategies, such as options contracts (including options on futures contracts), futures contracts, swap agreements (including total return and credit-default swaps) and short sales. As part of its strategy to invest in floating rate assets, the Fund may enter into derivatives in connection with investments in fixed rate securities to effectively



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convert the fixed rate interest payments into floating rate payments. The Fund may also have exposure to derivatives, such as interest rate or credit default swaps, through investment in credit-linked trust certificates and other securities issued by special purpose or structured vehicles. The Fund may use derivatives as a substitute for taking a position in an underlying debt instrument or other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate or currency risk. The Fund also may use derivatives to add leverage to the portfolio, but only as a substitute for leverage obtained through the AMPS or other preferred shares. The Fund's use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks described elsewhere in this prospectus, such as liquidity risk, interest rate risk, issuer risk, credit risk, leveraging risk, counterparty risk, management risk and, if applicable, smaller company risk. They also involve the risk of mispricing or improper valuation, the risk of ambiguous documentation, and the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index. If the Fund invests in a derivative instrument, it could lose more than the principal amount invested. Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial. In addition, the Fund will be subject to certain restrictions on its use of derivative strategies imposed by Moody's and Fitch Ratings (and may be subject to these and/or other restrictions by any rating agency that may in the future rate the AMPS) in connection with their expected issuance of ratings for AMPS issued by the Fund. See Description of AMPS Rating Agency Guidelines and Asset Coverage. The use of derivatives also may increase the amount of taxes payable by shareholders. In addition to the risks applicable to derivatives generally, credit default swaps involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty).

*Counterparty Risk.* In addition to credit risk with respect to the counterparties to the Senior Loans in which the Fund invests, the Fund will also be subject to credit risk with respect to the derivative contracts entered into directly by the Fund or held by special purpose or structured vehicles in which the Fund invests. If a counterparty becomes bankrupt or otherwise fails to perform its obligations due to financial difficulties, the Fund may experience significant delays in obtaining any recovery in a bankruptcy or other reorganization proceeding. The Fund may obtain only a limited recovery or may obtain no recovery in such circumstances.

*Mortgage-Related and Asset-Backed Risk.* The Fund may invest in a variety of mortgage-related securities, including commercial mortgage securities and other mortgage-backed instruments. Generally, rising interest rates tend to extend the duration of fixed rate mortgage-related securities, making them more sensitive to changes in interest rates. As a result, in a period of rising interest rates, mortgage-related securities held by the Fund may exhibit additional volatility. This is known as extension risk. PIMCO expects that the Fund will focus its mortgage-related investments principally in floating rate mortgage-related and other asset-backed securities, which should minimize the Fund's overall sensitivity to interest rate volatility and extension risk. However, because interest rates on most adjustable rate mortgage- and other asset-backed securities typically only reset periodically (e.g., monthly or quarterly), changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuation in the market value of these securities, including declines in market value as interest rates rise. In addition, adjustable and fixed rate mortgage-related securities are subject to prepayment risk—the risk that borrowers may pay off their mortgages sooner than expected, particularly when interest rates decline. This can reduce the Fund's returns because the Fund may have to reinvest that money at lower prevailing interest rates. The Fund's investments in other asset-backed securities are subject to risks similar to those associated with mortgage-related securities, as well as additional risks associated with the nature of the assets and the servicing of those assets.

*Risk of Investing in REITs.* Like other mortgage-related securities, REITs are subject to interest rate risk and prepayment risk. Investing in REITs also involves certain unique risks in addition to those risks associated with investing in the real estate industry in general. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A mortgage REIT may be affected by changes in interest

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rates and the ability of the issuers of its portfolio mortgages to repay their obligations. REITs are dependent upon the skills of their managers and are not diversified. REITs are generally dependent upon maintaining cash flows to repay borrowings and to make distributions to shareholders and are subject to the risk of default by lessees or borrowers. REITs whose underlying assets are concentrated in properties used by a particular industry, such as health care, are also subject to risks associated with such industry.

REITs may have limited financial resources, and their securities may trade less frequently and in a limited volume and may be subject to more abrupt or erratic price movements than larger company securities. Historically, REITs have been more volatile in price than the larger capitalization stocks included in Standard & Poor's 500 Stock Index.

*Interest Rate Risk.* Generally, when market interest rates rise, the prices of debt obligations (and particularly longer-term fixed rate obligations) fall, and vice versa. This interest rate risk is the risk that the debt obligations in the Fund's portfolio will decline in value because of increases in market interest rates. The prices of short-term floating rate and other debt obligations generally fluctuate less than prices of long-term debt obligations as interest rates change. Because the Fund will normally have a short portfolio duration (*i.e.*, a zero to one-year time frame), the Fund's net asset value will tend to fluctuate less in response to changes in market interest rates than if the Fund invested mainly in long-term debt securities. Although the Fund's net asset value will vary, PIMCO expects the Fund's policy of investing principally in floating rate assets will substantially reduce the Fund's overall sensitivity to market interest rate fluctuations. However, because rates on certain floating rate debt instruments typically only reset periodically (*e.g.*, monthly or quarterly), changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuation in the Fund's net asset value. Moreover, a portion of the Fund's assets may be invested in debt instruments with fixed rates of interest (including up to 20% of its assets in longer duration fixed rate instruments), which will generally lose value in direct response to rising interest rates. The Fund's use of leverage will tend to increase interest rate risk.

The AMPS pay dividends based on short-term interest rates for higher quality obligations, which will be reset frequently. The Fund will use the proceeds from the issuance of AMPS to buy floating rate high yield debt obligations and other investments in accordance with the Fund's investment objectives and policies. The yields on the floating rate debt and other obligations purchased by the Fund are ordinarily expected to be higher than the short-term interest rates payable on the AMPS. If short-term interest rates rise, the dividend rate on the AMPS may rise so that the amount of dividends paid to the holders of AMPS may approach or exceed the income from the portfolio securities purchased with the proceeds from the AMPS, although this risk should be partially mitigated due to the variable rate nature of the Fund's portfolio investments. Also, as described above, if long-term rates rise, the value of the Fund's investment portfolio may decline, reducing the amount of assets serving as asset coverage for the AMPS.

*Reinvestment Risk.* Reinvestment risk is the risk that income from the Fund's portfolio will decline if and when the Fund invests the proceeds from prepaid, matured, traded or called debt obligations at market interest rates that are below the portfolio's current earnings rate. A decline in income could affect the Fund's net asset value or reduce asset coverage on the AMPS.

*Inflation/Deflation Risk.* Inflation risk is the risk that the value of assets or income from the Fund's investments will be worth less in the future as inflation decreases the value of payments at future dates. As inflation increases, the real, or inflation-adjusted, value of the AMPS and distributions as well as the real value of the Fund's portfolio could decline. Deflation risk is the risk that prices throughout the economy decline over time the opposite of inflation. Deflation may have an adverse effect on the creditworthiness of issuers and may make issuer default more likely, which may result in a decline in the value of the Fund's portfolio. Deflation may also result in a decline in the dividend rate of the AMPS.

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*Regulatory Changes.* To the extent that legislation or state or federal bank or other regulators impose additional requirements or restrictions on the ability of certain financial institutions to make loans, particularly in connection with highly leverage transactions, the availability of Senior Loans and other related investments sought after by the Fund may be reduced. Further, such legislation or regulation could depress the market value of Senior Loans and other instruments held by the Fund.

*Confidential Information Access Risk.* In managing the Fund, PIMCO normally will seek to avoid the receipt by portfolio managers and analysts of material, non-public information ( Confidential Information ) about the issuers of Senior Loans and related investments being considered for acquisition by the Fund or held in the Fund's portfolio. In many instances, issuers offer to furnish Confidential Information to prospective purchasers or holders of the issuer's Senior Loans. In circumstances where PIMCO's portfolio managers and analysts do not receive Confidential Information from these issuers, the Fund may be disadvantaged in comparison to other Senior Loan investors, including with respect to the price the Fund pays or receives when it buys or sells a Senior Loan. Further, in situations where the Fund is asked, for example, to grant consents, waivers or amendments with respect to Senior Loans, PIMCO's ability to assess the desirability of such consents, waivers and amendments may be compromised.

*Market Disruption and Geopolitical Risk.* The war with Iraq, its aftermath and the continuing occupation of Iraq are likely to have a substantial impact on the U.S. and world economies and securities markets. The nature, scope and duration of the war and occupation and the potential costs of rebuilding the Iraqi infrastructure cannot be predicted with any certainty. Terrorist attacks on the World Trade Center and the Pentagon on September 11, 2001 closed some of the U.S. securities markets for a four-day period and similar future events cannot be ruled out. The war and occupation, terrorism and related geopolitical risks have led, and may in the future lead to, increased short-term market volatility and may have adverse long-term effects on U.S. and world economies and markets generally. Those events could also have an acute effect on individual issuers or related groups of issuers. These risks could also adversely affect individual issuers and securities markets, interest rates, auctions and auction participants, secondary trading, ratings, credit risk, inflation, deflation and other factors relating to the AMPS.

*Certain Affiliations.* Certain broker-dealers may be considered to be affiliated persons of the Fund, the Manager and/or PIMCO due to their possible affiliations with Allianz AG, the ultimate parent of the Manager and PIMCO. Absent an exemption from the Securities and Exchange Commission or other regulatory relief, the Fund is generally precluded from effecting certain principal transactions with affiliated brokers, and its ability to purchase securities being underwritten by an affiliated broker or a syndicate including an affiliated broker, or to utilize affiliated brokers for agency transactions, is subject to restrictions. This could limit the Fund's ability to engage in securities transactions and take advantage of market opportunities. In addition, unless and until the underwriting syndicate is broken in connection with the initial public offering of the AMPS, the Fund will be precluded from effecting principal transactions with brokers who are members of the syndicate.

*Anti-Takeover Provisions.* The Fund's Declaration and Amended Bylaws include provisions that could limit the ability of other entities or persons to acquire control of the Fund, convert the Fund to open-end status or change the composition of the Board of Trustees. See Anti-Takeover and Other Provisions in the Declaration of Trust.



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### **HOW THE FUND MANAGES RISK**

#### **Investment Limitations**

The Fund has adopted certain investment limitations designed to limit investment risk and maintain portfolio diversification. These limitations (two of which are listed below) are fundamental and may not be changed without the approval of the holders of a majority of the outstanding Common Shares and any preferred shares (including the AMPS) voting together as a single class, and the approval of the holders of a majority of any preferred shares (including the AMPS) voting as a separate class. The Fund may not:

- r Concentrate its investments in a particular industry, as that term is used in the 1940 Act and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time; and
  
- r With respect to 75% of the Fund's total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities of other investment companies, if, as a result, (i) more than 5% of the Fund's total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of that issuer.

The Fund would be deemed to concentrate its investments in a particular industry if it invested more than 25% of its net assets in that industry. The Fund's industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities).

The Fund is subject to guidelines which are more limiting than the investment restrictions set forth above and other restrictions set forth in the SAI in order to obtain and maintain ratings on the AMPS of Aaa from Moody's and AAA from Fitch Ratings and may become subject to additional guidelines in the future. See Description of AMPS Rating Agency Guidelines and Asset Coverage. The Fund does not anticipate that such guidelines would have a material adverse effect on the Fund's ability to achieve its investment objective. See Description of AMPS Rating Agency Guidelines and Asset Coverage in this prospectus and Investment Objective and Policies and Investment Restrictions in the SAI for information about these guidelines and a complete list of the fundamental investment policies of the Fund.

#### **Management of Investment Portfolio and Capital Structure to Limit Leverage Risk**

The Fund may take certain actions if market conditions change (or the Fund anticipates such change) and the Fund's leverage begins (or is expected) to adversely affect Common Shareholders. In order to attempt to offset such a negative impact of leverage on Common Shareholders, the Fund may invest substantially in short-term, high quality securities, implement certain hedging strategies or extend the maturity of the AMPS. The Fund also may attempt to reduce leverage by redeeming or otherwise purchasing AMPS (subject to any restrictions discussed under Description of AMPS Redemption ) or by reducing any holdings in other instruments that create leverage. As explained under Risks General Risks of Investing in the Fund Leverage Risk, the success of any such attempt to limit leverage risk depends on PIMCO's ability to accurately predict interest rate or other market changes. Because of the difficulty of making such predictions, the Fund may not be successful in managing its exposure to risks in the manner described above.

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If market conditions suggest that additional leverage would be beneficial, the Fund may issue additional preferred shares (including AMPS) or preferred shares (including AMPS) that the Fund previously issued but later repurchased. The Fund may also leverage the portfolio by borrowing money, issuing debt securities or using reverse repurchase agreements, loans of portfolio securities, credit default swap contracts and other derivatives, as well as when-issued, delayed delivery and forward commitment transactions. However, these forms of leverage will only be used, if at all, as a substitute for, rather than in addition to, the leverage obtained through the issuance of AMPS. See Investment Objective and Strategies Portfolio Contents and Other Information and Risks General Risks of Investing in the Fund Liquidity Risk.

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### **Hedging and Related Strategies**

The Fund may use various investment strategies designed to limit the risk of price fluctuations of its portfolio securities and to preserve capital. For instance, the Fund may purchase credit default swap contracts for the purpose of hedging the Fund's exposure to certain issuers and, thereby, decreasing its exposure to credit risk. See "Investment Objective and Strategies - Credit Default Swaps" in this prospectus. Other hedging strategies that the Fund may use include: financial futures contracts; short sales; other types of swap agreements or options thereon; options on financial futures; and options based on either an index, currencies, interest rates or individual debt securities whose prices, PIMCO believes, correlate with the prices of the Fund's investments. Income earned by the Fund from many hedging activities will be treated as capital gain and, if not offset by net realized capital loss, will be distributed to shareholders in taxable distributions. If effectively used, hedging strategies will offset in varying percentages losses incurred on the Fund's investments due to adverse changes involving issuers or economic conditions. There is no assurance that these hedging strategies will be available at any time or that PIMCO will determine to use them for the Fund or, if used, that the strategies will be successful. In addition, the Fund will be subject to certain restrictions on its use of hedging strategies imposed by Moody's and Fitch Ratings (and may be subject to these and/or other restrictions by any rating agency that may in the future rate the AMPS) in connection with their expected issuance of ratings for AMPS issued by the Fund. See "Description of AMPS - Rating Agency Guidelines and Asset Coverage."

### **DESCRIPTION OF AMPS**

*The following is a brief description of the terms of the AMPS. For a more complete description of the AMPS, please refer to Article 11 of the Amended Bylaws, which is attached as Appendix A to the SAI. Certain of the capitalized terms used herein are defined in Article 11 of the Amended Bylaws. This description does not purport to be complete and is subject to and qualified in its entirety by reference to the Fund's Declaration and Amended Bylaws. The Fund's Declaration and the Amended Bylaws have been filed as exhibits to the Registration Statement of which this prospectus is a part.*

### **General**

Under the Declaration, the Fund is authorized to issue preferred shares having such par value and such preferences, voting powers, terms of redemption, if any, and special or relative rights or privileges (including conversion rights, if any) as determined by the Board of Trustees, without the approval of Common Shareholders. The AMPS are preferred shares of beneficial interest with \$.00001 par value. Each series of AMPS will have a liquidation preference of \$25,000 per share, plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared). The AMPS of each series will rank on a parity with shares of any other series of preferred shares of the Fund as to the payment of dividends and the distribution of assets upon liquidation. The AMPS carry one vote per share on all matters on which such shares are entitled to vote. The AMPS, when issued by the Fund and paid for pursuant to the terms of this prospectus, will be fully paid and, subject to matters discussed in "Anti-Takeover and Other Provisions in the Declaration of Trust," non-assessable and will have no preemptive, exchange or conversion rights. Any AMPS repurchased or redeemed by the Fund will be classified as authorized and unissued preferred shares without designation as to series. The AMPS will not be convertible into Common Shares or other shares of beneficial interest of the Fund. The AMPS will not be subject to any sinking fund, but will be subject to mandatory redemption and optional redemption under certain circumstances as described below.

### **Dividends and Rate Periods**

*General.* Each series of AMPS entitles its holders to receive dividends when, as and if declared by the Board of Trustees, out of funds legally available therefor, at a rate per annum that may vary for the successive rate periods for each such series. The following is a general description

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of dividends and rate periods for the AMPS. The initial rate period for the Series M AMPS will be 15 days, and the dividend rate for this period

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will be 2.40%. The initial rate period for the Series T AMPS will be 16 days, and the dividend rate for this period will be 2.40%. The initial rate period for the Series W AMPS will be 17 days, and the dividend rate for this period will be 2.40%. The initial rate period for the Series TH AMPS will be 18 days, and the dividend rate for this period will be 2.40%. The initial rate period for Series F AMPS will be 21 days, and the dividend rate for this period will be 2.40%. Subsequent dividend rate periods generally will be seven days, and the dividend rates for those periods will generally be determined by auction. Further description of the auction procedures can be found below under *The Auction* and in Article 11 of the Amended Bylaws attached as Appendix A to the SAI. The Fund, subject to certain conditions, may change the length of subsequent rate periods by designating them as special rate periods. See *Designation and Notification of Special Rate Periods* below in this section.

*Dividend Payment Dates.* As noted above, dividends on AMPS will be payable when, as and if declared by the Board of Trustees, out of legally available funds in accordance with the Declaration, the Amended Bylaws and applicable law. Rate periods generally will begin on the first Business Day after an auction. If dividends are scheduled to be payable on a day that is not a Business Day, then dividends will generally be payable on the next Business Day, or as otherwise specified in the Amended Bylaws. No rate period of any series of AMPS shall be co-extensive with any rate period of any other series of AMPS unless the Fund has received an opinion of tax counsel that having such co-extensive periods will not affect the deductibility, for federal income tax purposes, of dividends paid on the different series of AMPS. If for any reason a rate period for a series of AMPS is scheduled to begin on the same day and end on the same day as a rate period for another series of AMPS, then the last day of the rate period for such other series of AMPS shall be the second Business Day next succeeding such scheduled day unless the Fund obtains the opinion of tax counsel referred to in the preceding sentence. The Fund, in its discretion, may establish dividend payment dates in respect of any special rate period of AMPS consisting of more than seven days, provided that such dates shall be set forth in the related notice of special rate period and that certain conditions are met. See *Designation and Notification of Special Rate Periods* below in this section.

If a dividend payment date is not a Business Day because the NYSE is closed for business for more than three consecutive Business Days due to an act of God, natural disaster, act of war, civil or military disturbance, act of terrorism, sabotage, riots or a loss or malfunction of utilities or communications services, or the dividend payable on such date can not be paid for any such reason, then:

- r the dividend payment date for the affected rate period will be the next Business Day on which the Fund and its paying agent, if any, are able to cause the dividend to be paid using their reasonable best efforts;
- r the affected rate period will end on the day it would have ended had such event not occurred and the dividend payment date had remained the schedule date; and
- r the next rate period will begin and end on the dates it would have begun and ended had such event not occurred and the dividend payment date had remained the scheduled date, and the dividend rate shall be the same as for the prior rate period.

Dividends will be paid through the Securities Depository on each dividend payment date. The dividend payment date will normally be the first Business Day after the rate period ends. The Securities Depository, in accordance with its current procedures, is expected to distribute dividends received from the auction agent in same-day funds on each dividend payment date to members of the Securities Depository that will act on behalf of existing or potential holders of AMPS ( *Agent Members* ). These Agent Members are in turn expected to distribute such dividends to the persons for whom they are acting as agents. However, each of the current Broker-Dealers has currently indicated to the Fund that dividend payments will be available in same-day funds on each dividend payment date to customers that use a Broker-Dealer or a Broker-Dealer's designee as Agent Member.

The nominee of the Securities Depository is expected to be the sole holder of record of each series of AMPS. Accordingly, each purchaser of AMPS must rely on (i) the procedures of the Securities Depository and, if such purchaser is not a member of the Securities Depository, such purchaser's Agent Member, to receive



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dividends, distributions and notices and to exercise voting rights (if and when applicable) and (ii) the records of the Securities Depository and, if such purchaser is not a member of the Securities Depository, such purchaser's Agent Member, to evidence its beneficial ownership of the AMPS.

*Calculation of Dividend Payment.* The Fund computes the dividend per share of each series of AMPS by multiplying the applicable rate for such series of shares in effect by a fraction. The numerator of this fraction will be the number of days in the rate period (normally seven, except for special rate periods) and the denominator will normally be 365. This rate is then multiplied by \$25,000 to arrive at the dividend per share.

Dividends on the AMPS will accumulate from the date of their original issue. For each dividend payment period after the initial rate period, the dividend rate will be the dividend rate determined at auction, except as provided in the Amended Bylaws, as described below. The dividend rate that results from an auction will not be greater than the maximum applicable rate described below.

The maximum applicable rate for any regular rate period (*i.e.*, any rate period other than a non-payment period) will be the higher of the applicable percentage of the reference rate, or the applicable spread plus the reference rate. The reference rate will be the applicable LIBOR Rate (as defined below) (for a rate period of fewer than 365 days) or the Treasury Index Rate (as defined below) (for a rate period of 365 days or more). The applicable percentage and applicable spread for any regular rate period will generally be determined based on the credit ratings assigned to the AMPS by Moody's and Fitch Ratings on the auction date for such period (as set forth in the table below). If Moody's and/or Fitch Ratings shall not make such rating available, the rate shall be determined by reference to equivalent ratings issued by a substitute rating agency. In the case of a special rate period, (1) the maximum applicable rate may be specified by the Fund in the notice of special rate period for such dividend payment period, (2) the applicable percentage and applicable spread will be determined on the date two Business Days before the first day of such special rate period, and (3) the reference rate will be the applicable LIBOR Rate (for a rate period of fewer than 365 days) or the Treasury Index Rate (for a rate period of 365 days or more).

| <b>Moody's Credit<br/>Rating</b> | <b>Fitch's Credit<br/>Rating</b> | <b>Applicable<br/>Percentage</b> | <b>Applicable<br/>Spread</b> |
|----------------------------------|----------------------------------|----------------------------------|------------------------------|
| Aaa                              | AAA                              | 125%                             | 125 bps                      |
| Aa3 to Aa1                       | AA- to AA+                       | 150%                             | 150 bps                      |
| A3 to A1                         | A- to A+                         | 200%                             | 200 bps                      |
| Baa3 to Baa1                     | BBB- to BBB+                     | 250%                             | 250 bps                      |
| Ba1 and below                    | BB+ and below                    | 300%                             | 300 bps                      |

The Fund will take all reasonable action necessary to enable Moody's and Fitch Ratings to provide ratings for each series of AMPS. If such ratings are not made available by Moody's or Fitch Ratings, the Underwriters or their affiliates and successors, after consultation with the Fund, will attempt to select one or more other rating agencies to act as substitute rating agencies.

The LIBOR Rate is the applicable London Inter-Bank Offered Rate for deposits in U.S. dollars for the period most closely approximating the applicable rate period for a series of AMPS. For a more detailed description, please see the Amended Bylaws.

The Treasury Index Rate is the average yield to maturity for certain U.S. Treasury securities having substantially the same length to maturity as the applicable rate period for a series of AMPS. For a more detailed description, please see the Amended Bylaws.





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Assuming the Fund maintains an Aaa / AAA rating on the AMPS, the practical effect of the different methods used to calculate the Maximum Applicable Rate is shown in the table below:

| Reference Rate | Maximum Applicable Rate Using the Applicable Percentage | Maximum Applicable Rate Using the Applicable Spread | Method Used to Determine the Maximum Applicable Rate |
|----------------|---|---|--|
| 1%             | 1.25%   | 2.25%   | Spread   |
| 2%             | 2.50%   | 3.25%   | Spread   |
| 3%             | 3.75%   | 4.25%   | Spread   |
| 4%             | 5.00%   | 5.25%   | Spread   |
| 5%             | 6.25%   | 6.25%   | Either   |
| 6%             | 7.50%   | 7.25%   | Percentage   |

The Board of Trustees may amend the maximum applicable rate to increase the percentage amount by which the reference rate described above is multiplied, or to increase the spread added to the reference rate, to determine the maximum applicable rate shown without the vote or consent of the holders of AMPS, including each series, or any other shareholder of the Fund, but only with confirmation from each rating agency then rating the AMPS that such action will not adversely affect such agency's then-current rating of the AMPS, and after consultation with the Broker-Dealers, provided that immediately following any such increase the Fund could meet the Preferred Shares Basic Maintenance Amount test discussed below under Rating Agency Guidelines and Asset Coverage.

*Restrictions on Dividends and Other Distributions.* For so long as any AMPS are outstanding, the Fund generally may not declare, pay or set apart for payment any dividend or other distribution (other than a dividend or distribution paid in shares of additional Common Shares or rights to purchase Common Shares or other shares, if any, ranking junior to the AMPS as to dividends or upon liquidation) in respect of Common Shares or any other shares of the Fund ranking junior to or on a parity with the AMPS as to dividends or upon liquidation, or call for redemption, redeem, purchase or otherwise acquire for consideration any Common Shares or any other such junior shares (except by conversion into or exchange for shares of beneficial interest of the Fund ranking junior to AMPS as to dividends and upon liquidation) or any such parity shares (except by conversion into or exchange for shares of beneficial interest of the Fund ranking junior to or on a parity with AMPS as to dividends and upon liquidation), unless and only if:

- r immediately after such transaction, the Fund would have Moody's Eligible Assets and Fitch Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount, and the 1940 Act Preferred Shares Asset Coverage would be satisfied;
- r full cumulative dividends on the AMPS due on or prior to date of the transaction have been declared and paid or shall have been declared and sufficient funds for the payment thereof deposited with the auction agent; and
- r the Fund has redeemed the full number of AMPS required to be redeemed by any provision for mandatory redemption contained in the Amended Bylaws.

The Fund generally will not declare, pay or set apart for payment any dividend on any class or series of shares of the Fund ranking, as to the payment of dividends, on a parity with the AMPS unless the Fund has declared, paid or set apart for payment, as the case may be, the same proportionate share of dividends on the AMPS. When the Fund has not paid dividends in full upon a series of the AMPS through the most recent dividend payment date or upon any class or series of shares of the Fund ranking, as to the payment of dividends, on a parity with such series of AMPS through their most recent respective dividend payment dates, the amount of dividends declared per share on such series of AMPS and such other class or series of shares will in all cases bear to each other the same ratio that accumulated dividends per share on such series of AMPS and such other class or series of shares bear to each other.



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*Designation and Notification of Special Rate Periods.* The Fund, at its sole option and to the extent permitted by law, by telephonic and written notice to the auction agent and to each Broker-Dealer, may request that the next succeeding rate period for a series of AMPS be a special rate period, with a number of days greater than seven but evenly divisible by seven, and no more than 364 (a Short Term Special Rate Period ) or one whole year or more but not greater than five years (a Long Term Special Rate Period ) specified in such notice, provided that the Fund may not give a request for a special rate period of greater than 28 days (and any such request will be null and void) unless, for any auction occurring after the initial auction, sufficient clearing bids (as described in The Auction Auction Procedures below) were made in the last occurring auction and unless full cumulative dividends and any amounts due with respect to redemptions payable prior to such date have been paid in full. For any special rate period the Fund must also have received confirmation from Moody's and Fitch Ratings or any substitute rating agency that the proposed special rate period will not adversely affect their then current ratings of the AMPS. Such request for a special rate period shall be given on or prior to the second Business Day but, in the case of a Short Term Special Rate Period, not more than seven Business Days prior to an auction date for the AMPS of that series and, in the case of a Long Term Special Rate Period, not more than 28 days prior to an auction date for the AMPS of that series. Upon receiving any such request, the Broker-Dealers jointly shall determine the optional redemption price of the AMPS of that series during such special rate period and the specific redemption provisions and shall give the Fund and the auction agent written notice (a Response ) of such determination by no later than the second Business Day prior to such auction date. In making such determination, the Broker-Dealers will consider (i) existing short-term and long-term market rates and indices of such short-term and long-term rates, (ii) existing market supply and demand for short-term and long-term securities, (iii) existing yield curves for short-term and long-term securities comparable to the AMPS, (iv) industry and financial conditions which may affect the AMPS of that series, (v) the investment objectives of the Fund and (vi) the rate periods and dividend rates at which current and potential beneficial holders of the AMPS would remain or become beneficial holders.

The Fund, by no later than the second Business Day prior to such auction date, may give a notice to the auction agent, the Securities Depository and each Broker-Dealer, which notice will specify (i) the duration of the special rate period, (ii) the optional redemption price, if any, as specified in the related Response and (iii) the specific redemption provisions, if any, as specified in the related Response. The Fund has agreed to provide a copy of such notice of special rate period to Moody's and Fitch Ratings (or to any substitute rating agency then rating the AMPS). The Fund will not give a notice of a special rate period, and, if such notice of a special rate period was given already, will give telephonic and written notice of its revocation to the auction agent, each Broker-Dealer, and the Securities Depository on or prior to the Business Day prior to the relevant auction date if (x) either the 1940 Act Preferred Shares Asset Coverage is not satisfied or the Fund fails to maintain Moody's Eligible Assets and Fitch Eligible Assets with an aggregate discounted value at least equal to the Preferred Shares Basic Maintenance Amount, on each of the two valuation dates immediately preceding the Business Day prior to the relevant auction date on an actual basis and on a pro forma basis giving effect to the proposed special rate period (using as a pro forma dividend rate with respect to such special rate period the dividend rate which the Broker-Dealers shall advise the Fund is an approximately equal rate for securities similar to the AMPS with an equal rate period) or (y) sufficient funds for the payment of dividends payable on the immediately succeeding rate payment date have not been irrevocably deposited with the auction agent by the close of business on the third Business Day preceding the auction date immediately preceding such dividend payment date. The Fund also shall provide a copy of such notice of revocation to Moody's and Fitch Ratings (or to any substitute rating agency then rating the AMPS). If the Fund is prohibited from giving a notice of special rate period as a result of the factors enumerated in clause (x) or (y) above or if the Fund gives a notice of revocation with respect to a notice of special rate period, the next succeeding rate period for that series will be a seven-day rate period. In addition, in the event that sufficient clearing bids are not made in an auction or an auction is not held for any reason, the next succeeding rate period will be a seven-day rate period, and the Fund may not again give a notice of special rate period (and any such attempted notice will be null and void) until sufficient clearing bids have been made in an auction with respect to a seven-day rate period.

The Fund may provide that, in order to redeem AMPS at the Fund's option during a special rate period, the Fund must pay to holders of the AMPS a redemption premium in addition to the redemption price per share

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of \$25,000, plus an amount equal to the accumulated but unpaid dividends. A notice of special rate period will specify whether the shares of a particular series of AMPS will be subject to optional redemption during such special rate period and, if so, the redemption premium, if any, required to be paid by the Fund in connection with such optional redemption.

The Fund's declaration of a special rate period may affect the liquidity of your investment. A special rate period would be longer than a regular rate period, and you would be unable to sell AMPS in an auction for a correspondingly longer period of time. If you sell your AMPS between auctions, you may receive less than the price you paid for them, especially when market interest rates have risen. The risks described in this paragraph will become greater as the length of the special rate period increases.

## **Voting Rights**

Except as otherwise described in this prospectus and in the SAI or as otherwise set forth in the Declaration or the Amended Bylaws or as required by law, holders of AMPS will have equal voting rights with Common Shareholders and holders of any other preferred shares of the Fund (each class having one vote per share) and will vote together with Common Shareholders and any other preferred shares as a single class.

Holders of outstanding preferred shares of the Fund, including AMPS, voting as a separate class, are entitled to elect two of the Fund's Trustees (in accordance with the timing of elections under the Fund's staggered Board structure). The remaining Trustees are elected by Common Shareholders and holders of preferred shares, including AMPS, voting together as a single class. In addition, if at any time dividends (whether or not earned or declared) on any outstanding preferred shares of the Fund, including AMPS, are due and unpaid in an amount equal to two full years of dividends, and sufficient cash or specified securities have not been deposited with the auction agent for the payment of such dividends, the sole remedy of holders of the outstanding preferred shares of the Fund shall be an automatic increase in the number of Trustees constituting the Board of Trustees by the smallest number that, when added to the two trustees elected exclusively by the holders of AMPS and any other preferred shares as described above, would constitute a majority of the Board of Trustees as so increased, and at a special meeting of shareholders which will be called as soon as practicable thereafter, and at all subsequent meetings at which trustees are to be elected until all dividends in arrears have been paid or otherwise provided for, the holders of the AMPS and any other preferred shares, voting as a separate class, will be entitled to elect the smallest number of additional trustees that, together with the two trustees that such holders in any event will be entitled to elect, constitutes a majority of the total number of trustees of the Fund as so increased. The terms of office of the persons who are Trustees at the time of that election will continue, unless otherwise terminated pursuant to the Declaration or Amended Bylaws. If the Fund thereafter pays in full (or otherwise provides for) all dividends payable on all outstanding preferred shares of the Fund, the special voting rights stated above will cease and the terms of office of the additional Trustees elected by the holders of the preferred shares (but not of the trustees with respect to whose election the holders of Common Shares were entitled to vote or the two trustees the holders of AMPS and any other preferred shares have the right to elect in any event) will automatically terminate.

Unless a higher percentage is provided for under the Declaration or the Amended Bylaws or applicable law, the affirmative vote of a majority of the votes entitled to be cast by holders of outstanding AMPS and any other preferred shares, voting together as one class, will be required to:

(i) authorize, create or issue any class or series of shares of beneficial interest ranking prior to the AMPS or any other series of preferred shares with respect to the payment of dividends or the distribution of assets upon liquidation; or

(ii) amend, alter or repeal the provisions of the Declaration or the Amended Bylaws, whether by merger, consolidation or otherwise, so as to adversely affect any of the contract rights expressly set forth in the Declaration or the Amended Bylaws of holders of AMPS or any other preferred shares.

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To the extent permitted under the 1940 Act, in the event shares of more than one series of preferred shares are outstanding, the Fund shall not approve any of the actions set forth in clause (i) or (ii) which adversely

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affects the contract rights expressly set forth in the Declaration or the Amended Bylaws of a holder of shares of a series of preferred shares differently than those of a holder of shares of any other series of preferred shares without the affirmative vote of at least a majority of votes entitled to be cast by holders of the preferred shares of each series adversely affected and outstanding at such time (each such adversely affected series voting separately as a class). The Board of Trustees, however, without shareholder approval, may amend, alter or repeal any or all of the various rating agency guidelines described herein in the event the Fund receives confirmation from Moody's and Fitch Ratings (or any applicable substitute rating agency) that any such amendment, alteration or repeal would not impair the rating then assigned to the AMPS by such rating agency.

Unless a higher percentage is provided for under the Declaration or the Amended Bylaws, the affirmative vote of a majority of the votes entitled to be cast by holders of outstanding AMPS and any other preferred shares, voting together as a separate class, will be required to approve any plan of reorganization (including bankruptcy proceedings) adversely affecting such shares or any action requiring a vote of security holders under Section 13(a) of the 1940 Act including, among other things, changes in the investment restrictions described as fundamental policies under Investment Restrictions in the SAI. To the extent permitted under the 1940 Act, the Amended Bylaws provide that, in the event shares of more than one series of preferred shares are outstanding, with respect to any action requiring shareholder approval pursuant to the operation of Section 2 or Section 3 of Article V of the Declaration, the affirmative vote of at least seventy-five percent of the AMPS of each series outstanding at such time (each such series voting separately as a class) shall also be required. The class (and, where applicable, series) vote of holders of AMPS and any other preferred shares described above in each case will be in addition to a separate vote of the requisite percentage of Common Shares and AMPS and any other preferred shares, voting together as a single class, necessary to authorize the action in question.

The foregoing voting provisions will not apply with respect to AMPS if, at or prior to the time when a vote is required, such shares have been (i) redeemed or (ii) called for redemption and sufficient funds have been deposited in trust to effect such redemption.

If a series of preferred shares other than the AMPS is issued in the future, it is anticipated that such series would have voting rights comparable to those described above.

## **Rating Agency Guidelines and Asset Coverage**

The Fund will be required to satisfy two separate asset maintenance requirements under the terms of the Amended Bylaws. These requirements are summarized below.

*1940 Act Preferred Shares Asset Coverage.* The Fund will be required under the 1940 Act and the Amended Bylaws to maintain, with respect to the AMPS, as of the last Business Day of each month in which any AMPS are outstanding, the 1940 Act Preferred Shares Asset Coverage (as defined below) of at least 200% with respect to senior securities that are equity securities, including the AMPS. If the Fund fails to maintain the 1940 Act Preferred Shares Asset Coverage and such failure is not cured as of the last Business Day of the following month (the 1940 Act Cure Date), the Fund will be required under certain circumstances to redeem certain of the AMPS. See Redemption below.

The 1940 Act Preferred Shares Asset Coverage immediately following the issuance of AMPS offered hereby (after giving effect to the deduction of the sales load and offering expenses for the AMPS), computed using the Fund's net assets as of December 14, 2004, and assuming the AMPS had been issued as of such date, will be as follows:

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|   |                  |        |
|---|------------------|--------|
| Value of the Fund's total assets less all liabilities and indebtedness not represented by senior securities | \$ 1,269,229,762 |        |
| <hr/>   | <hr/>            | = 264% |
| Senior securities representing indebtedness plus liquidation value of the AMPS                              | \$ 480,000,000   |        |

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*Preferred Shares Basic Maintenance Amount.* In connection with the Fund's receipt of ratings of Aaa from Moody's and AAA from Fitch Ratings with respect to the AMPS, the Fund is required to maintain assets having in the aggregate a discounted value at least equal to the Preferred Shares Basic Maintenance Amount. The Preferred Shares Basic Maintenance Amount includes the sum of (a) the aggregate liquidation preference of the preferred shares then outstanding (including the AMPS) and (b) certain accrued and projected payment obligations of the Fund, including without limitation any accrued and projected dividends on the preferred shares then outstanding (including the AMPS).

Moody's and Fitch Ratings have established separate guidelines for calculating discounted value. These guidelines specify discount factors that the Fund must apply to various types of securities in its portfolio for purposes of calculating whether the discounted value of the Fund's assets equals the Preferred Shares Basic Maintenance Amount (with the level of discount generally becoming greater as the credit quality of a security becomes lower). In addition, under the guidelines, certain types of securities (including securities in which the Fund may otherwise invest) are not eligible for inclusion in the calculation of the discounted value of the Fund's portfolio. Such ineligible securities may include, for example, certain privately placed debt securities (other than Rule 144A securities) and debt securities of certain non-U.S. issuers. Accordingly, although the Fund may invest in such securities to the extent set forth herein, it is currently anticipated that they will not constitute a significant portion of the Fund's portfolio under normal circumstances. The rating agency guidelines for calculating discounted value do not impose any limitations on the percentage of the Fund's assets that may be invested in ineligible assets, and the amount of ineligible assets included in the Fund's portfolio at any time may vary depending upon the rating, diversification and other characteristics of the eligible assets included in the portfolio.

In the event the Fund does not timely cure a failure to maintain (a) a discounted value of its portfolio equal to the Preferred Shares Basic Maintenance Amount or (b) the 1940 Act Preferred Shares Asset Coverage, in each case in accordance with the requirements of the rating agency or agencies then rating the AMPS, the Fund will be required to redeem AMPS as described under "Redemption" Mandatory Redemption below.

In addition to the requirements described above, the rating agency guidelines impose restrictions on the Fund's use of certain financial instruments or investment techniques that the Fund might otherwise utilize in order to obtain and maintain a rating from Moody's and Fitch Ratings on the AMPS. For example, the guidelines limit the use of certain hedging transactions such as futures contracts, options and other derivative transactions for hedging or investment purposes. The guidelines also limit the use of certain other investment techniques, including borrowing of money, short sales, loans of portfolio securities, reverse repurchase agreements, issuing any class or series of shares ranking prior to or on a parity with the AMPS with respect to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Fund or merging or consolidating into or with any other entity. It is not currently anticipated that these guidelines will materially impede PIMCO from managing the Fund's portfolio in accordance with the Fund's investment objective and policies. For a complete description of such restrictions, see Article 11 of the Amended Bylaws, which is attached as Appendix A to the Fund's SAI.

The Fund may, but is not required to, adopt any modifications to the guidelines that may be established by Moody's and/or Fitch Ratings. Failure to adopt any such modifications, however, may result in a change in the ratings described above or a withdrawal of ratings altogether. In addition, any rating agency providing a rating for the AMPS may, at any time, change or withdraw any such rating. The Trustees may, without shareholder approval, amend, alter or repeal any or all of the definitions and related provisions that have been adopted by the Fund pursuant to the rating agency guidelines in the event the Fund receives written confirmation from Moody's or Fitch Ratings (or any substitute rating agency) that any such amendment, alteration or repeal would not impair the rating then assigned to the AMPS.

As described by Moody's, a preferred stock rating is an assessment of the capacity and willingness of an issuer to pay preferred stock obligations. The rating on the AMPS is not a recommendation to purchase, hold or sell those shares, inasmuch as the rating does not comment as to market price or suitability for a particular



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investor. The rating agency guidelines described above also do not address the likelihood that an owner of AMPS will be able to sell such shares in an auction or otherwise. The ratings are based on current information furnished to Moody's and Fitch Ratings by the Fund, the Manager and/or PIMCO or information obtained from other sources. The ratings may be changed, suspended or withdrawn as a result of changes in, or the unavailability of, such information. The Fund's Common Shares have not been rated by a nationally recognized statistical rating organization.

A rating agency's guidelines will apply to the AMPS only so long as the rating agency is rating the shares. The Fund will pay certain fees to Moody's and Fitch Ratings for rating the AMPS. A more detailed description of how Moody's and Fitch Ratings calculate discounted value and the other limitations imposed by the rating agencies is contained in Article 11 of the Amended Bylaws, which is attached as Appendix A to the Fund's SAI.

## **Liquidation**

Subject to the rights of holders of any series or class or classes of shares ranking on a parity with AMPS with respect to the distribution of assets upon liquidation of the Fund, upon a liquidation of the Fund (whether voluntary or involuntary), the holders of AMPS then outstanding will be entitled to receive and to be paid, out of the assets of the Fund available for distribution to its shareholders, before any payment or distribution will be made on the Common Shares or any other class of shares of the Fund ranking junior in right of payment upon liquidation to the AMPS, an amount equal to the liquidation preference with respect to such AMPS (\$25,000 per share), plus an amount equal to all dividends thereon (whether or not earned or declared by the Fund, but excluding the interest thereon) accumulated but unpaid to (but not including) the date of final distribution in same-day funds in connection with the liquidation of the Fund. If such assets of the Fund are insufficient to make the full liquidation payment on outstanding AMPS and liquidation payments on any other outstanding class or series of preferred shares of the Fund ranking on parity with the AMPS as to payment upon liquidation, then such assets will be distributed among the holders of AMPS and the holders of shares of such other class or series ratably in proportion to the respective preferential amounts to which they are entitled. After the payment to the holders of AMPS of the full preferential amounts provided for as described herein, the holders of AMPS as such will have no right or claim to any of the remaining assets of the Fund.

For purposes of the foregoing paragraph, a liquidation of the Fund does not include:

- r the sale of all or any portion of the assets of the Fund; or
  
- r the merger, consolidation or statutory share exchange of the Fund into or with any trust or other entity.

## **Redemption**

*Mandatory Redemption.* As noted above, the Fund is required under the Amended Bylaws to maintain (a) a discounted value of eligible portfolio securities equal to the Preferred Shares Basic Maintenance Amount and (b) the 1940 Act Preferred Shares Asset Coverage. Eligible portfolio securities for the purposes of (a) above will be determined from time to time by the rating agency then rating the AMPS. If the Fund fails to maintain such asset coverage amounts and does not timely cure such failure in accordance with the Amended Bylaws, the Fund must redeem all or a portion of the AMPS. This mandatory redemption will take place on a date that the Trustees specify out of legally available funds in accordance with the Declaration, the Amended Bylaws and applicable law, at the redemption price of \$25,000 per share, plus accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption. In determining the number of AMPS required to be redeemed in accordance with the foregoing, the Fund will redeem the lesser of (a) the minimum number of AMPS necessary to satisfy the Preferred Shares Basic Maintenance Amount or the 1940 Act Preferred Shares Asset Coverage, as the case may be, and (b) the

maximum number of AMPS and any other preferred

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shares of the Fund subject to redemption or retirement that can be redeemed out of funds expected to be legally available therefor at the time of redemption, and in any case will redeem such AMPS pro rata among the AMPS and any other preferred shares of the Fund subject to redemption or retirement. The mandatory redemption will be limited to the number of AMPS and any other preferred shares necessary to restore the required discounted value or the 1940 Act Preferred Shares Asset Coverage, as the case may be.

*Optional Redemption.* To the extent permitted under the 1940 Act and under Massachusetts law, upon giving notice of redemption, as provided below, the Fund, at its option, may redeem the AMPS, in whole or in part, out of funds legally available therefore, at the Optional Redemption Price per share on any dividend payment date; provided that no AMPS may be redeemed at the option of the Fund during (a) the initial rate period with respect to the AMPS or (b) a non-call period to which such shares are subject. Optional Redemption Price means \$25,000 per AMPS plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption plus the applicable redemption premium, if any. The Fund has the authority to redeem the AMPS for any reason and may redeem all or part of the outstanding AMPS if it anticipates that the Fund's leveraged capital structure will result, for a significant period of time, in a lower rate of return to holders of Common Shares than that obtainable if the Common Shares were unleveraged.

The Fund will not make any optional redemption unless the Fund has eligible assets with an aggregate discounted value at least equal to the Preferred Shares Basic Maintenance Amount (both before and after giving effect to such redemption).

Although the AMPS are subject to redemption under certain circumstances as described above, unlike the shares of an open-end mutual fund, the AMPS may not be redeemed at a shareholder's option at net asset value.

## **The Auction**

### **General**

Under the Amended Bylaws, the applicable rate for the AMPS for each rate period after the initial rate period will generally be the rate that results from an auction conducted as set forth in the Amended Bylaws and summarized below. In such an auction, persons determine to hold or offer to sell AMPS regardless of the rate set by the auction or offer to purchase or sell AMPS based on specific dividend rates bid by them. See the Amended Bylaws for a more complete description of the auction process.

*Auction Agency Agreement.* The Fund will enter into an auction agency agreement with the auction agent (initially, Deutsche Bank) which provides, among other things, that the auction agent will follow the auction procedures set forth in the Amended Bylaws to determine the applicable rate for AMPS so long as the applicable rate for AMPS is to be based on the results of an auction.

The auction agent will act as agent for the Fund in connection with auctions. In the absence of bad faith or negligence on its part, the auction agent will not be liable for any action taken, suffered or omitted, or for any error of judgment made, by it in the performance of its duties under the auction agency agreement. Pursuant to the auction agency agreement, the Fund is required to indemnify the auction agent for certain losses and liabilities incurred by the auction agent without negligence or bad faith on its part in connection with the performance of its duties under such agreement.

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The auction agent may terminate the auction agency agreement upon notice to the Fund no earlier than 60 days after such notice. If the auction agent should resign, the Fund will attempt to appoint another qualified institution to act as auction agent. The Fund may remove the auction agent provided that prior to such removal the Fund has entered into an agreement with a successor auction agent to perform substantially similar services.

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Except in an auction, the Fund will have the right (to the extent permitted by applicable law) to purchase or otherwise acquire any AMPS so long as the Fund is current in the payment of dividends on AMPS and on any other shares of beneficial interest of the Fund ranking on a parity with the AMPS with respect to the payment of dividends or upon liquidation.

*Broker-Dealer Agreements.* Each auction requires the participation of one or more Broker-Dealers. The auction agent will enter into agreements with one or more Broker-Dealers selected by the Fund that provide for the participation of those Broker-Dealers in auctions for AMPS ( Broker-Dealer Agreements ).

The auction agent will pay to each Broker-Dealer after each auction, from funds provided by the Fund, a service charge that will generally be at the annual rate of 1/4 of 1% of the stated value (\$25,000 per share) of the AMPS placed by a Broker-Dealer at such auction. For any special rate period, the service charge shall be determined by mutual consent of the Fund and any such Broker-Dealer or Broker-Dealers and shall be based upon a selling concession that would be applicable to an underwriting of fixed or variable rate preferred shares with a similar final maturity or variable rate period, respectively, at the commencement of the rate period with respect to such auction. For purposes of the foregoing, the AMPS will be placed by a Broker-Dealer if such shares were (i) the subject of hold orders deemed to have been made by beneficial owners that were acquired by such beneficial owners through such Broker-Dealer or (ii) the subject of the following orders submitted by such Broker-Dealer: (A) a submitted bid of a Beneficial Owner that resulted in such Beneficial Owner continuing to hold such shares as a result of the auction, (B) a submitted bid of a potential Beneficial Owner that resulted in such potential Beneficial Owner purchasing such shares as a result of the auction or (C) a submitted hold order. A Broker-Dealer may share a portion of any such fees with non-participating Broker-Dealers that submit orders to the Broker-Dealer for an auction that are placed by that broker-dealer in such auction.

The Fund may request the auction agent to terminate one or more Broker-Dealer Agreements at any time upon five days' notice, provided that at least one Broker-Dealer Agreement is in effect after such termination.

The Depository Trust Company ( DTC ) initially will act as the securities depository for the Agent Members with respect to the AMPS. All of the shares of each series of AMPS initially will be registered in the name of Cede & Co., as nominee of the Securities Depository. Such shares will be subject to the provisions restricting transfers of the AMPS contained in the Amended Bylaws. Cede & Co. initially will be the holder of record of all AMPS, and beneficial owners will not be entitled to receive certificates representing their ownership interest in such shares. See Appendix A (Article 11 of the Amended Bylaws) to the SAI. The Securities Depository will maintain lists of its participants and will maintain the positions (ownership interests) of the AMPS held by each Agent Member, whether as the Beneficial Owner thereof for its own account or as nominee for the Beneficial Owner thereof. Payments made by the Fund to holders of AMPS will be duly made by making payments to the nominee of the Securities Depository.

## **Auction Procedures**

The following is a brief summary of the procedures to be used in conducting auctions. This summary is qualified in its entirety by reference to Article 11 of the Amended Bylaws set forth in Appendix A to the SAI. The Settlement Procedures to be used with respect to auctions are set forth in Exhibit A to each Broker-Dealer Agreement, the form of which has been filed as an exhibit to the Registration Statement of which this prospectus is a part.

Prior to the submission deadline on each auction date for the AMPS, each customer of a Broker-Dealer who is listed on the records of that Broker-Dealer (or, if applicable, the auction agent) as a Beneficial Owner of AMPS may submit the following types of orders with respect to AMPS to that Broker-Dealer:

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1. Hold Order indicating its desire to hold the indicated number of AMPS without regard to the applicable rate for shares of such series for the next rate period.

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2. Bid indicating its desire to purchase or hold the indicated number of AMPS if the applicable rate for shares of such series for the next rate period is not less than the rate specified in the bid. A bid order by an existing holder will be deemed an irrevocable offer to sell AMPS at \$25,000 per share if the applicable rate for shares of such series for the next rate period is less than the rate specified in the bid.
3. Sell Order indicating its desire to sell AMPS at \$25,000 per share without regard to the applicable rate for shares of such series for the next rate period.

A Beneficial Owner of AMPS may submit different types of orders to its Broker-Dealer with respect to different AMPS then held by the Beneficial Owner. A Beneficial Owner that submits a bid to its Broker-Dealer having a rate higher than the maximum applicable rate on the auction date will be treated as having submitted a sell order to its Broker-Dealer. A Beneficial Owner that fails to submit an order to its Broker-Dealer will ordinarily be deemed to have submitted a hold order to its Broker-Dealer. However, if a Beneficial Owner fails to submit an order for some or all of its shares to its Broker-Dealer for an auction relating to a rate period of more than 91 days, such Beneficial Owner will be deemed to have submitted a sell order for such shares to its Broker-Dealer. A sell order constitutes an irrevocable offer to sell the AMPS subject to the sell order.

In an auction, a Beneficial Owner may submit different types of orders with respect to AMPS then held by such Beneficial Owner, as well as bids for additional AMPS. A Beneficial Owner that offers to become the Beneficial Owner of additional AMPS is, for the purposes of such offer, a potential holder as discussed below.

A potential holder is either a customer of a Broker-Dealer that is not a Beneficial Owner of AMPS but wishes to purchase AMPS or a Beneficial Owner that wishes to purchase additional AMPS. A potential holder may submit bids to its Broker-Dealer in which it offers to purchase AMPS at \$25,000 per share if the applicable rate for the next rate period is not less than the rate specified in such bid. A bid placed by a potential holder specifying a rate higher than the maximum applicable rate on the auction date will not be accepted.

The Broker-Dealers in turn will submit the orders of their respective customers who are beneficial owners and potential holders to the auction agent. Unless otherwise permitted by the Fund, the Broker-Dealers will designate themselves as existing holders of shares subject to orders submitted or deemed submitted to them by beneficial owners. They will also designate themselves as potential holders of shares subject to orders submitted to them by potential holders. However, neither the Fund nor the auction agent will be responsible for a Broker-Dealer's failure to comply with these procedures. Any order placed with the auction agent by a Broker-Dealer as or on behalf of an existing holder or a potential holder will be treated the same way as an order placed with a Broker-Dealer by a Beneficial Owner or potential holder. Similarly, any failure by a Broker-Dealer to submit to the auction agent an order for any AMPS held by it or its customers who are Beneficial Owners will be treated as a Beneficial Owner's failure to submit to its Broker-Dealer an order in respect of AMPS held by it. A Broker-Dealer may also submit orders to the auction agent for its own account as an existing holder or potential holder. If a Broker-Dealer submits an order for its own account in any auction of AMPS, it may have knowledge of orders placed through it in that auction and therefore have an advantage over other bidders, but such Broker-Dealer would not have knowledge of orders submitted by other Broker-Dealers in that auction. As a result of bidding by the Broker-Dealer in an auction, the auction rate may be higher or lower than the rate that would have prevailed had the Broker-Dealer not bid.

There are sufficient clearing bids in an auction if the number of shares of a series of AMPS subject to bids submitted or deemed submitted to the auction agent by Broker-Dealers for potential holders with rates equal to or lower than the maximum applicable rate for shares of such series is at least equal to the sum of the number of applicable AMPS subject to sell orders submitted or deemed submitted to the auction agent by Broker-Dealers for existing holders and the number of applicable AMPS subject to bids specifying rates higher than the maximum applicable rate for shares of such series submitted or deemed submitted to the auction agent by Broker-Dealers for existing holders. If there are sufficient clearing bids, the applicable rate for the relevant





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AMPS for the next succeeding rate period thereof will be the lowest rate specified in the submitted bids that, taking into account such rate and all lower rates bid by Broker-Dealers as or on behalf of existing holders and potential holders, would result in such existing holders and potential holders owning the relevant AMPS available for purchase in the auction.

If there are not sufficient clearing bids, the applicable rate for the next rate period will be the maximum applicable rate on the auction date. If there are not sufficient clearing bids, beneficial owners of AMPS that have submitted or are deemed to have submitted sell orders may not be able to sell in the auction all shares subject to such sell orders. If all existing holders of AMPS submit (or are deemed to have submitted) hold orders in an auction, the rate period next following the auction automatically shall be the same length as the immediately preceding rate period, and the applicable rate will be 80% of the Reference Rate (as defined in the Amended Bylaws).

A Broker-Dealer may also bid in an auction in order to prevent what would otherwise be (i) a failed auction, (ii) an all-hold auction, or (iii) an applicable rate that the Broker-Dealer believes, in its sole discretion, does not reflect the market for the AMPS at the time of the auction. A Broker-Dealer may, but is not obligated to, advise Beneficial Owners of AMPS that the applicable rate that would apply in an all-hold auction may be lower than would apply if beneficial owners submit bids, and such advice, if given, may facilitate the submission of bids by Beneficial Owners that would avoid the occurrence of an all-hold auction.

The auction procedures include a pro rata allocation of shares for purchase and sale, which may result in an existing holder continuing to hold or selling, or a potential holder purchasing, a number of AMPS that is different from the number of shares specified in its order. To the extent the allocation procedures have that result, Broker-Dealers that have designated themselves as existing holders or potential holders in respect of customer orders will be required to make appropriate pro rata allocations among their respective customers.

Settlement of purchases and sales will be made on the next Business Day (which is also a dividend payment date) after the auction date through DTC. Purchasers will make payment through their Agent Members in same-day funds to DTC against delivery to their respective Agent Members. DTC will make payment to the sellers' Agent Members in accordance with DTC's normal procedures, which currently provide for payment against delivery by their Agent Members in same-day funds.

If any existing holder selling AMPS in an auction fails to deliver such shares, the Broker-Dealer of any person that was to have purchased AMPS in such auction may deliver to such person a number of whole AMPS that is less than the number of shares that otherwise was to be purchased by such person. In such event, the number of AMPS to be so delivered will be determined by such Broker-Dealer. Delivery of such lesser number of shares will constitute good delivery. Each Broker-Dealer Agreement also will provide that neither the Fund nor the auction agent will have any responsibility or liability with respect to the failure of a Beneficial Owner, potential Beneficial Owner or their respective Agent Members to deliver AMPS or to pay for AMPS purchased or sold pursuant to an auction or otherwise.

The auctions for AMPS will normally be held every seven days, and each subsequent rate period will normally begin on the following Business Day.

The auctions for the Series M AMPS will normally be held on every Monday beginning on January 3, 2005, the Business Day preceding the dividend payment date for the initial rate period, and each subsequent rate period will normally begin on the following Tuesday. Thereafter, except during special rate periods, auctions for the Series M AMPS normally will be held every seven days thereafter, and each subsequent rate period for the Series M AMPS normally will begin on the following Business Day.

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The auctions for the Series T AMPS will normally be held on every Tuesday beginning on January 4, 2005, the Business Day preceding the dividend payment date for the initial rate period, and each subsequent rate period will normally begin on the following Wednesday. Thereafter, except during special rate periods, auctions for the Series T AMPS normally will be held every seven days thereafter, and each subsequent rate period for the Series T AMPS normally will begin on the following Business Day.

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The auctions for the Series W AMPS will normally be held on every Wednesday beginning on January 5, 2005, the Business Day preceding the dividend payment date for the initial rate period, and each subsequent rate period will normally begin on the following Thursday. Thereafter, except during special rate periods, auctions for the Series W AMPS normally will be held every seven days thereafter, and each subsequent rate period for the Series W AMPS normally will begin on the following Business Day.

The auctions for the Series TH AMPS will normally be held on every Thursday beginning on January 6, 2005, the Business Day preceding the dividend payment date for the initial rate period, and each subsequent rate period will normally begin on the following Friday. Thereafter, except during special rate periods, auctions for the Series TH AMPS normally will be held every seven days thereafter, and each subsequent rate period for the Series TH AMPS normally will begin on the following Business Day.

The auctions for the Series F AMPS will normally be held on every Friday beginning on January 7, 2005, the Business Day preceding the dividend payment date for the initial rate period, and each subsequent rate period will normally begin on the following Monday. Thereafter, except during special rate periods, auctions for the Series F AMPS normally will be held every seven days thereafter, and each subsequent rate period for the Series F AMPS normally will begin on the following Business Day.

The following is a simplified example of how a typical auction works. Assume that the Fund has 1,000 outstanding AMPS of a series and three current holders of those shares. The three current holders and three potential holders submit orders through broker-dealers at the auction:

|                    |  |   |
|--------------------|--|---|
| Current Holder A   | Owens 500 shares, wants to sell all 500 shares if auction rate is less than 2.1% | Bid order of 2.1% rate for all 500 shares       |
| Current Holder B   | Owens 300 shares, wants to hold  | Hold order will take the auction rate           |
| Current Holder C   | Owens 200 shares, wants to sell all 200 shares if auction rate is less than 1.9% | Bid order of 1.9% rate for all 200 shares       |
| Potential Holder D | Wants to buy 200 shares if auction rate is 2.0% or above                         | Places order to buy 200 shares at or above 2.0% |
| Potential Holder E | Wants to buy 300 shares if auction rate is 1.9% or above                         | Places order to buy 300 shares at or above 1.9% |
| Potential Holder F | Wants to buy 200 shares if auction rate is 2.1% or above                         | Places order to buy 200 shares at or above 2.1% |

The lowest dividend rate that will result in all 1,000 AMPS continuing to be held is 2.0% (the offer by D). Therefore, the dividend rate will be 2.0%. Current holders B and C will continue to own their shares. Current holder A will sell its shares because A's dividend rate bid was higher than the dividend rate. Potential holder D will buy 200 shares and potential holder E will buy 300 shares because their bid rates were at or below the dividend rate. Potential holder F will not buy any shares because its bid rate was above the dividend rate.

The example above is not meant to be an indication of the dividend rates that may be payable on the AMPS.

For further description of the auction procedures, please see Article 11 of the Amended Bylaws, which is attached as Appendix A to the SAI. In the event of any conflict between the Amended Bylaws and the description of the AMPS and the auction procedures in this prospectus or the

SAI, the Amended Bylaws will control.

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### **Secondary Market Trading and Transfer of AMPS**

The Underwriters are not required to make a market in the AMPS. The Broker-Dealers (including the Underwriters) may maintain a secondary trading market for the AMPS outside of auctions, but they are not required to do so. There can be no assurance that a secondary trading market for AMPS will develop or, if it does develop, that it will provide holders of AMPS with liquidity of investment. AMPS will not be registered on any stock exchange or on the NASDAQ market. Investors who purchase AMPS in an auction (particularly if the Fund has declared a special rate period) should note that, because the dividend rate on such shares will be fixed for the length of that rate period, the value of such shares may fluctuate in response to the changes in interest rates, and may be more or less than their original cost if sold on the open market in advance of the next auction thereof, depending on market conditions. In addition, a Broker-Dealer may, in its own discretion, decide to sell AMPS in the secondary market to investors at any time and at any price, including at prices equivalent to, below or above the par value of the AMPS.

You may sell, transfer, or otherwise dispose of AMPS only in whole shares and only:

- r pursuant to a bid or sell order placed with the auction agent in accordance with the auction procedures;
- r to a Broker-Dealer; or
- r to such other persons as may be permitted by the Fund; provided, however, that (x) if you hold your AMPS in the name of a Broker-Dealer, a sale or transfer of your AMPS to that Broker-Dealer, or to another customer of that Broker-Dealer, will not be considered a sale or transfer for purposes of the foregoing limitation if that Broker-Dealer remains the existing holder of the AMPS immediately after the transaction; and (y) in the case of all transfers, other than through an auction, the Broker-Dealer (or other person, if the Fund permits) receiving the transfer will advise the auction agent of the transfer.

## **MANAGEMENT OF THE FUND**

### **Trustees and Officers**

The Board of Trustees is responsible for the management of the Fund, including supervision of the duties performed by the Manager and PIMCO. There are currently three Trustees of the Fund. The names and business addresses of the Trustees and officers of the Fund and their principal occupations and other affiliations during the past five years are set forth under "Management of the Fund" in the SAI.

### **Investment Manager**

The Manager serves as the investment manager of the Fund. Subject to the supervision of the Board of Trustees, the Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund's business affairs and other administrative matters. The Manager is located at 1345 Avenue of the Americas, New York, New York 10105.

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Organized in 2000 as a subsidiary successor of a business originally organized in 1987, the Manager provides investment management and advisory services to a number of closed-end and open-end investment company clients. As of September 30, 2004, the Manager had approximately \$33.6 billion in assets under management. Allianz Global Investors of America L.P. is the direct parent company of PA Retail Holdings LLC, of which the Manager is a wholly-owned subsidiary. As of September 30, 2004, Allianz Global Investors of America L.P. and its subsidiaries, including PIMCO, had approximately \$502 billion in assets under management.

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The Manager has retained its affiliate, PIMCO, to manage the Fund’s investments. See Portfolio Manager below. The Manager and PIMCO are each majority-owned indirect subsidiaries of Allianz AG, a publicly traded German insurance and financial services company.

**Portfolio Manager**

PIMCO serves as the portfolio manager for the Fund. Subject to the supervision of the Manager, PIMCO has full investment discretion and makes all determinations with respect to the investment of the Fund’s assets.

PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660. Organized in 1971, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to mutual funds. As of September 30, 2004, PIMCO had approximately \$415 billion in assets under management.

The Manager (and not the Fund) will pay a portion of the fees it receives to PIMCO in return for PIMCO’s services. For the period from the commencement of Fund operations through October 31, 2009 (*i.e.*, roughly the first five years of Fund operations), the fee will be paid monthly at the annual rate of .39% of the Fund’s average weekly total managed assets, provided, however, that the amounts payable for each month shall be reduced to reflect that PIMCO will bear 65% of the fees payable by the Manager to UBS Securities LLC for such month as described under Underwriting in the Fund’s prospectus for Common Shares. Beginning November 1, 2009 and thereafter, the Manager will pay a monthly fee to PIMCO at the annual rate of .55% of the Fund’s average weekly total managed assets, provided, however, that the amounts payable for each month shall be reduced by the amount of all fees payable by the Manager to UBS Securities LLC for such month (such that the Manager retains from its management fee, on an annual basis, .05% of the Fund’s average weekly total managed assets, after having paid PIMCO and UBS Securities LLC).

Bill Gross, a founder of PIMCO, serves as Managing Director and Chief Investment Officer of PIMCO. In his role as Chief Investment Officer, he serves as the head of the Investment Committee, which oversees setting investment policy decisions, including duration positioning, yield curve management, sector rotation, credit quality and overall portfolio composition, for all PIMCO portfolios and strategies, including the Fund. The following individuals at PIMCO share primary responsibility for the day-to-day portfolio management of the Fund:

| <u>Name</u>             | <u>Since</u>        | <u>Recent Professional Experience</u>  |
|-------------------------|---------------------|--|
| Raymond G. Kennedy, CFA | 2004<br>(Inception) | Mr. Kennedy is a Managing Director, portfolio manager and senior member of PIMCO’s investment strategy group. He also manages High Yield funds and oversees bank loan trading and collateralized debt obligations. Mr. Kennedy joined the firm in 1996, previously having been associated with the Prudential Insurance Company of America as a private placement asset manager, where he was responsible for investing and managing a portfolio of investment grade and high yield privately-placed fixed income securities. Prior to that, he was a consultant for Andersen Consulting (now Accenture) in Los Angeles and London. He has seventeen years of investment management experience and holds a bachelor’s degree from Stanford University and an MBA from the Anderson Graduate School of Management at the University of California, Los Angeles. Mr. Kennedy is also a member of LSTA. |





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| <u>Name</u>     | <u>Since</u>        | <u>Recent Professional Experience</u>   |
|-----------------|---------------------|---|
| Mark T. Hudoff  | 2004<br>(Inception) | Mr. Hudoff is an Executive Vice President and portfolio manager in the high yield area. He joined the firm in 1996, previously having been associated with BCA where he worked as a fixed income strategist. Mr. Hudoff started as a credit analyst for the high yield team and moved to Europe in 2000 to build and manage PIMCO's European credit business, including the management of PIMCO's European High Yield funds. He currently oversees the European team and PIMCO's Global High Yield products. Mr. Hudoff has seventeen years of investment experience and holds a bachelor's degree in economics from Arizona State University, and an MBA in finance from the University of Chicago School of Business. |
| Jason R. Rosiak | 2004<br>(Inception) | Mr. Rosiak is a Senior Vice President and portfolio manager. He focuses on high-yield corporate bonds and bank loans, oversees the construction of PIMCO's structured products and manages a trade-desk research group. Mr. Rosiak joined the firm in 1996, previously having been associated with Bankers Trust NA, where he worked in their mortgage backed securities division. He has eleven years of investment experience and holds a bachelor's degree in economics from the University of California, Los Angeles, and a master's degree in business administration from the Marshall School of Business at the University of Southern California.  |

Mr. Kennedy oversees Messrs. Hudoff and Rosiak regarding the management of the Fund.

**Investment Management Agreement**

Pursuant to an investment management agreement between the Manager and the Fund (the "Investment Management Agreement"), the Fund has agreed to pay the Manager an annual management fee payable on a monthly basis at the annual rate of .75% of the Fund's average weekly total managed assets (including assets attributable to any AMPS and borrowings that may be outstanding) for the services and facilities it provides.

In addition to the fees of the Manager, the Fund pays all other costs and expenses of its operations, including compensation of its Trustees (other than those affiliated with the Manager), custodial expenses, shareholder servicing expenses, transfer agency and dividend disbursing expenses, legal fees, expenses of independent auditors, expenses of repurchasing shares, expenses of issuing the AMPS and any other preferred shares, expenses of preparing, printing and distributing prospectuses, shareholder reports, notices, proxy statements and reports to governmental agencies, and taxes, if any.

Because the fees received by the Manager are based on the total managed assets of the Fund (including assets attributable to any AMPS and borrowings that may be outstanding), the Manager has a financial incentive for the Fund to issue AMPS and utilize borrowings, which may create a conflict of interest between the Manager and the Common Shareholders.



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### **Regulatory and Litigation Matters**

On September 13, 2004, the Securities and Exchange Commission announced that the Manager, PEA Capital LLC ( PEA ) and PA Distributors LLC ( PAD ) had agreed to a settlement of charges that they and certain of their officers had, among other things, violated various antifraud provisions of the federal securities laws in connection with an alleged market-timing arrangement involving trading of shares of certain open-end investment companies ( open-end funds ) advised or distributed by the Manager and certain of its affiliates. In their settlement with the Securities and Exchange Commission, the Manager, PAD and PEA consented to the entry of an order by the Securities and Exchange Commission and, without admitting or denying the findings contained in the order, agreed to implement certain compliance and governance changes and consented to cease-and-desist orders and censures. In addition, the Manager, PEA and PAD agreed to pay civil money penalties in the aggregate amount of \$40 million and to pay disgorgement in the amount of \$10 million, for an aggregate payment of \$50 million. In connection with the settlement, the Manager, PEA and PAD have been dismissed from the related complaint by the Securities and Exchange Commission filed on May 6, 2004 in the U.S. District Court in the Southern District of New York.

In a related action, on June 1, 2004, the Attorney General of the State of New Jersey ( NJAG ) announced that it had entered into a settlement agreement with PEA and PAD and their parent, Allianz Global Investors of America L.P. (formerly Allianz Dresdner Asset Management of America L.P., AGI ), in connection with a complaint filed by the NJAG on February 17, 2004. The NJAG dismissed its claims against PIMCO, which had been filed as part of the same complaint. In the settlement, AGI, PEA and PAD neither admitted nor denied the allegations or conclusions of law, but did agree to pay New Jersey a civil fine of \$15 million and \$3 million for investigative costs and further potential enforcement initiatives against unrelated parties. They also undertook to implement certain governance changes. The complaint relating to the settlement alleged, among other things, that AGI, PEA and PAD had failed to disclose that they improperly allowed certain hedge funds to engage in market timing in various open-end funds advised or distributed by the Manager and certain of its affiliates.

On September 15, 2004, the Securities and Exchange Commission announced that the Manager, PEA and PAD had agreed to settle a Securities and Exchange Commission enforcement action in connection with charges that they violated various antifraud and other provisions of federal securities laws as a result of, among other things, their failure to disclose to the board of trustees and shareholders of various open-end funds advised or distributed by the Manager and its affiliates material facts and conflicts of interest that arose from their use of brokerage commissions on portfolio transactions to pay for so-called shelf space arrangements with certain broker-dealers. In their settlement with the Securities and Exchange Commission, the Manager, PEA and PAD consented to the entry of an order by the Securities and Exchange Commission without admitting or denying the findings contained in the order. In connection with their settlement, the Manager, PEA and PAD agreed to undertake certain compliance and disclosure reforms and consented to cease-and-desist orders and censures. In addition, the Manager, PAD and PEA agreed to pay a civil money penalty of \$5 million and to pay disgorgement of approximately \$6.6 million based upon the aggregate amount of brokerage commissions alleged to have been paid by such open-end funds in connection with these shelf-space arrangements (and related interest). In a related action, the California Attorney General announced on September 15, 2004 that it had entered an agreement with PAD in resolution of an investigation into matters that are similar to those discussed in the Securities and Exchange Commission order. The settlement agreement resolves matters described in a complaint filed contemporaneously by the California Attorney General in the Superior Court of the State of California alleging, among other things, that PAD violated certain antifraud provisions of California law by failing to disclose matters related to the shelf-space arrangements described above. In the settlement agreement, PAD did not admit to any liability but agreed to pay \$5 million in civil penalties and \$4 million in recognition of the California Attorney General's fees and costs associated with the investigation and related matters.

Since February 2004, the Manager, the Sub-Adviser and certain of their affiliates and employees have been named as defendants in a total of 14 lawsuits filed in one of the following: U.S. District Court in the

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Southern District of New York, the Central District of California and the Districts of New Jersey and Connecticut. Ten of those lawsuits concern market timing, and they have been transferred to and consolidated for pre-trial proceedings in the U.S. District Court for the District of Maryland; the remaining four lawsuits concern revenue sharing with allegations of brokers offering shelf space and have been consolidated into a single action in the U.S. District Court for the District of Connecticut. The lawsuits have been commenced as putative class actions on behalf of investors who purchased, held or redeemed shares of affiliated funds during specified periods or as derivative actions on behalf of the funds. The lawsuits generally relate to the same facts that are the subject of the regulatory proceedings discussed above. The lawsuits seek, among other things, unspecified compensatory damages plus interest and, in some cases, punitive damages, the rescission of investment advisory contracts, the return of fees paid under those contracts and restitution. The Manager and the Sub-Adviser believe that other similar lawsuits may be filed in federal or state courts naming as defendants the Manager, the Sub-Adviser, AGI, open- and closed-end funds advised or distributed by the Manager, the Sub-Adviser and/or their affiliates, the boards of trustees of those funds, and/or other affiliates or employees as defendants.

Under Section 9(a) of the 1940 Act, if any of the various regulatory proceedings or lawsuits were to result in a court injunction against the Manager, AGI and/or their affiliates, they and their affiliates (including the Sub-Adviser) would, in the absence of exemptive relief granted by the Securities and Exchange Commission, be barred from serving as an investment adviser/sub-adviser or principal underwriter for any registered investment company, including the Fund. In connection with an inquiry from the Securities and Exchange Commission concerning the status of the New Jersey settlement under Section 9(a), the Manager, AGI, the Sub-Adviser and certain of their affiliates (together, the Applicants) sought exemptive relief from the Securities and Exchange Commission under Section 9(c) of the 1940 Act. The Securities and Exchange Commission has granted the Applicants a temporary exemption from the provisions of Section 9(a) with respect to the New Jersey settlement until the earlier of (i) September 13, 2006 and (ii) the date on which the Securities and Exchange Commission takes final action on their application for a permanent order. There is no assurance that the Securities and Exchange Commission will issue a permanent order.

In addition, it is possible that these matters and/or other developments resulting from these matters could lead to a decrease in the market value of the Fund's Common Shares or other adverse consequences to the Fund and its shareholders. However, the Manager and the Sub-Adviser believe that these matters are not likely to have a material adverse effect on the Fund or on the Manager's or the Sub-Adviser's ability to perform its respective investment advisory services relating to the Fund.

**NET ASSET VALUE**

The net asset value (NAV) of the Fund equals the total value of the Fund's portfolio investments and other assets, less any liabilities. For purposes of calculating NAV, portfolio securities and other assets for which market quotes are readily available are stated at market value. Market value is generally determined on the basis of the last reported sales price or, if available, the closing price reported for an issue traded on an over-the-counter stock market (including the NASDAQ Official Closing Price for NASD traded securities), or if no sales or closing prices are reported, based on quotes obtained from a quotation reporting system, established market makers or pricing services. Certain securities or investments for which market quotations are not readily available may be valued, pursuant to guidelines established by the Board of Trustees, with reference to other securities or indexes. For instance, a pricing service may recommend a fair market value based on prices of comparable securities. Short-term investments having a maturity of 60 days or less are generally valued at amortized cost. Exchange traded options, futures and options on futures are valued at the settlement price determined by the exchange. Other securities for which market quotes are not readily available are valued at fair value as determined in good faith by the Board of Trustees or persons acting at their direction.

The NAV of the Fund will be determined weekly, generally on the last day of the week that the New York Stock Exchange is open for trading, as of the close of regular trading on the New York Stock Exchange that

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day (normally 4:00 p.m., Eastern time) (the NYSE Close ). Domestic debt securities and foreign securities are normally priced using data reflecting the earlier closing of the principal markets for those securities. Information that becomes known to the Fund or its agent after the Fund's NAV has been calculated on a particular day will not be used to retroactively adjust the price of a security or the Fund's NAV determined earlier that day.

Investments initially valued in currencies other than the U.S. dollar are converted to U.S. dollars using exchange rates obtained from pricing services. As a result, the NAV of the Fund's shares may be affected by changes in the value of currencies in relation to the U.S. dollar. The value of securities traded in markets outside the United States or denominated in currencies other than the U.S. dollar may be affected significantly on a day that the New York Stock Exchange is closed.

In unusual circumstances, instead of valuing securities in the usual manner, the Fund may value securities at fair value as determined in good faith by the Board of Trustees, generally based upon recommendations provided by PIMCO. Fair valuation also may be required due to material events that occur after the close of the relevant market but prior to the NYSE Close.

## **TAX MATTERS**

### **Federal Income Tax Matters**

The following federal income tax discussion is based on the advice of Ropes & Gray LLP, counsel to the Fund, and reflects provisions of the Code, existing U.S. Treasury regulations, rulings published by the IRS, and other applicable authority, as of the date of this prospectus. These authorities are subject to change by legislative or administrative action, possibly with retroactive effect. The following discussion is only a summary of some of the important tax considerations generally applicable to investments in the Fund. For more detailed information regarding tax considerations, see the SAI. There may be other tax considerations applicable to particular investors. In addition, income earned through an investment in the Fund may be subject to state, local and foreign taxes.

The Fund intends to elect to be treated and to qualify each year for taxation as a regulated investment company eligible for treatment under the provisions of Subchapter M of the Code. If the Fund so qualifies and satisfies certain distribution requirements, the Fund will not be subject to federal income tax on income distributed in a timely manner to its shareholders in the form of dividends or capital gain distributions.

In order for any portion of any distributions to holders of AMPS to be eligible for favorable tax treatment (in this instance, capital gain dividends), the AMPS must be treated as equity for federal income tax purposes. Based in part on certain representations made by the Fund to Ropes & Gray LLP relating to the lack of any present intention to redeem or purchase AMPS at any time in the future, it is the opinion of Ropes & Gray LLP that the AMPS will constitute equity for federal income tax purposes. This opinion relies in part on a published ruling of the IRS stating that certain auction preferred stock similar in many material respects to the AMPS represents equity. The opinion of Ropes & Gray LLP represents only its best legal judgment and is not binding on the IRS or the courts. If the IRS were to assert successfully that variable rate preferred stock such as the AMPS should be treated as debt for federal income tax purposes, distributions on AMPS (including distributions designated by the Fund as capital gain dividends) would be interest income (as opposed to dividend income or capital gain). Ropes & Gray LLP has advised the Fund that, should the IRS pursue in court the position that the AMPS should be treated as debt for federal income tax purposes, the IRS would be unlikely to prevail.

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To satisfy the distribution requirements applicable to regulated investment companies, amounts paid as dividends by the Fund to its shareholders, including holders of AMPS, must qualify for the dividends-paid deduction. If the Fund realizes a long-term capital gain, it will be required to allocate such gain between and

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among the Common Shares and any AMPS issued by the Fund in proportion to the total dividends paid to each class during the year in which the income is realized. In certain circumstances, the IRS could take the position that dividends paid on the AMPS constitute preferential dividends under Section 562(c) of the Code, and thus do not qualify for the dividends-paid deduction. The Fund believes this position, if asserted, would be unlikely to prevail.

If at any time when AMPS are outstanding the Fund does not meet applicable asset coverage requirements, it will be required to suspend distributions to Common Shareholders until the requisite asset coverage is restored. Any such suspension may cause the Fund to pay a 4% federal excise tax (imposed on regulated investment companies that fail to distribute for a given calendar year, generally, at least 98% of their net investment income and capital gain net income) and income tax on undistributed income or gains, and may, in certain circumstances, prevent the Fund from qualifying for treatment as a regulated investment company. The Fund may redeem AMPS in an effort to comply with the distribution requirement applicable to regulated investment companies and to avoid income and excise taxes. The Fund may have to dispose of portfolio securities to generate cash for such redemption, which may result in transaction expenses and gain at the Fund level and in further distributions.

The Fund's investments in certain debt obligations may cause the Fund to recognize taxable income in excess of the cash generated by such obligations. Thus, the Fund could be required at times to liquidate other investments in order to satisfy its distribution requirements.

For federal income tax purposes, distributions of investment income generally are taxable as ordinary income to the extent of the Fund's current and accumulated earnings and profits. Taxes on distributions of capital gains are determined by how long the Fund owned the investments that generated them, rather than how long a shareholder has owned his or her shares. Distributions of net capital gains from the sale of investments that the Fund owned for more than one year and that are properly designated by the Fund as capital gain dividends will be taxable as long-term capital gains. Distributions of gains from the sale of investments that the Fund owned for one year or less will be taxable as ordinary income. Distributions in excess of the Fund's current and accumulated earnings and profits are treated as returns of capital to the extent of the shareholder's basis in the shares, and thereafter as capital gain.

For taxable years beginning on or before December 31, 2008, distributions of investment income designated by the Fund as derived from qualified dividend income will be taxed in the hands of individuals at the rates applicable to long-term capital gain, provided holding period and other requirements are met at both the shareholder and Fund level. The Fund does not expect a significant portion of Fund distributions to be derived from qualified dividend income.

Distributions are taxable to shareholders even if they are paid from income or gains earned by the Fund before a shareholder's investment (and thus were included in the price the shareholder paid). Any gain resulting from the sale or exchange of Fund shares generally will be taxable as capital gain.

Long-term capital gain rates applicable to individuals have been temporarily reduced in general, to 15% with lower rates applying to taxpayers in the 10% and 15% brackets for taxable years beginning on or before December 31, 2008.

The Fund's investments in foreign securities may be subject to foreign withholding taxes. In that case, the Fund's yield on those securities would be decreased. Shareholders will not be entitled to claim a credit or deduction with respect to foreign taxes paid by the Fund. In addition, the Fund's investments in foreign securities or foreign currencies may increase or accelerate the Fund's recognition of ordinary income and may affect the timing or amount of the Fund's distributions.

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If, in connection with the designation of a special rate period, (i) the Fund provides in a notice of special rate period that the Fund may redeem all or part of a series of AMPS and that upon such redemption the holders



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of that series of AMPS may receive a premium in addition to receipt of a redemption price per share equal to the sum of \$25,000 plus an amount equal to the accumulated but unpaid dividends thereon during the whole or any part of the special rate period, (ii) based on all the facts and circumstances at the time of the designation of the special rate period the Fund is more likely than not to redeem such series of AMPS during the special rate period, and (iii) the premium to be paid upon redemption during such special rate period exceeds a specified de minimis amount, it is possible that the holders of such series will be required to accrue the premium as a dividend (to the extent of the Fund's earnings and profits).

In general, dividends (other than capital gain dividends) paid to a shareholder that is not a U.S. person within the meaning of the Code (a foreign person) are subject to withholding of U.S. federal income tax at a rate of 30% (or lower applicable treaty rate). However, under the American Jobs Creation Act of 2004 (the 2004 Act), effective for taxable years of the Fund beginning after December 31, 2004 and before January 1, 2008, the Fund generally will not be required to withhold any amounts with respect to distributions of (i) U.S. source interest income that would not be subject to U.S. federal income tax if earned directly by an individual foreign person, and (ii) net short-term capital gains in excess of net long-term capital losses, in each case to the extent such distributions are properly designated by the Fund. This provision will first apply to the Fund in its taxable year beginning September 1, 2005.

The 2004 Act modifies the tax treatment of distributions from the Fund that are paid to a foreign person and are attributable to gain from U.S. real property interests (USRPIs), which the Code defines to include direct holdings of U.S. real property and interests (other than solely as a creditor) in U.S. real property holding corporations such as certain REITs. Under the 2004 Act, which is generally effective for taxable years of RICs beginning after December 31, 2004, and which applies to dividends paid or deemed paid on or before December 31, 2007, distributions to foreign persons attributable to gains from the sale or exchange of USRPIs will give rise to an obligation for those foreign persons to file a U.S. tax return and pay tax, and may well be subject to withholding under future regulations. It is not expected that a significant portion of the Fund's distributions will be attributable to gains from the sale or exchange of USRPIs.

Under current law, the backup withholding tax rate is 28% for amounts paid through 2010 and will be 31% for amounts paid after December 31, 2010. The Fund may be required to apply backup withholding to taxable distributions or redemption proceeds payable to a shareholder. Please see Tax Matters in the SAI for additional information about (and changes to) the new backup withholding tax rates.

This section relates only to federal income tax consequences of investing in the Fund; the consequences under other tax laws may differ. You should consult your tax advisor as to the possible application of foreign, state and local income tax laws to Fund dividends and capital distributions. Please see Tax Matters in the SAI for additional information regarding the tax aspects of investing in the Fund.

**Table of Contents****DESCRIPTION OF CAPITAL STRUCTURE**

The Fund is an unincorporated business trust established under the laws of The Commonwealth of Massachusetts by the Declaration. The Declaration provides that the Trustees of the Fund may authorize separate classes of shares of beneficial interest. The Trustees have authorized an unlimited number of common shares of beneficial interest and preferred shares of beneficial interest. Preferred shares (such as the AMPS) may be issued in one or more series, with such par value and with such rights as determined by the Board of Trustees, by action of the Board of Trustees without the approval of the Common Shareholders. For a description of the AMPS, see [Description of AMPS](#) above. The following table shows the amount of (i) shares authorized and (ii) shares outstanding, for each class of authorized securities of the Fund as of December 14, 2004:

| <b>Title of Class</b> | <b>Amount<br/>Authorized</b> | <b>Amount<br/>Outstanding</b> |
|-----------------------|------------------------------|-------------------------------|
| Common Shares         | Unlimited                    | 41,305,236                    |
| AMPS                  |                              |                               |
| Series M              | 3,840                        | 0                             |
| Series T              | 3,840                        | 0                             |
| Series W              | 3,840                        | 0                             |
| Series TH             | 3,840                        | 0                             |
| Series F              | 3,840                        | 0                             |

Holders of Common Shares are entitled to share equally in dividends declared by the Board of Trustees payable to holders of Common Shares and in the net assets of the Fund available for distribution to holders of Common Shares after payment of the preferential amounts payable to holders of any outstanding preferred shares of beneficial interest. Neither holders of Common Shares nor holders of preferred shares have preemptive or conversion rights or have the right to cause the Fund to redeem their shares. Upon liquidation of the Fund, after paying or adequately providing for the payment of all liabilities of the Fund and the liquidation preference with respect to any outstanding preferred shares, and upon receipt of such releases, indemnities and refunding agreements as they deem necessary for their protection, the Trustees may distribute the remaining assets of the Fund among the holders of the Fund's Common Shares.

Pursuant to the Fund's Dividend Reinvestment Plan, all Common Shareholders whose shares are registered in their own names will have all dividends, including any capital gain dividends, reinvested automatically in additional Common Shares by PFPC Inc., as agent for the Common Shareholders, unless the shareholder elects to receive cash. The Fund and PFPC Inc. reserve the right to amend or terminate the Dividend Reinvestment Plan.

Holders of Common Shares are entitled to one vote for each share held and will vote with the holders of any outstanding AMPS or other preferred shares on each matter submitted to a vote of holders of Common Shares, except as described under [Description of AMPS Voting Rights](#) and except as otherwise required by the Declaration, the Amended Bylaws or applicable law.

Shareholders of each class are entitled to one vote for each share held. Except as provided under [Description of AMPS Voting Rights](#) and except as otherwise required by the Declaration, the Amended Bylaws or applicable law, holders of AMPS are (voting as a separate class) entitled to elect two trustees (in accordance with the timing of elections under the Fund's staggered Board structure, and the remaining trustees shall be elected by holders of Common Shares and AMPS, voting as a single class.

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So long as any AMPS or any other preferred shares are outstanding, holders of Common Shares will not be entitled to receive any dividends of or other distributions from the Fund, unless at the time of such declaration, (1) all accrued dividends on AMPS and any other preferred shares of beneficial interest or accrued interest on

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borrowings (if any) have been paid and (2) the value of the Fund's total assets (determined after deducting the amount of such dividend or other distribution), less all liabilities and indebtedness of the Fund not represented by senior securities, is at least 300% of the aggregate amount of senior securities representing indebtedness and at least 200% of the aggregate amount of senior securities representing indebtedness plus the aggregate liquidation value of the outstanding preferred shares (expected to equal the aggregate original purchase price of the outstanding preferred shares plus the redemption premium, if any, together with any accrued and unpaid dividends thereon, whether or not earned or declared and on a cumulative basis). In addition to the requirements of the 1940 Act, the Fund is required to comply with other asset coverage requirements as a condition of the Fund obtaining a rating of the AMPS from a rating agency. These requirements include an asset coverage test more stringent than under the 1940 Act. See "Description of AMPS Dividends Restrictions on Dividends and Other Distributions."

The Fund will send unaudited reports at least semi-annually and audited financial statements annually to all of its shareholders.

The Common Shares of the Fund commenced trading on the NYSE on October 27, 2004. As of December 10, 2004, the net asset value per share of Common Shares was \$19.24, and the closing price per share of Common Shares on the NYSE was \$19.90.

## **Other Issues Relating to AMPS**

Under the 1940 Act, the Fund is permitted to have outstanding more than one series of preferred shares of beneficial interest as long as no single series has priority over another series as to the distribution of assets of the Fund or the payment of dividends. Neither holders of Common Shares nor holders of preferred shares have pre-emptive rights to purchase any AMPS or any other preferred shares that might be issued.

## **ANTI-TAKEOVER AND OTHER PROVISIONS IN THE DECLARATION OF TRUST**

The Declaration and Amended Bylaws include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to convert the Fund to open-end status. The Fund's Trustees are divided into three classes. At each annual meeting of shareholders, the term of one class will expire and each Trustee elected to that class will hold office for a term of three years. The classification of the Board of Trustees in this manner could delay for an additional year the replacement of a majority of the Board of Trustees. In addition, the Declaration provides that a Trustee may be removed only for cause and only (i) by action of at least seventy-five percent (75%) of the outstanding shares of the classes or series of shares entitled to vote for the election of such Trustee, or (ii) by at least seventy-five percent (75%) of the remaining Trustees.

As described below, the Declaration grants special approval rights with respect to certain matters to members of the Board who qualify as Continuing Trustees, which term means a Trustee who either (i) has been a member of the Board for a period of at least thirty-six months (or since the commencement of the Fund's operations, if less than thirty-six months) or (ii) was nominated to serve as a member of the Board of Trustees by a majority of the Continuing Trustees then members of the Board.

The Declaration requires the affirmative vote or consent of at least seventy-five percent (75%) of the Board of Trustees and holders of at least seventy-five percent (75%) of the Fund's shares (including common and preferred shares of beneficial interest) to authorize certain Fund transactions not in the ordinary course of business, including a merger or consolidation, issuance or transfer by the Fund of the Fund's shares (except as may be pursuant to a public offering, the Fund's dividend reinvestment plan or upon exercise of any stock subscription rights), a sale, transfer or other disposition of Fund assets, or any shareholder proposal regarding specific investment decisions, unless the transaction is

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authorized by both a majority of the Trustees and seventy-five percent (75%) of the Continuing Trustees (in which case no shareholder authorization would be required by

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the Declaration, but may be required in certain cases under the 1940 Act). The Declaration also requires the affirmative vote or consent of holders of at least seventy-five percent (75%) of each class of the Fund's shares entitled to vote on the matter to authorize a conversion of the Fund from a closed-end to an open-end investment company, unless the conversion is authorized by both a majority of the Trustees and seventy-five percent (75%) of the Continuing Trustees (in which case shareholders would have only the minimum voting rights required by the 1940 Act with respect to the conversion). Also, the Declaration provides that the Fund may be terminated at any time by vote or consent of at least seventy-five percent (75%) of the Fund's shares or, alternatively, by vote or consent of both a majority of the Trustees and seventy-five percent (75%) of the Continuing Trustees. See "Anti-Takeover and Other Provisions in the Declaration of Trust" in the SAI for a more detailed summary of these provisions.

The Trustees may from time to time grant other voting rights to shareholders with respect to these and other matters in the Fund's Amended Bylaws certain of which are required by the 1940 Act. For example, the Amended Bylaws grant holders of AMPS and any other preferred shares special voting rights with respect to certain matters described in the preceding paragraph. See "Description of AMPS Voting Rights."

The overall effect of these provisions is to render more difficult the accomplishment of a merger or the assumption of control by a third party. These provisions also provide, however, the advantage of potentially requiring persons seeking control of the Fund to negotiate with its management regarding the price to be paid and facilitating the continuity of the Fund's investment objective and policies. The provisions of the Declaration and Amended Bylaws described above could have the effect of discouraging a third party from seeking to obtain control of the Fund in a tender offer or similar transaction. The Board of Trustees of the Fund has considered the foregoing anti-takeover provisions and concluded that they are in the best interests of the Fund and its Common Shareholders.

The foregoing is intended only as a summary and is qualified in its entirety by reference to the full text of the Declaration and the Fund's Amended Bylaws, both of which are on file with the Securities and Exchange Commission.

Under Massachusetts law, shareholders could, in certain circumstances, be held personally liable for the obligations of the Fund. However, the Declaration contains an express disclaimer of shareholder liability for debts or obligations of the Fund and requires that notice of such limited liability be given in each agreement, obligation or instrument entered into or executed by the Fund or the Trustees. The Declaration further provides for indemnification out of the assets and property of the Fund for all loss and expense of any shareholder held personally liable for the obligations of the Fund. Thus, the risk of a shareholder incurring financial loss on account of shareholder liability is limited to circumstances in which the Fund would be unable to meet its obligations. The Fund believes that the likelihood of such circumstances is remote.

## **REPURCHASE OF COMMON SHARES; CONVERSION TO OPEN-END FUND**

The Fund is a closed-end investment company and as such holders of its Common Shares do not have the right to cause the Fund to redeem their shares. Instead, the Common Shares trade in the open market at a price that is a function of several factors, including dividend levels (which are in turn affected by changes in the floating rates of interest on the Fund's investments and expenses), net asset value, call protection, portfolio credit quality, relative demand for and supply of such shares in the market, general market and economic conditions, conditions affecting individual issuers and other factors. Shares of a closed-end investment company may frequently trade at prices lower than net asset value. The Fund's Board of Trustees regularly monitors the relationship between the market price and net asset value of the Common Shares. If the Common Shares were to trade at a substantial discount to net asset value for an extended period of time, the Board may consider the repurchase of its Common Shares on the open market or in private transactions, the making of a tender offer for such shares, or the conversion of the Fund to an open-end investment company. The Fund cannot assure you that its Board of Trustees will decide to take or propose any of these actions, or that share repurchases or tender offers will actually reduce market discount.



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If the Fund were to convert to an open-end investment company, it would be required to redeem all AMPS and other preferred shares then outstanding (requiring in turn that it liquidate a portion of its investment portfolio), and the Common Shares would no longer be listed on the New York Stock Exchange. In contrast to a closed-end investment company, shareholders of an open-end investment company may require the company to redeem their shares at any time (except in certain circumstances as authorized by or under the 1940 Act) at their net asset value, less any redemption charge that is in effect at the time of redemption.

Before deciding whether to take any action to convert the Fund to an open-end investment company, the Board would consider all relevant factors, including the extent and duration of the discount, the liquidity of the Fund's portfolio, the impact of any action that might be taken on the Fund or its shareholders, and market considerations. Based on these considerations, even if the Fund's shares should trade at a discount, the Board of Trustees may determine that, in the interest of the Fund and its shareholders, no action should be taken. See the SAI under "Repurchase of Common Shares; Conversion to Open-End Fund" for a further discussion of possible action to reduce or eliminate such discount to net asset value.



**Table of Contents****UNDERWRITING**

Subject to the terms and conditions of a purchase agreement dated December 16, 2004, each Underwriter named below has agreed to purchase, and the Fund has agreed to sell to such Underwriter, the number of AMPS set forth opposite the name of such Underwriter.

| <u>Underwriter</u>                                 | <u>Number of AMPS</u> |                 |                 |                  |                 |
|--|-----------------------|-----------------|-----------------|------------------|-----------------|
|  | <u>Series M</u>       | <u>Series T</u> | <u>Series W</u> | <u>Series TH</u> | <u>Series F</u> |
| Merrill Lynch, Pierce, Fenner & Smith Incorporated | 1,920                 | 1,920           | 1,920           | 1,920            | 1,920           |
| UBS Securities LLC                                 | 1,344                 | 1,344           | 1,344           | 1,344            | 1,344           |
| A.G. Edwards & Sons, Inc.                          | 192                   | 192             | 192             | 192              | 192             |
| Oppenheimer & Co. Inc.                             | 192                   | 192             | 192             | 192              | 192             |
| Wachovia Capital Markets, LLC                      | 192                   | 192             | 192             | 192              | 192             |
| Total  | <u>3,840</u>          | <u>3,840</u>    | <u>3,840</u>    | <u>3,840</u>     | <u>3,840</u>    |

The purchase agreement provides that the obligations of the Underwriters to purchase the shares included in this offering are subject to the approval of certain legal matters by counsel and to other conditions, including, without limitation, the receipt by the Underwriters of customary closing certificates, opinions and other documents and the receipt by the Fund of an Aaa rating on the AMPS from Moody's and of an AAA rating on the AMPS from Fitch Ratings as of the time of the closing of the offering. The Underwriters are obligated to purchase all the AMPS sold under the purchase agreement if they purchase any of the AMPS. In the purchase agreement, the Fund and the Manager have agreed to indemnify the Underwriters against certain liabilities, including certain liabilities arising under the Securities Act of 1933, as amended, or to contribute to payments the Underwriters may be required to make for any of those liabilities.

The Underwriters propose to initially offer some of the AMPS directly to the public at the public offering price set forth on the cover page of this prospectus and some of the AMPS to certain dealers at the public offering price less a concession not in excess of \$137.50 per share. The sales load the Fund will pay of \$250 per share is equal to 1% of the initial offering price of the AMPS. After the initial public offering, the Underwriters may change the public offering price and the concession. Investors must pay for any AMPS purchased on or before December 20, 2004.

The Fund anticipates that the Underwriters may from time to time act as brokers or dealers in executing the Fund's portfolio transactions after they have ceased to be Underwriters. The Underwriters are active Underwriters of, and dealers in, securities and act as market makers in a number of such securities, and therefore can be expected to engage in portfolio transactions with, and perform services for, the Fund.

Certain of the Underwriters have advised the Fund that they and certain Broker-Dealers and other participants in the auction rate securities markets, including both taxable and tax exempt markets, have received letters from the Securities and Exchange Commission requesting that each of them voluntarily conduct an investigation regarding their respective practices and procedures in those markets. Those Underwriters have advised the Fund that they are cooperating fully with the Securities and Exchange Commission in this process. No assurance can be given as to whether the results of this process will affect the market for the AMPS or the auctions.

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The Fund anticipates that the Underwriters or their affiliates may, from time to time, act in auctions as Broker-Dealers and receive fees as set forth under Description of AMPS The Auction and in the SAI.

The principal business address of Merrill Lynch, Pierce, Fenner & Smith Incorporated is 4 World Financial Center, New York, New York 10080.

The settlement date for the purchase of the AMPS will be December 20, 2004, as agreed upon by the Underwriters, the Fund and Manager pursuant to Rule 15c6-1 under the Securities Exchange Act of 1934.

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**CUSTODIAN AND TRANSFER AGENT**

The custodian of the assets of the Fund is State Street Bank and Trust Co., 801 Pennsylvania Avenue, Kansas City, Missouri 64105. The Custodian performs custodial and fund accounting services.

Deutsche Bank Trust Company Americas, 280 Park Avenue, 9<sup>th</sup> Floor, New York, NY 10017, serves as the Fund's transfer agent, registrar, dividend paying agent and redemption agent.

**LEGAL MATTERS**

Certain legal matters in connection with the AMPS will be passed upon for the Fund by Ropes & Gray LLP, Boston, Massachusetts, and for the Underwriters by Clifford Chance US LLP, New York, New York. Clifford Chance US LLP may rely as to certain matters of Massachusetts law on the opinion of Ropes & Gray LLP.

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**APPENDIX A**

**DESCRIPTION OF SECURITIES RATINGS**

The Fund's investments may range in quality from securities rated in the lowest category to securities rated in the highest category (as rated by Moody's, S&P, Fitch Ratings, or Dominion or, if unrated, judged by PIMCO to be of comparable quality). The percentage of a Fund's assets invested in securities in a particular rating category will vary. The following terms are generally used to describe the credit quality of debt securities:

*High Quality Debt Securities* are those rated in one of the two highest rating categories (the highest category for commercial paper) or, if unrated, deemed comparable by PIMCO.

*Investment Grade Debt Securities* are those rated in one of the four highest rating categories or, if unrated, deemed comparable by PIMCO.

*Below Investment Grade, High Yield Securities ( Junk Bonds )* are those rated lower than Baa by Moody's, BBB by S&P, Fitch Ratings, or Dominion, and comparable securities. They are deemed predominantly speculative with respect to the issuer's ability to repay principal and interest.

Following is a description of Moody's, S&P's, Fitch Ratings', and Dominion's rating categories applicable to debt securities.

**Moody's Investors Service, Inc.**

*Corporate and Municipal Bond Ratings*

Aaa: Bonds which are rated Aaa are judged to be of the best quality. They carry the smallest degree of investment risk and are generally referred to as "gilt edge." Interest payments are protected by a large or by an exceptionally stable margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues.

Aa: Bonds which are rated Aa are judged to be of high quality by all standards. Together with the Aaa group they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities or fluctuation of protective elements may be of greater amplitude or there may be other elements present that make the long-term risks appear somewhat larger than with Aaa securities.

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A: Bonds which are rated A possess many favorable investment attributes and are to be considered as upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present that suggest a susceptibility to impairment sometime in the future.

Baa: Bonds which are rated Baa are considered as medium-grade obligations (*i.e.*, they are neither highly protected nor poorly secured). Interest payments and principal security appear adequate for the present but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and in fact have speculative characteristics as well.

Ba: Bonds which are rated Ba are judged to have speculative elements; their future cannot be considered as well-assured. Often the protection of interest and principal payments may be very moderate and thereby not well safeguarded during both good and bad times over the future. Uncertainty of position characterizes bonds in this class.

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B: Bonds which are rated B generally lack characteristics of a desirable investment. Assurance of interest and principal payments or of maintenance of other terms of the contract over any long period of time may be small.

Caa: Bonds which are rated Caa are of poor standing. Such issues may be in default or there may be present elements of danger with respect to principal or interest.

Ca: Bonds which are rated Ca represent obligations which are speculative in a high degree. Such issues are often in default or have other marked shortcomings.

C: Bonds which are rated C are the lowest rated class of bonds and issues so rated can be regarded as having extremely poor prospects of ever attaining any real investment standing.

Moody's bond ratings, where specified, are applicable to financial contracts, senior bank obligations and insurance company senior policyholder and claims obligations with an original maturity in excess of one year. Obligations relying upon support mechanisms such as letter-of-credit and bonds of indemnity are excluded unless explicitly rated. Obligations of a branch of a bank are considered to be domiciled in the country in which the branch is located.

Unless noted as an exception, Moody's rating on a bank's ability to repay senior obligations extends only to branches located in countries which carry a Moody's Sovereign Rating for Bank Deposits. Such branch obligations are rated at the lower of the bank's rating or Moody's Sovereign Rating for the Bank Deposits for the country in which the branch is located. When the currency in which an obligation is denominated is not the same as the currency of the country in which the obligation is domiciled, Moody's ratings do not incorporate an opinion as to whether payment of the obligation will be affected by the actions of the government controlling the currency of denomination. In addition, risk associated with bilateral conflicts between an investor's home country and either the issuer's home country or the country where an issuer branch is located are not incorporated into Moody's ratings.

Moody's makes no representation that rated bank obligations or insurance company obligations are exempt from registration under the U.S. Securities Act of 1933 or issued in conformity with any other applicable law or regulation. Nor does Moody's represent any specific bank or insurance company obligation is legally enforceable or a valid senior obligation of a rated issuer.

Moody's applies numerical modifiers, 1, 2, and 3, in each generic rating classified from Aa through Caa in its corporate bond rating system. The modifier 1 indicates that the security ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates that the issue ranks in the lower end of its generic rating category.

*Corporate Short-Term Debt Ratings*

Moody's short-term debt ratings are opinions of the ability of issuers to repay punctually senior debt obligations. These obligations have an original maturity not exceeding one year, unless explicitly noted.

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Moody's employs the following three designations, all judged to be investment grade, to indicate the relative repayment ability of rated issuers:

**PRIME-1:** Issuers rated Prime-1 (or supporting institutions) have a superior ability for repayment of senior short-term debt obligations. Prime-1 repayment ability will often be evidenced by many of the following characteristics: leading market positions in well-established industries; high rates of return on funds employed; conservative capitalization structure with moderate reliance on debt and ample asset protection; broad margins in earnings coverage of fixed financial charges and high internal cash generation; and well-established access to a range of financial markets and assured sources of alternate liquidity.

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PRIME-2: Issuers rated Prime-2 (or supporting institutions) have a strong ability for repayment of senior short-term debt obligations. This will normally be evidenced by many of the characteristics cited above but to a lesser degree. Earnings trends and coverage ratios, while sound, may be more subject to variation. Capitalization characteristics, while still appropriate, may be more affected by external conditions. Ample alternate liquidity is maintained.

PRIME-3: Issuers rated Prime-3 (or supporting institutions) have an acceptable ability for repayment of senior short-term obligations. The effect of industry characteristics and market compositions may be more pronounced. Variability in earnings and profitability may result in changes in the level of debt protection measurements and may require relatively high financial leverage. Adequate alternate liquidity is maintained.

NOT PRIME: Issuers rated Not Prime do not fall within any of the Prime rating categories.

## **Standard & Poor's**

### *Issue Credit Rating Definitions*

A Standard & Poor's issue credit rating is a current opinion of the creditworthiness of an obligor with respect to a specific financial obligation, a specific class of financial obligations, or a specific financial program (including ratings on medium term note programs and commercial paper programs). It takes into consideration the creditworthiness of guarantors, insurers, or other forms of credit enhancement on the obligation and takes into account the currency in which the obligation is denominated. The issue credit rating is not a recommendation to purchase, sell, or hold a financial obligation, inasmuch as it does not comment as to market price or suitability for a particular investor.

Issue credit ratings are based on current information furnished by the obligors or obtained by Standard & Poor's from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any credit rating and may, on occasion, rely on unaudited financial information. Credit ratings may be changed, suspended, or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances.

Issue credit ratings can be either long-term or short-term. Short-term ratings are generally assigned to those obligations considered short-term in the relevant market. In the U.S., for example, that means obligations with an original maturity of no more than 365 days including commercial paper. Short-term ratings are also used to indicate the creditworthiness of an obligor with respect to put features on long-term obligations. The result is a dual rating, in which the short-term rating addresses the put feature, in addition to the usual long-term rating. Medium-term notes are assigned long-term ratings.

Issue credit ratings are based, in varying degrees, on the following considerations: likelihood of payment capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation; nature of and provisions of the obligation; protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

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The issue rating definitions are expressed in terms of default risk. As such, they pertain to senior obligations of an entity. Junior obligations are typically rated lower than senior obligations, to reflect the lower priority in bankruptcy, as noted above. (Such differentiation applies when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.) Accordingly, in the case of junior debt, the rating may not conform exactly with the category definition.

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### *Corporate and Municipal Bond Ratings*

#### *Investment Grade*

AAA: An obligation rated AAA has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

AA: An obligation rated AA differs from the highest rated obligations only in small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

A: An obligation rated A is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

BBB: An obligation rated BBB exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

#### *Speculative Grade*

Obligations rated BB, B, CCC, CC, and C are regarded as having predominantly speculative characteristics with respect to capacity to pay interest and repay principal. BB indicates the least degree of speculation and C the highest. While such debt will likely have some quality and protective characteristics, these are outweighed by large uncertainties or major exposures to adverse conditions.

BB: An obligation rated BB is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

B: An obligation rated B is more vulnerable to nonpayment than obligations rated BB, but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

CCC: An obligation rated CCC is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

## Edgar Filing: PIMCO Floating Rate Strategy Fund - Form 497

CC: An obligation rated CC is currently highly vulnerable to nonpayment.

C: A subordinated debt or preferred stock obligation rated C is CURRENTLY HIGHLY VULNERABLE to nonpayment. The C rating may be used to cover a situation where a bankruptcy petition has been filed or similar action taken, but payments on this obligation are being continued. A C also will be assigned to a preferred stock issue in arrears on dividends or sinking fund payments, but that is currently paying.

CI: The rating CI is reserved for income bonds on which no interest is being paid.

D: An obligation rated D is in payment default. The D rating category is used when payments on an obligation are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period. The D rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.

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## **Table of Contents**

Plus (+) or Minus (-): The ratings from AA to CCC may be modified by the addition of a plus or minus sign to show relative standing within the major rating categories.

Provisional ratings: The letter *p* indicates that the rating is provisional. A provisional rating assumes the successful completion of the project being financed by the debt being rated and indicates that payment of debt service requirements is largely or entirely dependent upon the successful and timely completion of the project. This rating, however, while addressing credit quality subsequent to completion of the project, makes no comment on the likelihood of, or the risk of default upon failure of, such completion. The investor should exercise his own judgment with respect to such likelihood and risk.

*r*: This symbol is attached to the ratings of instruments with significant noncredit risks. It highlights risks to principal or volatility of expected returns which are not addressed in the credit rating. Examples include: obligations linked or indexed to equities, currencies, or commodities; obligations exposed to severe prepayment risk such as interest-only or principal-only mortgage securities; and obligations with unusually risky interest terms, such as inverse floaters.

The absence of an *r* symbol should not be taken as an indication that an obligation will exhibit no volatility or variability in total return.

N.R.: This indicates that no rating has been requested, that there is insufficient information on which to base a rating, or that Standard & Poor's does not rate a particular obligation as a matter of policy.

Debt obligations of issuers outside the United States and its territories are rated on the same basis as domestic corporate and municipal issues. The ratings measure the creditworthiness of the obligor but do not take into account currency exchange and related uncertainties.

### *Commercial Paper Rating Definitions*

A Standard & Poor's commercial paper rating is a current assessment of the likelihood of timely payment of debt having an original maturity of no more than 365 days. Ratings are graded into several categories, ranging from A for the highest quality obligations to D for the lowest. These categories are as follows:

A-1: A short-term obligation rated A-1 is rated in the highest category by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong.

A-2: A short-term obligation rated A-2 is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.

## Edgar Filing: PIMCO Floating Rate Strategy Fund - Form 497

A-3: A short-term obligation rated A-3 exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

B: A short-term obligation rated B is regarded as having significant speculative characteristics. The obligor currently has the capacity to meet its financial commitment on the obligation; however, it faces major ongoing uncertainties which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

C: A short-term obligation rated C is currently vulnerable to nonpayment and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation.

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D: A short-term obligation rated D is in payment default. The D rating category is used when payments on an obligation are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period. The D rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.

A commercial paper rating is not a recommendation to purchase, sell or hold a security inasmuch as it does not comment as to market price or suitability for a particular investor. The ratings are based on current information furnished to Standard & Poor's by the issuer or obtained from other sources it considers reliable. Standard & Poor's does not perform an audit in connection with any rating and may, on occasion, rely on unaudited financial information. The ratings may be changed, suspended, or withdrawn as a result of changes in or unavailability of such information.

### **Fitch, Inc.**

A brief description of the applicable Fitch Ratings ratings symbols and meanings (as published by Fitch Ratings) follows:

#### *Long-Term Credit Ratings*

##### *Investment Grade*

AAA: Highest credit quality. AAA ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events.

AA: Very high credit quality. AA ratings denote a very low expectation of credit risk. They indicate very strong capacity for timely payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.

A: High credit quality. A ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings.

BBB: Good credit quality. BBB ratings indicate that there is currently a low expectation of credit risk. The capacity for timely payment of financial commitments is considered adequate, but adverse changes in circumstances and in economic conditions are more likely to impair this capacity. This is the lowest investment-grade category.

##### *Speculative Grade*

## Edgar Filing: PIMCO Floating Rate Strategy Fund - Form 497

BB: Speculative. BB ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade.

B: Highly speculative. B ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment.

CCC, CC, C: High default risk. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favorable business or economic developments. A CC rating indicates that default of some kind appears probable. C ratings signal imminent default.

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DDD, DD, D: Default. The ratings of obligations in this category are based on their prospects for achieving partial or full recovery in a reorganization or liquidation of the obligor. While expected recovery values are highly speculative and cannot be estimated with any precision, the following serve as general guidelines. DDD obligations have the highest potential for recovery, around 90%-100% of outstanding amounts and accrued interest. DD indicates potential recoveries in the range of 50%-90%, and D the lowest recovery potential, *i.e.*, below 50%. Entities rated in this category have defaulted on some or all of their obligations. Entities rated DDD have the highest prospect for resumption of performance or continued operation with or without a formal reorganization process. Entities rated DD and D are generally undergoing a formal reorganization or liquidation process; those rated DD are likely to satisfy a higher portion of their outstanding obligations, while entities rated D have a poor prospect for repaying all obligations.

### *Short-Term Credit Ratings*

A short-term rating has a time horizon of less than 12 months for most obligations, or up to three years for U.S. public finance securities, and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

F1: Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments; may have an added + to denote any exceptionally strong credit feature.

F2: Good credit quality. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings.

F3: Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near-term adverse changes could result in a reduction to non-investment grade.

B: Speculative. Minimal capacity for timely payment of financial commitments, plus vulnerability to near-term adverse changes in financial and economic conditions.

C: High default risk. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favorable business and economic environment.

D: Default. Denotes actual or imminent payment default.

+ or - may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the AAA long-term rating category, to categories below CCC, or to short-term ratings other than F1.

NR indicates that Fitch Ratings does not rate the issuer or issue in question.

## Edgar Filing: PIMCO Floating Rate Strategy Fund - Form 497

**Withdrawn:** A rating is withdrawn when Fitch Ratings deems the amount of information available to be inadequate for rating purposes, or when an obligation matures, is called, or refinanced.

**Rating Watch:** Ratings are placed on Rating Watch to notify investors that there is a reasonable probability of a rating change and the likely direction of such change. These are designated as **Positive**, indicating a potential upgrade, **Negative**, for a potential downgrade, or **Evolving**, if ratings may be raised, lowered or maintained. Rating Watch is typically resolved over a relatively short period.

A Rating Outlook indicates the direction a rating is likely to move over a one to two year period. Outlooks may be positive, stable, or negative. A positive or negative Rating Outlook does not imply a rating change is inevitable. Similarly, companies whose outlooks are **stable** could be downgraded before an outlook moves to positive or negative if circumstances warrant such an action. Occasionally, Fitch Ratings may be unable to identify the fundamental trend. In these cases, the Rating Outlook may be described as **evolving**.

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### **Dominion Bond Rating Service Limited**

DBRS ratings are meant to give an indication of the risk that the borrower will not fulfill its obligations in a timely manner. DBRS ratings do not take factors such as pricing or market risk into consideration and are expected to be used by purchasers as one part of their investment process. Every DBRS rating is based on quantitative and qualitative considerations which are relevant for the borrowing entity.

#### *DBRS Bond and Long Term Debt Rating Scale*

**AAA:** Bonds rated **AAA** are of the highest credit quality, with exceptionally strong protection for the timely repayment of principal and interest. Earnings are considered stable, the structure of the industry in which the entity operates is strong, and the outlook for future profitability is favorable. There are few qualifying factors present which would detract from the performance of the entity, the strength of liquidity and coverage ratios is unquestioned and the entity has established a creditable track record of superior performance. Given the extremely tough definition which DBRS has established for this category, few entities are able to achieve a AAA rating.

**AA:** Bonds rated **AA** are of superior credit quality, and protection of interest and principal is considered high. In many cases, they differ from bonds rated AAA only to a small degree. Given the extremely tough definition which DBRS has for the AAA category (which few companies are able to achieve), entities rated AA are also considered to be strong credits which typically exemplify above-average strength in key areas of consideration and are unlikely to be significantly affected by reasonably foreseeable events.

**A:** Bonds rated **A** are of satisfactory credit quality. Protection of interest and principal is still substantial, but the degree of strength is less than with AA rated entities. While a respectable rating, entities in the **A** category are considered to be more susceptible to adverse economic conditions and have greater cyclical tendencies than higher rated companies.

**BBB:** Bonds rated **BBB** are of adequate credit quality. Protection of interest and principal is considered adequate, but the entity is more susceptible to adverse changes in financial and economic conditions, or there may be other adversities present which reduce the strength of the entity and its rated securities.

**BB:** Bonds rated **BB** are defined to be speculative, where the degree of protection afforded interest and principal is uncertain, particularly during periods of economic recession. Entities in the BB area typically have limited access to capital markets and additional liquidity support and, in many cases, small size or lack of competitive strength may be additional negative considerations.

**B:** Bonds rated **B** are highly speculative and there is a reasonably high level of uncertainty which exists as to the ability of the entity to pay interest and principal on a continuing basis in the future, especially in periods of economic recession or industry adversity.

**CCC, CC, C:** Bonds rated in any of these categories are very highly speculative and are in danger of default of interest and principal. The degree of adverse elements present is more severe than bonds rated **B**. Bonds rated below **B** often have characteristics which, if not remedied, may lead to default. In practice, there is little difference between the **C** to **CCC** categories, with **CC** and **C** normally used to lower ranking debt of

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companies where the senior debt is rated in the CCC to B range.

D: This category indicates Bonds in default of either interest or principal.

High, Low: high and low grades are used to indicate the relative standing of a credit within a particular rating category. The lack of one of these designations indicates a rating which is essentially in the middle of the category. Note that high and low grades are not used for the AAA category.

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### *DBRS Commercial Paper and Short Term Debt Rating Scale*

All three DBRS rating categories for short term debt use high , middle or low as subset grades to designate the relative standing of the credit within a particular rating category.

#### *Prime Credit Quality*

R-1 (high): Short term debt rated R-1 (high) is of the highest credit quality, and indicates an entity which possesses unquestioned ability to repay current liabilities as they fall due. Entities rated in this category normally maintain strong liquidity positions, conservative debt levels and profitability which is both stable and above average. Companies achieving an R-1 (high) rating are normally leaders in structurally sound industry segments with proven track records, sustainable positive future results and no substantial qualifying negative factors. Given the extremely tough definition which DBRS has established for an R-1 (high), few entities are strong enough to achieve this rating.

R-1 (middle): Short term debt rated R-1 (middle) is of superior credit quality and, in most cases, ratings in this category differ from R-1 (high) credits to only a small degree. Given the extremely tough definition which DBRS has for the R-1 (high) category (which few companies are able to achieve), entities rated R-1 (middle) are also considered strong credits which typically exemplify above average strength in key areas of consideration for debt protection.

R-1 (low): Short term debt rated R-1 (low) is of satisfactory credit quality. The overall strength and outlook for key liquidity, debt and profitability ratios is not normally as favorable as with higher rating categories, but these considerations are still respectable. Any qualifying negative factors which exist are considered manageable, and the entity is normally of sufficient size to have some influence in its industry.

#### *Adequate Credit Quality*

R-2 (high), R-2 (middle), R-2 (low): Short term debt rated R-2 is of adequate credit quality and within the three subset grades, debt protection ranges from having reasonable ability for timely repayment to a level which is considered only just adequate. The liquidity and debt ratios of entities in the R-2 classification are not as strong as those in the R-1 category, and the past and future trend may suggest some risk of maintaining the strength of key ratios in these areas. Alternative sources of liquidity support are considered satisfactory; however, even the strongest liquidity support will not improve the commercial paper rating of the issuer. The size of the entity may restrict its flexibility, and its relative position in the industry is not typically as strong as an R-1 credit. Profitability trends, past and future, may be less favorable, earnings not as stable, and there are often negative qualifying factors present which could also make the entity more vulnerable to adverse changes in financial and economic conditions.

#### *Speculative*

R-3 (high), R-3 (middle), R-3 (low): Short term debt rated R-3 is speculative, and within the three subset grades, the capacity for timely payment ranges from mildly speculative to doubtful. R-3 credits tend to have weak liquidity and debt ratios, and the future trend of these ratios is also

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unclear. Due to its speculative nature, companies with R-3 ratings would normally have very limited access to alternative sources of liquidity. Earnings would typically be very unstable, and the level of overall profitability of the entity is also likely to be low. The industry environment may be weak, and strong negative qualifying factors are also likely to be present.

### *DBRS Preferred Share Rating Scale*

Pfd-1: Preferred shares rated Pfd-1 are of superior credit quality, and are supported by entities with strong earnings and balance sheet characteristics. Pfd-1 generally corresponds with companies whose senior

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bonds are rated in the AAA or AA categories. As is the case with all rating categories, the relationship between senior debt ratings and preferred share ratings should be understood as one where the senior debt rating effectively sets a ceiling for the preferred shares issued by the entity. However, there are cases where the preferred share rating could be lower than the normal relationship with the issuer's senior debt rating.

Pfd-2: Preferred shares rated Pfd-2 are of satisfactory credit quality. Protection of dividends and principal is still substantial, but earnings, the balance sheet, and coverage ratios are not as strong as Pfd-1 rated companies. Generally, Pfd-2 ratings correspond with companies whose senior bonds are rated in the A category.

Pfd-3: Preferred shares rated Pfd-3 are of adequate credit quality. While protection of dividends and principal is still considered acceptable, the issuing entity is more susceptible to adverse changes in financial and economic conditions, and there may be other adversities present which detract from debt protection. Pfd-3 ratings generally correspond with companies whose senior bonds are rated in the higher end of the BBB category.

Pfd-4: Preferred shares rated Pfd-4 are speculative, where the degree of protection afforded to dividends and principal is uncertain, particularly during periods of economic adversity. Companies with preferred shares rated Pfd-4 generally coincide with entities that have senior bond ratings ranging from the lower end of the BBB category through the BB category.

Pfd-5: Preferred shares rated Pfd-5 are highly speculative and the ability of the entity to maintain timely dividend and principal payments in the future is highly uncertain. The Pfd-5 rating generally coincides with companies with senior bond ratings of B or lower. Preferred shares rated Pfd-5 often have characteristics which, if not remedied, may lead to default.

D: This category indicates preferred shares that are in arrears of paying either dividends or principal.

High, Low: high and low grades are used to indicate the relative standing of a credit within a particular rating category. The lack of one of these designations indicates a rating that is essentially in the middle of the category.

n: Non-Cumulative Risk. In the past several years, DBRS had designated all non-cumulative preferred shares as low to alert subscribers to the fact that non-cumulative shares have a higher risk of loss once dividend payments have been missed. In the future, high and low designations will be used on preferred share ratings to indicate the relative standing of a credit within a particular rating category, and we will no longer use low to alert holders to the non-cumulative nature of the shares. Rather, the n designation will be attached to all ratings for securities that are non-cumulative. The risk with non-cumulative securities is essentially no different than with cumulative securities unless there is a default situation, in which case, the non-cumulative shares have the added risk of missing dividend payments that have no potential of being made up in the future. However, non-cumulative shares do not have a higher risk of default than do equivalently ranking cumulative shares of the same issuer. We believe that the risk added under the non-cumulative covenant is a market risk and not a credit risk. This supports our view that the ratings on equally ranking cumulative and non-cumulative securities should be the same, with the n used to alert subscribers to the additional potential for missed dividend payments that exists with non-cumulative issues, if default should occur. After several years of using our present scale, our conclusion is that trying to provide all of this information with one rating symbol is confusing to the market. We believe that it is more valuable to our subscribers if the rating symbol simply provides our base evaluation of the credit, along with information that alerts the holder to any unique covenants that can add market risk.

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y: Hybrid Instruments. While DBRS credit ratings are focused on providing a measure of the issuer's ability to meet its obligations in a timely manner, there are situations where securities carry unique covenants that can add a variety of risks that are not captured in the DBRS rating. By definition, hybrids are instruments that combine certain characteristics of debt and equity and have been issued under various acronyms such as LYONS, PERCS, COPrS, TOPrS, PRYDES, MIDS and MIPS. In some cases, holders of these instruments have agreed

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that under set circumstances, the Company may repay certain obligations with more of the security or with another security, such as common equity. In other cases, the terms allow the Company to defer interest or dividend payments for a period of time. While these are obviously important considerations for the holder to understand, they normally do not cause any change in the likelihood of default and, as such, DBRS has chosen not to penalize the instrument for the special features associated with the hybrid. In order to alert hybrid holders of the unique factors inherent in the security, DBRS will attach the y appendage to the rating. Note that DBRS will not be adding the y to issues that simply have more normal soft retraction or conversion features.

m: Market Risk. DBRS ratings represent an evaluation which is based on only credit related factors and not market risk factors. The most obvious example of a market risk factor would be the potential impact that changing interest rates could have on a fixed pay security. While the absence of market risk considerations in DBRS credit ratings should be well understood by investors who use DBRS as part of their investment process, there are cases where DBRS desires to draw attention to market risk for a given security because the potential for volatility due to market risk factors greatly exceeds what would be considered normal. To accomplish this, DBRS attaches the letter m (market risk) to a rated security. Given the understanding that market risk is present in every investment decision, it is important to note that the absence of m does not indicate that there will be no volatility of returns related to non-credit factors. DBRS uses m only in cases where market risk is considered exceptionally high, or in cases where there are unusual circumstances.

p: The symbol p indicates that the report and rating rely on public information only.

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**\$480,000,000**

**PIMCO Floating Rate Strategy Fund**

**Auction Market Preferred Shares ( AMPS )**

**3,840 Shares, Series M**

**3,840 Shares, Series T**

**3,840 Shares, Series W**

**3,840 Shares, Series TH**

**3,840 Shares, Series F**

**Liquidation Preference \$25,000 per Share**

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**PROSPECTUS**

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**Merrill Lynch & Co.**

**UBS Investment Bank**

**A.G. Edwards**

**Oppenheimer & Co.**

# Wachovia Securities

December 16, 2004

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**PIMCO FLOATING RATE STRATEGY FUND**

**STATEMENT OF ADDITIONAL INFORMATION**

**December 16, 2004**

PIMCO Floating Rate Strategy Fund (the Fund) is a recently organized, diversified, closed-end management investment company.

This Statement of Additional Information relating to auction market preferred shares of the Fund ( AMPS ) is not a prospectus, and should be read in conjunction with the Fund's prospectus relating to the AMPS dated December 16, 2004 (the Prospectus ). This Statement of Additional Information does not include all information that a prospective investor should consider before purchasing AMPS, and investors should obtain and read the Prospectus prior to purchasing such shares. A copy of the Prospectus may be obtained without charge by calling (877) 819-2224. You may also obtain a copy of the Prospectus on the web site (<http://www.sec.gov>) of the Securities and Exchange Commission (the SEC ). Capitalized terms used but not defined in this Statement of Additional Information have the meanings ascribed to them in the Prospectus.

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This Statement of Additional Information is dated December 16, 2004.

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**USE OF PROCEEDS**

The net proceeds of the offering of AMPS of the Fund will be approximately \$474,615,000 after payment of estimated offering costs and the sales load.

It is presently anticipated that the Fund will be able to invest substantially all of the net proceeds in floating rate debt instruments and other securities that meet its investment objective and policies within six months after the completion of the offering. The Fund anticipates that it may take up to six months to complete this initial investment process due to potential limited availability of suitable Senior Loans in the marketplace as well as additional time required for PIMCO to analyze and assess counterparties and contractual and other features associated with Senior Loans, which are typically more detailed and complex than those associated with more traditional debt instruments. Pending such investment, it is anticipated that the proceeds will be invested in high grade, short-term securities, credit-linked trust certificates, and/or index futures contracts or similar derivative instruments designed to give the Fund exposure to the markets in which it intends to invest while PIMCO selects specific securities. During the period in which the Fund is investing the net proceeds of the offering, it may not be in a position to achieve its investment objective.

**INVESTMENT OBJECTIVE AND POLICIES**

The investment objective and general investment policies of the Fund are described in the Prospectus. Additional information concerning the characteristics of certain of the Fund's investments is set forth below.

**Floating Rate Debt Instruments**

As described in the Prospectus, the Fund will ordinarily invest in floating rate debt instruments, a substantial portion of which will be senior floating rate loans ( Senior Loans ). Floating rate debt instruments are debt instruments that pay interest at rates which adjust whenever a specified interest rate changes and/or which reset on predetermined dates (such as the last day of a month or calendar quarter). These floating rate debt instruments may include, in addition to Senior Loans, instruments such as catastrophe bonds, bank capital securities, unsecured bank loans, corporate bonds, money market instruments and certain types of mortgage-backed and other asset-backed securities. Due to their floating rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt instrument is generally expected to have less sensitivity to fluctuations in market interest rates than a longer-term fixed rate debt instrument, although the value of a floating rate instrument may nonetheless decline as interest rates rise and due to other factors, such as changes in credit quality.

**Senior Loans**

The Fund expects to ordinarily invest a substantial portion of its assets in Senior Loans. Senior Loans include senior floating rate loans and institutionally traded senior floating rate debt obligations issued by asset-backed pools and other issues, and interests therein. Loan interests generally take the form of direct interests acquired during a primary distribution and may also take



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the form of assignments of, novations of, or participations in a Senior Loan acquired in secondary markets. Loan interests may be acquired from U.S. or foreign commercial banks, insurance companies, finance companies or other financial institutions who have made loans or are members of a lending syndicate or from other holders of loan interests.

Senior Loans typically pay interest at rates which are re-determined periodically on the basis of a floating base lending rate (such as the London Inter-Bank Offered Rate, LIBOR ) plus a premium. Although Senior Loans are typically of below investment grade quality, they tend to have more favorable recovery rates than other types of below investment grade quality debt obligations. Senior Loans generally (but not always) hold the most senior position in the capital structure of a borrower and are often secured with collateral. A Senior Loan is typically originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other financial institution (the Agent ) for a lending syndicate of financial institutions ( Lenders ). The Agent typically administers and enforces the Senior Loan on behalf of the other Lenders in the syndicate. In addition, an institution, typically but not always the Agent, holds any collateral on behalf of the Lenders.

The Fund may purchase assignments and participations in commercial loans, as well as debtor-in-possession loans. Such indebtedness may be secured or unsecured. Loan participations typically represent direct participations in a loan to a corporate borrower, and generally are offered by banks or other financial institutions or lending syndicates. The Fund may participate in such syndications, or can buy part of a loan, becoming a part lender. When purchasing loan participations, the Fund assumes the credit risk associated with the corporate or other borrower and may assume the credit risk associated with an interposed bank or other financial intermediary. The participation interests in which the Fund intends to invest may not be rated by any nationally recognized rating service.

Unless, under the terms of the loan or other indebtedness (such as may be the case in an assignment), the Fund has direct recourse against the borrower, the Fund may have to rely on the Agent or other financial intermediary to apply appropriate credit remedies against a borrower.

Purchasers of loans and other forms of direct indebtedness depend primarily upon the creditworthiness of the corporate or other borrower for payment of principal and interest. If the Fund does not receive scheduled interest or principal payments on such indebtedness, the Fund's share price and yield could be adversely affected. Senior Loans that are fully secured offer the Fund more protection than an unsecured loan in the event of non-payment of scheduled interest or principal. However, there is no assurance that the liquidation of collateral from a secured Senior Loan would satisfy the borrower's obligation, or that such collateral could be liquidated.

The Fund may invest in loan participations with credit quality comparable to that of many issuers of its other debt securities investments. Indebtedness of companies whose creditworthiness is poor involves substantially greater risks, and may be highly speculative.

Some companies may never pay off their indebtedness, or may pay only a small fraction of the amount owed. Consequently, when investing in indebtedness of companies with poor credit, the Fund bears a substantial risk of losing the entire amount invested.



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The Fund limits the amount of its total assets that it will invest in any one issuer or in issuers within the same industry. See *Investment Restrictions*. For purposes of these limits, the Fund generally will treat the corporate or other borrower as the issuer of indebtedness held by the Fund. In the case of loan participations where a bank or other lending institution serves as a financial intermediary between the Fund and the borrower, if the participation does not shift to the Fund the direct debtor-creditor relationship with the borrower, the Fund shall treat both the lending bank or other lending institution and the borrower as issuers for the purposes of the Fund's sub-classification as a diversified company under the 1940 Act, for purposes of the Fund's industry concentration policy set forth in paragraph (1) under *Investment Restrictions* *Fundamental Investment Restriction* below and for the purposes of meeting the issuer diversification test under Section 851 of the Code. See *Tax Matters* below. Treating a financial intermediary as an issuer of indebtedness may restrict the Fund's ability to invest in indebtedness related to a single financial intermediary, or a group of intermediaries engaged in the same industry, even if the underlying borrowers represent many different companies and industries.

Loans and other types of direct indebtedness may not be readily marketable and may be subject to restrictions on resale. In some cases, negotiations involved in disposing of indebtedness may require weeks to complete. Consequently, some indebtedness may be difficult or impossible to dispose of readily at what PIMCO believes to be a fair price. In addition, valuation of illiquid indebtedness involves a greater degree of judgment in determining the Fund's net asset value than if that value were based on available market quotations. PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions. Investments in loan participations are considered to be debt obligations for purposes of the Fund's investment restriction relating to the lending of funds or assets.

Investments in loans through a direct assignment of the financial institution's interests with respect to the loan may involve additional risks to the Fund. For example, if a loan is foreclosed, the Fund could become part owner of any collateral, and would bear the costs and liabilities associated with owning and disposing of the collateral. In addition, it is conceivable that, under emerging legal theories of lender liability, the Fund could be held liable as co-lender. It is unclear whether loans and other forms of direct indebtedness offer securities law protections against fraud and misrepresentation. In the absence of definitive regulatory guidance, the Fund relies on PIMCO's research in an attempt to avoid situations where fraud or misrepresentations could adversely affect the Fund.

From time to time, PIMCO and its affiliates may borrow money from various banks in connection with their business activities. Such banks may also sell Senior Loans to or acquire them from the Fund or may be intermediate participants with respect to Senior Loans in which the Fund owns interests. Such banks may also act as Agents for Senior Loans held by the Fund.

*Lending Fees.* In the process of buying, selling and holding Senior Loans, the Fund may receive and/or pay certain fees. These fees are in addition to interest payments received and may include facility fees, commitment fees, commissions and prepayment penalty fees. When the Fund buys a Senior Loan it may receive a facility fee and when it sells a Senior Loan it may pay a facility fee. On an ongoing basis, the Fund may receive a commitment fee based on the undrawn portion of the underlying line of credit portion of the Senior Loan. In certain circumstances, the Fund may receive a prepayment penalty fee upon the prepayment of a Senior Loan by a borrower.

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Other fees received by the Fund may include covenant waiver fees and covenant modification fees.

*Borrower Covenants.* A borrower under a Senior Loan typically must comply with various restrictive covenants contained in a loan agreement or note purchase agreement between the borrower and the Lender or lending syndicate (the Loan Agreement). Such covenants, in addition to requiring the scheduled payment of interest and principal, may include restrictions on dividend payments and other distributions to stockholders, provisions requiring the borrower to maintain specific minimum financial ratios, and limits on total debt. In addition, the Loan Agreement may contain a covenant requiring the borrower to prepay the Senior Loan with any free cash flow. Free cash flow is generally defined as net cash flow after scheduled debt service payments and permitted capital expenditures, and includes the proceeds from asset dispositions or sales of securities. A breach of a covenant which is not waived by the Agent, or by the lenders directly, as the case may be, is normally an event of acceleration; i.e., the Agent, or the lenders directly, as the case may be, has the right to call the outstanding Senior Loan. The typical practice of an Agent or a Lender in relying exclusively or primarily on reports from the borrower may involve a risk of fraud by the borrower. In the case of a Senior Loan in the form of a participation, the agreement between the buyer and seller may limit the rights of the holder of a Senior Loan to vote on certain changes which may be made to the Loan Agreement, such as waiving a breach of a covenant. However, the holder of the participation will, in almost all cases, have the right to vote on certain fundamental issues such as changes in principal amount, payment dates and interest rate.

*Administration of Loans.* In a typical Senior Loan, the Agent administers the terms of the Loan Agreement. In such cases, the Agent is normally responsible for the collection of principal and interest payments from the borrower and the apportionment of these payments to the credit of all institutions which are parties to the Loan Agreement. The Fund will generally rely upon the Agent or an intermediate participant to receive and forward to the Fund its portion of the principal and interest payments on the Senior Loan. Furthermore, unless under the terms of a participation agreement the Fund has direct recourse against the borrower, the Fund will rely on the Agent and the other members of the lending syndicate to use appropriate credit remedies against the borrower. The Agent is typically responsible for monitoring compliance with covenants contained in the Loan Agreement based upon reports prepared by the borrower. The seller of the Senior Loan usually does, but is often not obligated to, notify holders of Senior Loans of any failures of compliance. The Agent may monitor the value of the collateral, if any, and if the value of such collateral declines, may accelerate the Senior Loan, may give the borrower an opportunity to provide additional collateral or may seek other protection for the benefit of the participants in the Senior Loan. The Agent is compensated by the borrower for providing these services under a Loan Agreement, and such compensation may include special fees paid upon structuring and funding the Senior Loan and other fees paid on a continuing basis. With respect to Senior Loans for which the Agent does not perform such administrative and enforcement functions, PIMCO will perform such tasks on behalf of the Fund, although a collateral bank will typically hold any collateral on behalf of the Fund and the other lenders pursuant to the applicable Loan Agreement.

A financial institution's appointment as Agent may usually be terminated in the event that it fails to observe the requisite standard of care or becomes insolvent, enters Federal Deposit Insurance Corporation (FDIC) receivership, or, if not FDIC insured, enters into bankruptcy

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proceedings. A successor Agent would generally be appointed to replace the terminated Agent, and assets held by the Agent under the Loan Agreement should remain available to holders of Senior Loans. However, if assets held by the Agent for the benefit of the Fund were determined to be subject to the claims of the Agent's general creditors, the Fund might incur certain costs and delays in realizing payment on a Senior Loan, or suffer a loss of principal and/or interest. In situations involving other intermediate participants similar risks may arise.

*Prepayments.* Senior Loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the Senior Loan from free cash flow, as defined above. The degree to which borrowers prepay Senior Loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among others. As such, prepayments cannot be predicted with accuracy. Upon a prepayment, either in part or in full, the actual outstanding debt on which the Fund derives interest income will be reduced. However, the Fund may receive both a prepayment penalty fee from the prepaying borrower and a facility fee upon the purchase of a new Senior Loan with the proceeds from the prepayment of the former. Prepayments generally will not materially affect the Fund's performance because the Fund should be able to reinvest prepayments in other Senior Loans that have similar or identical yields and because receipt of such fees may mitigate any adverse impact on the Fund's yield.

*Bridge Financings.* The Fund may acquire interests in Senior Loans which are designed to provide temporary or "bridge" financing to a borrower pending the sale of identified assets or the arrangement of longer-term loans or the issuance and sale of debt obligations. The Fund may also invest in Senior Loans of borrowers who have obtained bridge loans from other parties. A borrower's use of bridge loans involves a risk that the borrower may be unable to locate permanent financing to replace the bridge loan, which may impair the borrower's perceived creditworthiness.

*Secured Senior Loans.* To the extent that the collateral, if any, securing a Senior Loan consists of the stock of the borrower's subsidiaries or other affiliates, the Fund will be subject to the risk that this stock will decline in value. Such a decline, whether as a result of bankruptcy proceedings or otherwise, could cause the Senior Loan to be undercollateralized or unsecured. In most credit agreements there is no formal requirement to pledge additional collateral. In addition, the Fund may invest in Senior Loans guaranteed by, or fully secured by assets of, shareholders or owners, even if the Senior Loans are not otherwise collateralized by assets of the borrower. There may be temporary periods when the principal asset held by a borrower is the stock of a related company, which may not legally be pledged to secure a secured Senior Loan. On occasions when such stock cannot be pledged, the secured Senior Loan will be temporarily unsecured until the stock can be pledged or is exchanged for or replaced by other assets, which will be pledged as security for such Senior Loan. However, the borrower's ability to dispose of such securities, other than in connection with such pledge or replacement, will be strictly limited for the protection of the holders of secured Senior Loans.

If a borrower becomes involved in bankruptcy proceedings, a court may invalidate the Fund's security interest in any loan collateral or subordinate the Fund's rights under a secured Senior Loan to the interests of the borrower's unsecured creditors. Such action by a court could be based, for example, on a "fraudulent conveyance" claim to the effect that the borrower did not

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receive fair consideration for granting the security interest in the loan collateral to the Fund. For secured Senior Loans made in connection with a highly leveraged transaction, consideration for granting a security interest may be deemed inadequate if the proceeds of such loan were not received or retained by the borrower, but were instead paid to other persons, such as shareholders of the borrower, in an amount which left the borrower insolvent or without sufficient working capital. There are also other events, such as the failure to perfect a security interest due to faulty documentation or faulty official filings, which could lead to the invalidation of the Fund's security interest in any loan collateral. If the Fund's security interest in loan collateral is invalidated or a secured Senior Loan is subordinated to other debt of a borrower in bankruptcy or other proceedings, it is unlikely that the Fund would be able to recover the full amount of the principal and interest due on the secured Senior Loan.

The Fund may also invest in Senior Loans that are not secured by collateral or otherwise.

## **High Yield Securities ( Junk Bonds )**

The Fund may invest without limit and ordinarily expects to invest a substantial portion of its assets in Senior Loans and other debt securities that are, at the time of purchase, rated below investment grade (below Baa3 by Moody's Investors Service, Inc. ( Moody's ), below BBB- by either Standard & Poor's ( S&P ) or Fitch, Inc. ( Fitch ), or below a comparable rating by Dominion Bond Rating Service Limited ( Dominion )) or unrated but judged by PIMCO to be of comparable quality. These securities are sometimes referred to as high yield securities or junk bonds. The Fund will not invest more than 10% of its total assets in securities that are, at the time of purchase, rated CCC+/Caa1 or lower by each agency rating the security or that are unrated but judged by PIMCO to be of comparable quality.

Many of the Senior Loans in which the Fund invests will be high yield securities. See Senior Loans.

Investments in high yield securities generally provide greater income and increased opportunity for capital appreciation than investments in higher quality securities, but they also typically entail greater price volatility and principal and income risk, including the possibility of issuer default and bankruptcy. High yield securities are regarded as predominantly speculative with respect to the issuer's continuing ability to meet principal and interest payments. Debt securities in the lowest investment grade category also may be considered to possess some speculative characteristics by certain rating agencies. In addition, analysis of the creditworthiness of issuers of high yield securities may be more complex than for issuers of higher quality securities.

High yield securities may be more susceptible to real or perceived adverse economic and competitive industry conditions than investment grade securities. A projection of an economic downturn or of a period of rising interest rates, for example, could cause a decline in high yield security prices because the advent of a recession could lessen the ability of an issuer to make principal and interest payments on its debt obligations. If an issuer of high yield securities defaults, in addition to risking non-payment of all or a portion of interest and principal, the Fund may incur additional expenses to seek recovery. The market prices of high yield securities structured as zero-coupon, step-up or payment-in-kind securities will normally be affected to a

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greater extent by interest rate changes, and therefore tend to be more volatile than the prices of securities that pay interest currently and in cash.

The secondary market on which high yield securities are traded may be less liquid than the market for investment grade securities. Less liquidity in the secondary trading market could adversely affect the price at which the Fund could sell a high yield security, and could adversely affect the net asset value of the shares. Adverse publicity and investor perceptions, whether or not based on fundamental analysis, may decrease the values and liquidity of high yield securities, especially in a thinly-traded market. When secondary markets for high yield securities are less liquid than the market for investment grade securities, it may be more difficult to value the securities because such valuation may require more research, and elements of judgment may play a greater role in the valuation because there is less reliable, objective data available. During periods of thin trading in these markets, the spread between bid and asked prices is likely to increase significantly and the Fund may have greater difficulty selling its portfolio securities. The Fund will be more dependent on PIMCO's research and analysis when investing in high yield securities. PIMCO seeks to minimize the risks of investing through in-depth credit analysis and attention to current developments in interest rates and market conditions.

A general description of the ratings of securities by Moody's, S&P, Fitch and Dominion is set forth in Appendix A to the Prospectus. The ratings of Moody's, S&P, Fitch and Dominion represent their opinions as to the quality of the securities they rate. It should be emphasized, however, that ratings are general and are not absolute standards of quality. Consequently, debt obligations with the same maturity, coupon and rating may have different yields while obligations with the same maturity and coupon with different ratings may have the same yield. For these reasons, the use of credit ratings as the sole method of evaluating high yield securities can involve certain risks. For example, credit ratings evaluate the safety of principal and interest payments, not the market value risk of high yield securities. Also, credit rating agencies may fail to change credit ratings in a timely fashion to reflect events since the security was last rated. PIMCO does not rely solely on credit ratings when selecting securities for the Fund, and develops its own independent analysis of issuer credit quality.

The Fund's credit quality policies apply only at the time a security is purchased, and the Fund is not required to dispose of a security in the event that a rating agency or PIMCO downgrades its assessment of the credit characteristics of a particular issue. In determining whether to retain or sell such a security, PIMCO may consider such factors as PIMCO's assessment of the credit quality of the issuer of such security, the price at which such security could be sold and the rating, if any, assigned to such security by other rating agencies. However, analysis of creditworthiness may be more complex for issuers of Senior Loans and other high yield securities than for issuers of higher quality debt securities.

## **Distressed Securities**

Securities in which the Fund invests may be subject to significant risk of an issuer's inability to meet principal and interest payments on the obligations and also may be subject to price volatility due to such factors as market perception of the creditworthiness of an issuer and general market liquidity. If PIMCO's evaluation of the anticipated outcome of an investment situation should prove incorrect, such Fund investments could experience a loss.

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### **Bonds**

The Fund may invest in a variety of bonds and related debt obligations of varying maturities (with predominantly low durations) issued by U.S. corporations, foreign corporations, domestic banks, foreign banks and other business entities. Bonds include bills, notes, debentures, money market instruments and similar instruments and securities. Bonds generally are used by corporations and other issuers to borrow money from investors. The issuer pays the investor a variable or fixed rate of interest and normally must repay the amount borrowed on or before maturity. Certain bonds are perpetual in that they have no maturity date.

The Fund's investments in bonds are often subject to a number of risks described in the Prospectus and elaborated upon elsewhere in this section of the Statement of Additional Information, including credit risk, high yield risk, interest rate risk, issuer risk, foreign (non-U.S.) investment risk, inflation risk, liquidity risk, smaller company risk and management risk.

### **Event-Linked Bonds**

The Fund may invest in event-linked bonds. Event-linked bonds, which are sometimes referred to as catastrophe bonds, are debt obligations for which the return of principal and payment of interest is contingent on the non-occurrence of a specific trigger event, such as a hurricane or an earthquake. They may be issued by government agencies, insurance companies, reinsurers, special purpose corporations or other on-shore or off-shore entities. If a trigger event causes losses exceeding a specific amount in the geographic region and time period specified in a bond, the Fund may lose a portion or all of its principal invested in the bond. If no trigger event occurs, the Fund will recover its principal plus interest. For some event-linked bonds, the trigger event or losses may be based on company-wide losses, index-portfolio losses, industry indexes or readings of scientific instruments rather than specified actual losses. Often event-linked bonds provide for extensions of maturity that are mandatory, or optional at the discretion of the issuer, in order to process and audit loss claims in those cases when a trigger event has, or possibly has, occurred. In addition to the specified trigger events, event-linked bonds may also expose the Fund to certain unanticipated risks including but not limited to issuer (credit) default, adverse regulatory or jurisdictional interpretations and adverse tax consequences.

Event-linked bonds are a relatively new type of financial instrument. As such, there is no significant trading history of these securities, and there can be no assurance that a liquid market in these instruments will develop. Lack of a liquid market may impose the risk of higher transaction costs and the possibility that the Fund may be forced to liquidate positions when it would not be advantageous to do so. Event-linked bonds are typically rated.

### **Inflation-Indexed Bonds**

The Fund may invest in inflation-indexed bonds, which are debt obligations whose value is periodically adjusted according to the rate of inflation. Two structures are common. The U.S. Treasury and some other issuers utilize a structure that accrues inflation into the principal value of the bond. Most other issuers pay out the Consumer Price Index accruals as part of a semiannual coupon.

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Inflation-indexed securities issued by the U.S. Treasury have maturities of approximately five, ten or thirty years, although it is possible that securities with other maturities will be issued in the future. The U.S. Treasury securities pay interest on a semi-annual basis equal to a fixed percentage of the inflation-adjusted principal amount. For example, if the Fund purchased an inflation-indexed bond with a par value of \$1,000 and a 3% real rate of return coupon (payable 1.5% semi-annually), and the rate of inflation over the first six months was 1%, the mid-year par value of the bond would be \$1,010 and the first semi-annual interest payment would be \$15.15 (\$1,010 times 1.5%). If inflation during the second half of the year resulted in the whole year's inflation equaling 3%, the end-of-year par value of the bond would be \$1,030 and the second semi-annual interest payment would be \$15.45 (\$1,030 times 1.5%).

If the periodic adjustment rate measuring inflation falls, the principal value of inflation-indexed bonds will be adjusted downward, and consequently the interest payable on these securities (calculated with respect to a smaller principal amount) will be reduced. Repayment of the original bond principal upon maturity (as adjusted for inflation) is guaranteed in the case of U.S. Treasury inflation-indexed bonds, even during a period of deflation. However, the current market value of the bonds is not guaranteed and will fluctuate. The Fund may also invest in other inflation-related bonds which may or may not provide a similar guarantee. If a guarantee of principal is not provided, the adjusted principal value of the bond repaid at maturity may be less than the original principal amount.

The value of inflation-indexed bonds is expected to change in response to changes in real interest rates. Real interest rates in turn are tied to the relationship between nominal interest rates and the rate of inflation. Therefore, if the rate of inflation rises at a faster rate than nominal interest rates, real interest rates might decline, leading to an increase in value of inflation-indexed bonds. In contrast, if nominal interest rates increase at a faster rate than inflation, real interest rates might rise, leading to a decrease in value of inflation-indexed bonds.

While these securities are expected to be protected from long-term inflationary trends, short-term increases in inflation may lead to a decline in value. If interest rates rise due to reasons other than inflation (for example, due to changes in currency exchange rates), investors in these securities may not be protected to the extent that the increase is not reflected in the bond's inflation measure.

The periodic adjustment of U.S. inflation-indexed bonds is tied to the Consumer Price Index for Urban Consumers (CPI-U), which is calculated monthly by the U.S. Bureau of Labor Statistics. The CPI-U is a measurement of changes in the cost of living, made up of components such as housing, food, transportation and energy. Inflation-indexed bonds issued by a foreign government are generally adjusted to reflect a comparable inflation index calculated by that government. There can be no assurance that the CPI-U or any foreign inflation index will accurately measure the real rate of inflation in the prices of goods and services. Moreover, there can be no assurance that the rate of inflation in a foreign country will be correlated to the rate of inflation in the United States.

For federal income tax purposes, any increase in the principal amount of an inflation-indexed bond will be original issue discount which is taxable as ordinary income in the year

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accrued, even though investors do not receive their principal, including any increases thereto, until maturity. See **Tax Matters** **Discount Obligations and Payment-in-Kind Securities** below.

### **Mortgage-Related and Other Asset-Backed Securities**

The Fund may invest in mortgage-related securities, and may also invest in other asset-backed securities (unrelated to mortgage loans) that are offered to investors currently or in the future. Mortgage-related securities are interests in pools of residential or commercial mortgage loans, including mortgage loans made by savings and loan institutions, mortgage bankers, commercial banks and others. Pools of mortgage loans are assembled as securities for sale to investors by various governmental, government-related and private organizations. Like other debt obligations, the ability of the Fund to successfully utilize these instruments may depend in part upon the ability of PIMCO to forecast certain macro-economic factors correctly. See **Mortgage Pass-Through Securities** below. Certain debt obligations are also secured with collateral consisting of mortgage-related securities. See **Collateralized Mortgage Obligations ( CMOs )** below.

The mortgage-related securities in which the Fund will invest will typically pay variable rates of interest, although the Fund may invest in fixed rate obligations as well.

*Commercial Mortgage-Backed Securities.* Commercial mortgage-backed securities include securities that reflect an interest in, and are secured by, mortgage loans on commercial real property. The market for commercial mortgage-backed securities developed more recently and in terms of total outstanding principal amount of issues is relatively small compared to the market for residential single-family mortgage-backed securities. Many of the risks of investing in commercial mortgage-backed securities reflect the risks of investing in the real estate securing the underlying mortgage loans. These risks reflect the effects of local and other economic conditions on real estate markets, the ability of tenants to make loan payments, and the ability of a property to attract and retain tenants. Commercial mortgage-backed securities may be less liquid and exhibit greater price volatility than other types of mortgage- or asset-backed securities.

*Mortgage Pass-Through Securities.* Mortgage pass-through securities are securities representing interests in pools of mortgage loans secured by residential or commercial real property. Interests in pools of mortgage-related securities differ from other forms of debt obligations, which normally provide for periodic payment of interest in fixed or variable amounts with principal payments at maturity or specified call dates. Instead, these securities provide a monthly payment which consists of both interest and principal payments. In effect, these payments are a pass-through of the monthly payments made by the individual borrowers on their residential or commercial mortgage loans, net of any fees paid to the issuer or guarantor of such securities. Additional payments are caused by repayments of principal resulting from the sale of the underlying property, refinancing or foreclosure, net of fees or costs which may be incurred. Some mortgage-related securities (such as securities issued by the Government National Mortgage Association (the GNMA )) are described as modified pass-through. These securities entitle the holder to receive all interest and principal payments owed on the mortgage pool, net of certain fees, at the scheduled payment dates regardless of whether or not the mortgagor actually makes the payment.



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The rate of prepayments on underlying mortgages will affect the price and volatility of a mortgage-related security, and may have the effect of shortening or extending the effective maturity of the security beyond what was anticipated at the time of purchase. Early repayment of principal on some mortgage-related securities (arising from prepayments of principal due to the sale of the underlying property, refinancing, or foreclosure, net of fees and costs which may be incurred) may expose the Fund to a lower rate of return upon reinvestment of principal. Also, if a security subject to prepayment has been purchased at a premium, the value of the premium would be lost in the event of prepayment. Like other fixed rate debt obligations, when interest rates rise, the value of a fixed rate mortgage-related security generally will decline; however, when interest rates are declining, the value of fixed rate mortgage-related securities with prepayment features may not increase as much as other debt obligations. Investments in mortgage-backed and other asset-backed securities with variable rates of interest would minimize the Fund's sensitivity to such interest rate volatility. However, adjustable rate mortgage-related and other asset-backed securities are also subject to some interest rate risk. For example, because interest rates on most adjustable rate mortgage- and other asset-backed securities only reset periodically (e.g., monthly or quarterly), changes in prevailing interest rates (and particularly sudden and significant changes) can be expected to cause some fluctuations in the market value of these securities, including declines in value as interest rates rise. In addition, to the extent that unanticipated rates of prepayment on underlying mortgages increase the effective maturity of a mortgage-related security, the volatility of such security can be expected to increase.

Payment of principal and interest on some mortgage pass-through securities (but not the market value of the securities themselves) may be guaranteed by the full faith and credit of the U.S. Government (in the case of securities guaranteed by the GNMA) or guaranteed by agencies or instrumentalities of the U.S. Government (in the case of securities guaranteed by the Federal National Mortgage Association (the FNMA) or the Federal Home Loan Mortgage Corporation (the FHLMC)). The principal governmental guarantor of mortgage-related securities is the GNMA. GNMA is a wholly-owned U.S. Government corporation within the Department of Housing and Urban Development. GNMA is authorized to guarantee, with the full faith and credit of the U.S. Government, the timely payment of principal and interest on securities issued by institutions approved by GNMA (such as savings and loan institutions, commercial banks and mortgage bankers) and backed by pools of mortgages insured by the Federal Housing Administration (the FHA), or guaranteed by the Department of Veterans Affairs (the VA).

Government-related guarantors (i.e., not backed by the full faith and credit of the U.S. Government) include the FNMA and the FHLMC. FNMA is a government-sponsored corporation owned entirely by private stockholders. It is subject to general regulation by the Secretary of Housing and Urban Development. FNMA purchases conventional (i.e., not insured or guaranteed by any government agency) residential mortgages from a list of approved sellers/servicers which include state and federally chartered savings and loan associations, mutual savings banks, commercial banks, and credit unions and mortgage bankers. Pass-through securities issued by FNMA are guaranteed as to timely payment of principal and interest by FNMA but are not backed by the full faith and credit of the U.S. Government. Instead, they are supported only by the discretionary authority of the U.S. Government to purchase the agency's obligations, and therefore involve increased credit risk.

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FHLMC was created by Congress in 1970 for the purpose of increasing the availability of mortgage credit for residential housing. It is a government-sponsored corporation formerly owned by the twelve Federal Home Loan Banks and now owned entirely by private stockholders. FHLMC issues Participation Certificates ( PCs ) which represent interests in conventional mortgages from FHLMC's national portfolio. FHLMC guarantees the timely payment of interest and ultimate collection of principal, but PCs are not backed by the full faith and credit of the U.S. Government. Instead, they are supported only by the discretionary authority of the U.S. Government to purchase the agency's obligations, and therefore involve increased credit risk.

Commercial banks, savings and loan institutions, private mortgage insurance companies, mortgage bankers and other secondary market issuers also create pass-through pools of conventional residential mortgage loans. Such issuers may, in addition, be the originators and/or servicers of the underlying mortgage loans as well as the guarantors of the mortgage-related securities. Pools created by such non-governmental issuers generally offer a higher rate of interest than government and government-related pools because there are no direct or indirect government or agency guarantees of payments in such pools. However, timely payment of interest and principal of these pools may be supported by various forms of insurance or guarantees, including individual loan, title, pool and hazard insurance and letters of credit. The insurance and guarantees are issued by governmental entities, private insurers and the mortgage poolers. There can be no assurance that the private insurers or guarantors can meet their obligations under the insurance policies or guarantee arrangements. Although the market for such securities is becoming increasingly liquid, securities issued by certain private organizations may not be readily marketable.

Mortgage-related securities that are issued or guaranteed by the U.S. Government, its agencies or instrumentalities, are not subject to the Fund's industry concentration restriction (see Investment Restrictions ) by virtue of the exclusion from that restriction available to all U.S. Government securities. In the case of privately issued mortgage-related securities, the Fund takes the position that mortgage-related securities do not represent interests in any particular industry or group of industries. The assets underlying such securities may be represented by a portfolio of first lien residential mortgages (including both whole mortgage loans and mortgage participation interests) or portfolios of mortgage pass-through securities issued or guaranteed by GNMA, FNMA or FHLMC. Mortgage loans underlying a mortgage-related security may in turn be insured or guaranteed by the FHA or the VA. In the case of private issue mortgage-related securities whose underlying assets are neither U.S. Government securities nor U.S. Government insured mortgages, to the extent that real properties securing such assets may be located in the same geographical region, the security may be subject to a greater risk of default than other comparable securities in the event of adverse economic, political or business developments that may affect such region and, ultimately, the ability of residential homeowners to make payments of principal and interest on the underlying mortgages.

*Collateralized Mortgage Obligations ( CMOs ).* A CMO is a hybrid between a mortgage-backed bond and a mortgage pass-through security. Similar to a bond, interest and prepaid principal is paid, in most cases, semi-annually. CMOs may be collateralized by whole mortgage loans, but are more typically collateralized by portfolios of mortgage pass-through securities guaranteed by GNMA, FHLMC, or FNMA, and their income streams.

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CMOs are structured into multiple classes, each bearing a different stated maturity. Actual maturity and average life will depend upon the prepayment experience of the collateral. CMOs provide for a modified form of call protection through a de facto breakdown of the underlying pool of mortgages according to how quickly the loans are repaid. Monthly payment of principal received from the pool of underlying mortgages, including prepayments, is first returned to investors holding the shortest maturity class. Investors holding the longer maturity classes receive principal only after the first class has been retired. An investor is partially guarded against a sooner than desired return of principal because of the sequential payments.

In a typical CMO transaction, a corporation ( issuer ) issues multiple series (e.g., A, B, C, Z) of CMO bonds (the Bonds ). Proceeds of the Bond offering are used to purchase mortgages or mortgage pass-through certificates (the Collateral ). The Collateral is pledged to a third party trustee as security for the Bonds. Principal and interest payments from the Collateral are used to pay principal on the Bonds in the order A, B, C, Z. The Series A, B and C Bonds all bear current interest. Interest on the Series Z Bond is accrued and added to principal and a like amount is paid as principal on the Series A, B or C Bond currently being paid off. When the Series A, B and C Bonds are paid in full, interest and principal on the Series Z Bond begin to be paid currently. With some CMOs, the issuer serves as a conduit to allow loan originators (primarily builders or savings and loan associations) to borrow against their loan portfolios.

CMOs that are issued or guaranteed by the U.S. Government or by any of its agencies or instrumentalities will be considered U.S. Government securities by the Fund, while other CMOs, even if collateralized by U.S. Government securities, will have the same status as other privately issued securities for purposes of applying the Fund's diversification tests.

*FHLMC Collateralized Mortgage Obligations.* FHLMC CMOs are debt obligations of FHLMC issued in multiple classes having different maturity dates which are secured by the pledge of a pool of conventional mortgage loans purchased by FHLMC. Unlike FHLMC PCs, payments of principal and interest on the CMOs are made semi-annually, as opposed to monthly. The amount of principal payable on each semi-annual payment date is determined in accordance with FHLMC's mandatory sinking fund schedule, which in turn, is equal to approximately 100% of FHA prepayment experience applied to the mortgage collateral pool. All sinking fund payments in the CMOs are allocated to the retirement of the individual classes of bonds in the order of their stated maturities. Payments of principal on the mortgage loans in the collateral pool in excess of the amount of FHLMC's minimum sinking fund obligation for any payment date are paid to the holders of the CMOs as additional sinking fund payments. Because of the pass-through nature of all principal payments received on the collateral pool in excess of FHLMC's minimum sinking fund requirement, the rate at which principal of the CMOs is actually repaid is likely to be such that each class of bonds will be retired in advance of its scheduled maturity date.

If collection of principal (including prepayments) on the mortgage loans during any semi-annual payment period is not sufficient to meet FHLMC's minimum sinking fund obligation on the next sinking fund payment date, FHLMC agrees to make up the deficiency from its general funds.

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Criteria for the mortgage loans in the pool backing the FHLMC CMOs are identical to those of FHLMC PCs. FHLMC has the right to substitute collateral in the event of delinquencies and/or defaults.

*Other Mortgage-Related Securities.* Other mortgage-related securities include securities other than those described above that directly or indirectly represent a participation in, or are secured by and payable from, mortgage loans on real property, including CMO residuals and stripped mortgage-backed securities. Other mortgage-related securities may be equity or debt securities issued by agencies or instrumentalities of the U.S. Government or by private originators of, or investors in, mortgage loans, including savings and loan associations, homebuilders, mortgage banks, commercial banks, investment banks, partnerships, trusts and special purpose entities of the foregoing.

*CMO Residuals.* CMO residuals are mortgage securities issued by agencies or instrumentalities of the U.S. Government or by private originators of, or investors in, mortgage loans, including savings and loan associations, homebuilders, mortgage banks, commercial banks, investment banks and special purpose entities of the foregoing.

The cash flow generated by the mortgage assets underlying a series of CMOs is applied first to make required payments of principal and interest on the CMOs and second to pay the related administrative expenses of the issuer. The residual in a CMO structure generally represents the interest in any excess cash flow remaining after making the foregoing payments. Each payment of such excess cash flow to a holder of the related CMO residual represents income and/or a return of capital. The amount of residual cash flow resulting from a CMO will depend on, among other things, the characteristics of the mortgage assets, the coupon rate of each class of CMO, prevailing interest rates, the amount of administrative expenses and the prepayment experience on the mortgage assets. In particular, the yield to maturity on CMO residuals is extremely sensitive to prepayments on the related underlying mortgage assets. In addition, if a series of a CMO includes a class that bears interest at an adjustable rate, the yield to maturity on the related CMO residual will also be extremely sensitive to changes in the level of the index upon which interest rate adjustments are based. The Fund may fail to recoup some or all of its initial investment in a CMO residual.

CMO residuals are generally purchased and sold by institutional investors through several investment banking firms acting as brokers or dealers. The CMO residual market has developed fairly recently and CMO residuals currently may not have the liquidity of other more established securities trading in other markets. Transactions in CMO residuals are generally completed only after careful review of the characteristics of the securities in question. In addition, CMO residuals may, or pursuant to an exemption therefrom, may not, have been registered under the Securities Act of 1933, as amended (the 1933 Act). CMO residuals, whether or not registered under the 1933 Act, may be subject to certain restrictions on transferability, and may be deemed illiquid. As used in this Statement of Additional Information, the term CMO residual does not include residual interests in real estate mortgage investment conduits.

*Other Asset-Backed Securities.* Similarly, PIMCO expects that other asset-backed securities (unrelated to mortgage loans) will be offered to investors in the future and may be purchased by the Fund. Several types of asset-backed securities have already been offered to

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investors, including Enhanced Equipment Trust Certificates ( EETCs ), Certificates for Automobile Receivables ( CARSM ) and Collateralized Debt Obligations ( CDOs ).

Although any entity may issue EETCs, to date, U.S. airlines are the primary issuers. An airline EETC is an obligation secured directly by aircraft or aircraft engines as collateral. Airline EETCs generally have credit enhancement in the form of over-collateralization and cross-subordination (i.e., multiple tranches and multiple aircraft as collateral). They also generally have a dedicated liquidity facility provided by a third-party insurer to insure that coupon payments are made on a timely basis until collateral is liquidated in the event of a default by the lessor of the collateral. Aircraft EETCs issued by registered U.S. carriers also benefit from a special section of the U.S. Bankruptcy Code, which allows the aircraft to be sold by the trust holding the collateral to repay note holders without participating in bankruptcy proceedings. EETCs tend to be less liquid than bonds.

CARS<sup>SM</sup> represent undivided fractional interests in a trust whose assets consist of a pool of motor vehicle retail installment sales contracts and security interests in the vehicles securing the contracts. Payments of principal and interest on CARS<sup>SM</sup> are passed through monthly to certificate holders, and are guaranteed up to certain amounts and for a certain time period by a letter of credit issued by a financial institution unaffiliated with the trustee or originator of the trust. An investor's return on CARS<sup>SM</sup> may be affected by early prepayment of principal on the underlying vehicle sales contracts. If the letter of credit is exhausted, the trust may be prevented from realizing the full amount due on a sales contract because of state law requirements and restrictions relating to foreclosure sales of vehicles and the obtaining of deficiency judgments following such sales or because of depreciation, damage or loss of a vehicle, the application of federal and state bankruptcy and insolvency laws, or other factors. As a result, certificate holders may experience delays in payments or losses if the letter of credit is exhausted.

The Fund may invest in CDOs, which includes collateralized bond obligations ( CBOs ), collateralized loan obligations ( CLOs ) and other similarly structured securities. CBOs and CLOs are types of asset-backed securities. A CBO is a trust which is backed by a diversified pool of high risk, below investment grade fixed income securities. A CLO is a trust typically collateralized by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans.

For both CBOs and CLOs, the cash flows from the trust are split into two or more portions, called tranches, varying in risk and yield. The riskiest portion is the residual or equity tranche which bears the bulk of defaults from the bonds or loans in the trust and serves to protect the other, more senior tranches from default in all but the most severe circumstances. Since it is partially protected from defaults, a senior tranche from a CBO trust or CLO trust typically have higher ratings and lower yields than their underlying securities, and can be rated investment grade. Despite the protection from the equity tranche, CBO or CLO tranches can experience substantial losses due to actual defaults, increased sensitivity to defaults due to collateral default and disappearance of protecting tranches, market anticipation of defaults, as well as aversion to CBO or CLO securities as a class.

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The risks of an investment in a CDO depend largely on the type of the collateral securities and the class of the CDO in which the Fund invests. Normally, CBOs, CLOs and other CDOs are privately offered and sold, and thus, are not registered under the securities laws. As a result, investments in CDOs may be characterized by the Fund as illiquid securities; however, an active dealer market may exist for CDOs allowing a CDO to qualify for Rule 144A transactions. In addition to the normal risks associated with debt instruments discussed elsewhere in this Statement of Additional Information and the Prospectus (e.g., interest rate risk and default risk), CDOs carry additional risks including, but not limited to, (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments, (ii) the quality of the collateral may decline in value or default, (iii) the Fund may invest in CDOs that are subordinate to other classes, and (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer or unexpected investment results.

Consistent with the Fund's investment objective and policies, PIMCO also may invest in other types of asset-backed securities. Other asset-backed securities may be collateralized by the fees earned by service providers. The value of asset-backed securities may be substantially dependent on the servicing of the underlying asset pools and are therefore subject to risks associated with the negligence by, or defalcation of, their servicers. In certain circumstances, the mishandling of related documentation may also affect the rights of the security holders in and to the underlying collateral. The insolvency of entities that generate receivables or that utilize the assets may result in added costs and delays in addition to losses associated with a decline in the value of the underlying assets.

## **Real Estate Investment Trusts ( REITs )**

REITs are pooled investment vehicles which invest primarily in income-producing real estate or real estate related loans or interests. REITs are generally classified as equity REITs, mortgage REITs or a combination of equity and mortgage REITs. Equity REITs invest the majority of their assets directly in real property and derive income primarily from the collection of rents. Equity REITs can also realize capital gains by selling properties that have appreciated in value. Mortgage REITs invest the majority of their assets in real estate mortgages and derive income from the collection of interest payments. REITs are not taxed on income distributed to shareholders provided they comply with the applicable requirements of the Code. The Fund will indirectly bear its proportionate share of any management and other expenses paid by REITs in which it invests in addition to the expenses paid by the Fund. Debt securities issued by REITs are, for the most part, general and unsecured obligations and are subject to risks associated with REITs.

Investing in REITs involves certain unique risks in addition to those risks associated with investing in the real estate industry in general. An equity REIT may be affected by changes in the value of the underlying properties owned by the REIT. A mortgage REIT may be affected by changes in interest rates and the ability of the issuers of its portfolio mortgages to repay their obligations. REITs are dependent upon the skills of their managers and are not diversified. REITs are generally dependent upon maintaining cash flows to repay borrowings and to make distributions to shareholders and are subject to the risk of default by lessees or borrowers. REITs whose underlying assets are concentrated in properties used by a particular industry, such as health care, are also subject to risks associated with such industry.

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REITs (especially fixed rate mortgage REITs) are also subject to interest rate risks that apply generally to mortgage-related securities and other debt instruments, as described above.

REITs may have limited financial resources, may trade less frequently and in a limited volume and may be subject to more abrupt or erratic price movements than larger company securities. Historically REITs have been more volatile in price than the larger capitalization stocks included in Standard & Poor's 500 Stock Index.

## **Bank Capital Securities and Obligations**

The Fund may invest in bank capital securities. Bank capital securities are issued by banks to help fulfill their regulatory capital requirements. There are three common types of bank capital: Lower Tier II, Upper Tier II and Tier I. To the extent that the Fund invests in bank capital, it expects to primarily invest in floating rate Upper Tier II and Tier I bank capital. Bank capital is generally, but not always, of investment grade quality. Upper Tier II securities are commonly thought of as hybrids of debt and preferred stock. Upper Tier II securities are often perpetual (with no maturity date), callable and have a cumulative interest deferral feature. This means that under certain conditions, the issuer bank can withhold payment of interest until a later date. However, such deferred interest payments generally earn interest. Tier I securities often take the form of trust preferred securities.

The Fund may also invest in other bank obligations including certificates of deposit, bankers' acceptances, and fixed time deposits. Certificates of deposit are negotiable certificates that are issued against funds deposited in a commercial bank for a definite period of time and earning a specified return. Bankers' acceptances are negotiable drafts or bills of exchange, normally drawn by an importer or exporter to pay for specific merchandise, which are accepted by a bank, meaning, in effect, that the bank unconditionally agrees to pay the face value of the instrument on maturity. Fixed time deposits are bank obligations payable at a stated maturity date and bearing interest at a fixed rate. Fixed time deposits may be withdrawn on demand by the investor, but may be subject to early withdrawal penalties which vary depending upon market conditions and the remaining maturity of the obligation. There are generally no contractual restrictions on the right to transfer a beneficial interest in a fixed time deposit to a third party, although there is no market for such deposits. The Fund may also hold funds on deposit with its custodian bank in an interest-bearing account for temporary purposes.

Subject to the Fund's limitation on concentration of no more than 25% of its total assets in the securities of issuers in a particular industry, the Fund may invest without limit in U.S. dollar-denominated obligations of foreign banks and may invest up to 25% of its total assets in foreign bank obligations denominated in foreign currencies, subject to the restriction that a maximum of 10% of the Fund's total assets may be invested in securities located in emerging markets. Obligations of foreign banks involve certain risks associated with investing in foreign securities described under Foreign (Non-U.S.) Securities below. Foreign banks are not generally subject to examination by any U.S. Government agency or instrumentality.

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### **Delayed Funding Loans and Revolving Credit Facilities**

The Fund may also enter into, or acquire participations in, delayed funding loans and revolving credit facilities. Delayed funding loans and revolving credit facilities are borrowing arrangements in which the lender agrees to make loans up to a maximum amount upon demand by the borrower during a specified term. A revolving credit facility differs from a delayed funding loan in that as the borrower repays the loan, an amount equal to the repayment may be borrowed again during the term of the revolving credit facility. Delayed funding loans and revolving credit facilities usually provide for floating or variable rates of interest. These commitments may have the effect of requiring the Fund to increase its investment in a company at a time when it might not otherwise be desirable to do so (including a time when the company's financial condition makes it unlikely that such amounts will be repaid).

The Fund may invest in delayed funding loans and revolving credit facilities with credit quality comparable to that of issuers of its securities investments. Delayed funding loans and revolving credit facilities may be subject to restrictions on transfer, and only limited opportunities may exist to resell such instruments. As a result, the Fund may be unable to sell such investments at an opportune time or may have to resell them at less than fair market value. Delayed funding loans and revolving credit facilities are considered to be debt obligations for the purposes of the Fund's investment restriction relating to the lending of funds or assets by the Fund.

### **Commercial Paper**

Commercial paper represents short-term unsecured promissory notes issued in bearer form by corporations such as banks or bank holding companies and finance companies. The Fund may invest in commercial paper of any credit quality consistent with the Fund's investment objective and policies, including unrated commercial paper for which PIMCO has made a credit quality assessment. See Appendix A to the Prospectus for a description of the ratings assigned by Moody's, S&P, Fitch and Dominion to commercial paper. The rate of return on commercial paper may be linked or indexed to the level of exchange rates between the U.S. dollar and a foreign currency or currencies.

### **U.S. Government Securities**

U.S. Government securities are obligations of, or guaranteed by, the U.S. Government, its agencies or instrumentalities. The U.S. Government does not guarantee the net asset value of the Fund's shares. Some U.S. Government securities, such as Treasury bills, notes and bonds, and securities guaranteed by the GNMA, are supported by the full faith and credit of the United States; others, such as those of the Federal Home Loan Banks, are supported by the right of the issuer to borrow from the U.S. Treasury; others, such as those of the FNMA and the FHLMC, are supported by the discretionary authority of the U.S. Government to purchase the agency's obligations; and still others, such as those of the Student Loan Marketing Association, are supported only by the credit of the instrumentality. Although U.S. Government sponsored enterprises such as Federal Home Loan Banks, FNMA, FHLMC, and the Student Loan Marketing Association may be chartered or sponsored by Congress, they are not funded by Congressional appropriations and their securities are not issued by the U.S. Treasury or supported by the full faith and credit of the U.S. Government, and include increased credit risks. U.S. Government



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securities include securities that have no coupons, or have been stripped of their unmatured interest coupons, individual interest coupons from such securities that trade separately, and evidences of receipt of such securities. Such securities may pay no cash income, and are purchased at a deep discount from their value at maturity. See Zero-Coupon Bonds, Step-Ups and Payment-In-Kind Securities. Custodial receipts issued in connection with so-called trademark zero-coupon securities, such as CATs and TIGRs, are not issued by the U.S. Treasury, and are therefore not U.S. Government securities, although the underlying bond represented by such receipt is a debt obligation of the U.S. Treasury. Other zero-coupon Treasury securities (e.g., STRIPs and CUBEs) are direct obligations of the U.S. Government.

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Preferred stock represents an equity interest in a company that generally entitles the holder to receive, in preference to the holders of other stocks such as common stocks, dividends and a fixed share of the proceeds resulting from a liquidation of the company. Some preferred stocks also entitle their holders to receive additional liquidation proceeds on the same basis as holders of a company's common stock, and thus also represent an ownership interest in that company. The Fund will ordinarily invest in preferred stocks that pay variable rates of return, but may also invest in fixed rate preferred stocks. See below. The value of a company's preferred stock may fall as a result of factors relating directly to that company's products or services. A preferred stock's value may also fall because of factors affecting not just the company, but companies in the same industry or in a number of different industries, such as increases in production costs. The value of preferred stock may also be affected by changes in financial markets that are relatively unrelated to the company or its industry, such as changes in interest rates or currency exchange rates. In addition, a company's preferred stock generally pays dividends only after the company makes required payments to holders of its bonds and other debt. For this reason, the value of the preferred stock will usually react more strongly than bonds and other debt to actual or perceived changes in the company's financial condition or prospects. Preferred stocks of smaller companies may be more vulnerable to adverse developments than those of larger companies.

*Adjustable Rate and Auction Preferred Stocks.* Typically, the dividend rate on an adjustable rate preferred stock is determined prospectively each quarter by applying an adjustment formula established at the time of issuance of the stock. Although adjustment formulas vary among issues, they typically involve a fixed premium or discount relative to rates on specified debt securities issued by the U.S. Treasury. Typically, an adjustment formula will provide for a fixed premium or discount adjustment relative to the highest base yield of three specified U.S. Treasury securities: the 90-day Treasury bill, the 10-year Treasury note and the 20-year Treasury bond. The premium or discount adjustment to be added to or subtracted from this highest U.S. Treasury base rate yield is fixed at the time of issue and cannot be changed without the approval of the holders of the stock. The dividend rate on other preferred stocks in which the Fund may invest, commonly known as auction preferred stocks, is adjusted at intervals that may be more frequent than quarterly, such as every 49 days, based on bids submitted by holders and prospective purchasers of such stocks and may be subject to stated maximum and minimum dividend rates. The issues of most adjustable rate and auction preferred stocks currently outstanding are perpetual, but are redeemable after a specified date at the option of the issuer. Certain issues supported by the credit of a high-rated financial institution provide for mandatory redemption prior to expiration of the credit arrangement. No redemption can occur if full cumulative dividends are not paid. Although the dividend rates on adjustable and auction preferred stocks are generally adjusted or reset frequently, the market values of these preferred stocks may still fluctuate in response to changes in interest rates. Market values of adjustable preferred stocks also may substantially fluctuate if interest rates increase or decrease once the maximum or minimum dividend rate for a particular stock is approached.

*Fixed Rate Preferred Stocks.* Some fixed rate preferred stocks in which the Fund may invest, known as perpetual preferred stocks, offer a fixed return with no maturity date. Because

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they never mature, perpetual preferred stocks act like long-term bonds, can be more volatile than other types of preferred stocks that have a maturity date and may have heightened sensitivity to changes in interest rates. The Fund may also invest in sinking fund preferred stocks. These preferred stocks also offer a fixed return, but have a maturity date and are retired or redeemed on a predetermined schedule. The shorter duration of sinking fund preferred stocks makes them perform somewhat like intermediate-term bonds and they typically have lower yields than perpetual preferred stocks.

### **Zero-Coupon Bonds, Step-Ups and Payment-In-Kind Securities**

Zero-coupon securities are debt obligations that do not entitle the holder to any periodic payments of interest either for the entire life of the obligation or for an initial period after the issuance of the obligations. Like zero-coupon bonds, step-up bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security.

Payment-in-kind securities (PIKs) pay dividends or interest in the form of additional securities of the issuer, rather than in cash. Each of these instruments is typically issued and traded at a deep discount from its face amount. The amount of the discount varies depending on such factors as the time remaining until maturity of the securities, prevailing interest rates, the liquidity of the security and the perceived credit quality of the issuer. The market prices of zero-coupon bonds, step-ups and PIKs generally are more volatile than the market prices of debt instruments that pay interest currently and in cash and are likely to respond to changes in interest rates to a greater degree than do other types of securities having similar maturities and credit quality. In order to satisfy a requirement for qualification as a regulated investment company under the Internal Revenue Code of 1986, as amended (the Code), an investment company, such as the Fund, must distribute each year at least 90% of its net investment income, including the original issue discount accrued on zero-coupon bonds, step-ups and PIKs. Because the Fund will not, on a current basis, receive cash payments from the issuer of these securities in respect of any accrued original issue discount, in some years the Fund may have to distribute cash obtained from selling other portfolio holdings of the Fund. In some circumstances, such sales might be necessary in order to satisfy cash distribution requirements even though investment considerations might otherwise make it undesirable for the Fund to sell securities at such time. Under many market conditions, investments in zero-coupon bonds, step-ups and PIKs may be illiquid, making it difficult for the Fund to dispose of them or determine their current value.

### **Convertible Securities and Synthetic Convertible Securities**

The Fund may invest in convertible securities, which are debt securities that may be converted at either a stated price or stated rate into underlying shares of common stock. Convertible securities have general characteristics similar to both debt securities and equity securities. PIMCO will generally evaluate these instruments based primarily on their debt characteristics. Because most convertible securities are fixed rate instruments, the market value of convertible securities tends to decline as interest rates increase and, conversely, tends to increase as interest rates decline. In addition, because of the conversion feature, the market value of convertible securities tends to vary with fluctuations in the market value of the underlying common stocks and, therefore, also will react to variations in the general market for equity securities.

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The Fund may also invest in synthetic convertible securities, which differ from convertible securities in certain respects. Unlike a true convertible security, which is a single security having a unitary market value, a synthetic convertible comprises two or more separate securities, each with its own market value. Therefore, the market value of a synthetic convertible security is the sum of the values of its debt component and its convertibility component. Synthetic convertible securities can be variable or fixed rate instruments. For these reasons, the values of a synthetic convertible and a true convertible security may respond differently to market fluctuations.

Convertible securities generally have higher yields than common stocks. There can be no assurance of current income because the issuers of the convertible securities may default on their obligations. A convertible security, in addition to providing current income, offers the potential for capital appreciation through the conversion feature, which enables the holder to benefit from increases in the market price of the underlying common stock.

## **Municipal Bonds**

The Fund may invest in municipal bonds which pay interest that, in the opinion of bond counsel to the issuer (or on the basis of other authority believed by PIMCO to be reliable), is exempt from federal income taxes ( municipal bonds ), although dividends that the Fund pays that are attributable to such interest will not be tax-exempt to shareholders of the Fund.

Municipal bonds share the attributes of debt obligations in general, but are generally issued by states, municipalities and other political subdivisions, agencies, authorities and instrumentalities of states and multi-state agencies or authorities. The municipal bonds that the Fund may purchase include general obligation bonds and limited obligation bonds (or revenue bonds), including industrial development bonds issued pursuant to former federal tax law. General obligation bonds are obligations involving the credit of an issuer possessing taxing power and are payable from such issuer's general revenues and not from any particular source. Limited obligation bonds are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise or other specific revenue source. Tax-exempt private activity bonds and industrial development bonds generally are also revenue bonds and thus are not payable from the issuer's general revenues. The credit and quality of private activity bonds and industrial development bonds are usually related to the credit of the user of the facilities. Payment of interest on and repayment of principal of such bonds is the responsibility of the user (and/or any guarantor).

Municipal bonds are subject to credit and market risk. Generally, prices of higher quality issues tend to fluctuate less with changes in market interest rates than prices of lower quality issues and prices of longer maturity issues tend to fluctuate more than prices of shorter maturity issues. Prices and yields on municipal bonds are dependent on a variety of factors, including general money-market conditions, the financial condition of the issuer, general conditions of the municipal bond market, the size of a particular offering, the maturity of the obligation and the rating of the issue. A number of these factors, including the ratings of particular issues, are subject to change from time to time. Information about the financial condition of an issuer of municipal bonds may not be as extensive as that which is made available by corporations whose securities are publicly traded. Obligations of issuers of municipal bonds are subject to the provisions of bankruptcy, insolvency and other laws, such as the Federal Bankruptcy Reform Act of 1978,

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affecting the rights and remedies of creditors. Congress or state legislatures may seek to extend the time for payment of principal or interest, or both, or to impose other constraints upon enforcement of such obligations. There is also the possibility that as a result of litigation or other conditions, the power or ability of issuers to meet their obligations for the payment of interest and principal on their municipal bonds may be materially affected or their obligations may be found to be invalid or unenforceable.

The Fund may also invest in residual interest municipal bonds ( RIBS ) whose interest rates bear an inverse relationship to the interest rate on another security or the value of an index. RIBS are created by dividing the income stream provided by the underlying bonds to create two securities, one short-term and one long-term. The interest rate on the short-term component is reset by an index or auction process normally every seven to 35 days. After income is paid on the short-term securities at current rates, the residual income from the underlying bond(s) goes to the long-term securities. Therefore, rising short-term interest rates result in lower income for the longer-term portion, and vice versa. The longer-term bonds can be very volatile and may be less liquid than other municipal bonds of comparable maturity. An investment in RIBS typically will involve greater risk than an investment in a fixed rate bond. Because increases in the interest rate on the other security or index reduce the residual interest paid on a RIB, the value of a RIB is generally more volatile than that of a fixed rate bond. RIBS have interest rate adjustment formulas that generally reduce or, in the extreme, eliminate the interest paid to the Fund when short-term interest rates rise, and increase the interest paid to the Fund when short-term interest rates fall. RIBS have varying degrees of liquidity that approximate the liquidity of the underlying bond(s), and the market price for these securities is volatile. These securities generally will underperform the market of fixed rate bonds in a rising interest rate environment, but tend to outperform the market of fixed rate bonds when interest rates decline or remain relatively stable. Although volatile, RIBS typically offer the potential for yields exceeding the yields available on fixed rate bonds with comparable credit quality, coupon, call provisions and maturity. The Fund may also invest in RIBS for the purpose of increasing the Fund's leverage as a more flexible alternative to the issuance of preferred shares. Should short-term and long-term interest rates rise, the combination of the Fund's investment in RIBS and its use of other forms of leverage (including through the issuance of AMPS or the use of other derivative instruments) likely will adversely affect the Fund's net asset value per share and income, distributions and total returns to shareholders. Trusts in which RIBS may be held could be terminated, in which case the residual bond holder would take possession of the underlying bond(s) on an unleveraged basis.

## **Foreign (Non-U.S.) Securities**

The Fund may invest some or all of its assets in U.S. dollar-denominated debt obligations of corporate and other foreign (non-U. S.) issuers, including obligations of foreign banks (see Bank Obligations above), foreign governments or their subdivisions, agencies and instrumentalities, international agencies and supra-national government entities. The Fund may invest up to 25% of its total assets in securities denominated in currencies other than the U.S. dollar.

The foreign securities in which the Fund may invest include Eurodollar obligations and Yankee Dollar obligations. Eurodollar obligations are U.S. dollar-denominated certificates of deposit and time deposits issued outside the U.S. capital markets by foreign branches of U.S.

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banks and by foreign banks. Yankee Dollar obligations are U.S. dollar-denominated obligations issued in the U.S. capital markets by foreign banks. Eurodollar and Yankee Dollar obligations are generally subject to the same risks that apply to domestic debt issues, notably credit risk, market risk and liquidity risk. Additionally, Eurodollar (and to a limited extent, Yankee Dollar) obligations are subject to certain sovereign risks. One such risk is the possibility that a sovereign country might prevent capital, in the form of U.S. dollars, from flowing across its borders. Other risks include adverse political and economic developments; the extent and quality of government regulation of financial markets and institutions; the imposition of foreign withholding taxes; and the expropriation or nationalization of foreign issuers.

The Fund may invest in American Depositary Receipts ( ADRs ), European Depositary Receipts ( EDRs ) or Global Depositary Receipts ( GDRs ). ADRs are U.S. dollar-denominated receipts issued generally by domestic banks and represent the deposit with the bank of a security of a foreign issuer. EDRs are foreign currency-denominated receipts similar to ADRs and are issued and traded in Europe, and are publicly traded on exchanges or over-the-counter in the United States. GDRs may be offered privately in the United States and also trade in public or private markets in other countries. ADRs, EDRs and GDRs may be issued as sponsored or unsponsored programs. In sponsored programs, an issuer has made arrangements to have its securities trade in the form of ADRs, EDRs or GDRs. In unsponsored programs, the issuer may not be directly involved in the creation of the program. Although regulatory requirements with respect to sponsored and unsponsored programs are generally similar, in some cases it may be easier to obtain financial information from an issuer that has participated in the creation of a sponsored program.

The Fund may invest in Brady Bonds. Brady Bonds are securities created through the exchange of existing commercial bank loans to sovereign entities for new obligations in connection with debt restructurings under a debt restructuring plan introduced by former U.S. Secretary of the Treasury, Nicholas F. Brady (the Brady Plan ). Brady Plan debt restructurings have been implemented in a number of countries, including: Argentina, Bolivia, Brazil, Bulgaria, Costa Rica, the Dominican Republic, Ecuador, Jordan, Mexico, Niger, Nigeria, Panama, Peru, the Philippines, Poland, Uruguay and Venezuela.

Brady Bonds may be collateralized or uncollateralized, are issued in various currencies (primarily the U.S. dollar) and are actively traded in the over-the-counter secondary market. Brady Bonds are not considered to be U.S. Government securities. U.S. dollar-denominated, collateralized Brady Bonds, which may be fixed rate par bonds or floating rate discount bonds, are generally collateralized in full as to principal by U.S. Treasury zero-coupon bonds having the same maturity as the Brady Bonds. Interest payments on these Brady Bonds generally are collateralized on a one-year or longer rolling-forward basis by cash or securities in an amount that, in the case of fixed rate bonds, is equal to at least one year of interest payments or, in the case of floating rate bonds, initially is equal to at least one year's interest payments based on the applicable interest rate at that time and is adjusted at regular intervals thereafter. Certain Brady Bonds are entitled to value recovery payments in certain circumstances, which in effect constitute supplemental interest payments but generally are not collateralized. Brady Bonds are often viewed as having three or four valuation components: (i) the collateralized repayment of principal at final maturity; (ii) the collateralized interest payments; (iii) the uncollateralized

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interest payments; and (iv) any uncollateralized repayment of principal at maturity (the uncollateralized amounts constitute the residual risk ).

Most Mexican Brady Bonds issued to date have principal repayments at final maturity fully collateralized by U.S. Treasury zero-coupon bonds (or comparable collateral denominated in other currencies) and interest coupon payments collateralized on an 18-month rolling-forward basis by funds held in escrow by an agent for the bondholders. A significant portion of the Venezuelan Brady Bonds and the Argentine Brady Bonds issued to date have repayments at final maturity collateralized by U.S. Treasury zero-coupon bonds (or comparable collateral denominated in other currencies) and/or interest coupon payments collateralized on a 14-month (for Venezuela) or 12-month (for Argentina) rolling-forward basis by securities held by the Federal Reserve Bank of New York as collateral agent.

Brady Bonds involve various risk factors including residual risk and the history of defaults with respect to commercial bank loans by public and private entities of countries issuing Brady Bonds. There can be no assurance that Brady Bonds in which the Fund may invest will not be subject to restructuring arrangements or to requests for new credit, which may cause the Fund to suffer a loss of interest or principal on any of its holdings.

Investing in the securities of foreign issuers involves special risks and considerations not typically associated with investing in U.S. companies. These include: differences in accounting; auditing and financial reporting standards; generally higher commission rates on foreign portfolio transactions; the possibility of expropriation or confiscatory taxation; adverse changes in investment or exchange control regulations (which may include suspension of the ability to transfer currency from a country); political instability which can affect U.S. investments in foreign countries; and potential restrictions on the flow of international capital. In addition, foreign securities and dividends and interest payable on those securities may be subject to foreign taxes, including taxes withheld from payments on those securities. Foreign securities often trade with less frequency and volume than domestic securities and therefore may exhibit greater price volatility. Changes in foreign exchange rates will affect the value of those securities which are denominated or quoted in currencies other than the U.S. dollar.

*Emerging Market Securities.* The Fund may invest up to 10% of its total assets in issuers located in emerging markets. PIMCO generally considers an emerging market to be one located in any country that is defined as an emerging or developing economy by the World Bank or its related organizations, or the United Nations or its subsidiaries. The risks of investing in foreign securities are particularly high when securities of issuers based in or denominated in currencies of developing or emerging market countries are involved. Investing in emerging market countries involves certain risks not typically associated with investing in U.S. securities, and imposes risks greater than, or in addition to, risks of investing in foreign, developed countries. These risks include: greater risks of nationalization or expropriation of assets or confiscatory taxation; currency devaluations and other currency exchange rate fluctuations; greater social, economic and political uncertainty and instability (including the risk of war); more substantial government involvement in the economy; less government supervision and regulation of the securities markets and participants in those markets; controls on foreign investment and limitations on repatriation of invested capital and on the Fund's ability to exchange local currencies for U.S. dollars; unavailability of currency hedging techniques in certain emerging market countries; the fact that

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companies in emerging market countries may be smaller, less seasoned and newly organized; the difference in, or lack of, auditing and financial reporting standards, which may result in unavailability of material information about issuers; the risk that it may be more difficult to obtain and/or enforce a judgment in a court outside the United States; and greater price volatility, substantially less liquidity and significantly smaller market capitalization of securities markets. In addition, a number of emerging market countries restrict, to various degrees, foreign investment in securities, and high rates of inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries. Also, any change in the leadership or politics of emerging market countries, or the countries that exercise a significant influence over those countries, may halt the expansion of or reverse the liberalization of foreign investment policies now occurring and adversely affect existing investment opportunities.

*Sovereign Debt.* The Fund may invest in sovereign debt issued by foreign developed and emerging market governments and their respective sub-divisions, agencies or instrumentalities, government sponsored enterprises and supra-national government entities. Supra-national entities include international organizations that are organized or supported by one or more government entities to promote economic reconstruction or development and by international banking institutions and related governmental agencies. Investment in sovereign debt can involve a high degree of risk. The governmental entity that controls the repayment of sovereign debt may not be able or willing to repay the principal and/or interest when due in accordance with the terms of the debt. A governmental entity's willingness or ability to repay principal and interest due in a timely manner may be affected by, among other factors, its cash flow situation, the extent of its foreign reserves, the availability of sufficient foreign exchange on the date a payment is due, the relative size of the debt service burden to the economy as a whole, the governmental entity's policy toward the International Monetary Fund, and the political constraints to which a governmental entity may be subject. Governmental entities may also depend on expected disbursements from foreign governments, multilateral agencies and others to reduce principal and interest arrearages on their debt. The commitment on the part of these governments, agencies and others to make such disbursements may be conditioned on a governmental entity's implementation of economic reforms and/or economic performance and the timely service of such debtor's obligations. Failure to implement such reforms, achieve such levels of economic performance or repay principal or interest when due may result in the cancellation of such third parties' commitments to lend funds to the governmental entity, which may further impair such debtor's ability or willingness to service its debts in a timely manner. Consequently, governmental entities may default on their sovereign debt. Holders of sovereign debt (including the Fund) may be requested to participate in the rescheduling of such debt and to extend further loans to governmental entities. There is no bankruptcy proceeding by which sovereign debt on which governmental entities have defaulted may be collected in whole or in part.

The Fund's investments in foreign currency-denominated debt obligations and hedging activities will likely produce a difference between its book income and its taxable income. This difference may cause a portion of the Fund's income distributions to constitute returns of capital for tax purposes or require the Fund to make distributions exceeding book income to qualify as a regulated investment company for federal income tax purposes.



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### **Foreign Currency Transactions**

Subject to the limitations discussed above and in the Prospectus, the Fund also may purchase and sell foreign currency options and foreign currency futures contracts and related options (see Derivative Instruments below), and may engage in foreign currency transactions either on a spot (cash) basis at the rate prevailing in the currency exchange market at the time or through forward foreign currency exchange contracts ( forwards ) with terms generally of less than one year. The Fund may engage in these transactions in order to protect against uncertainty in the level of future foreign exchange rates in the purchase and sale of securities. The Fund may also use foreign currency options and foreign currency forward contracts to increase exposure to a foreign currency or to shift exposure to foreign currency fluctuations from one country to another. Suitable currency hedging transactions may not be available in all circumstances and PIMCO may decide not to use hedging transactions that are available.

A forward involves an obligation to purchase or sell a specific currency at a future date, which may be any fixed number of days from the date of the contract agreed upon by the parties, at a price set at the time of the contract. These contracts may be bought or sold to protect the Fund against a possible loss resulting from an adverse change in the relationship between foreign currencies and the U.S. dollar or to increase exposure to a particular foreign currency. Although forwards are intended to minimize the risk of loss due to a decline in the value of the hedged currencies, at the same time, they tend to limit any potential gain which might result should the value of such currencies increase. Forwards will be used primarily to adjust the foreign exchange exposure of the Fund with a view to protecting the outlook, and the Fund might be expected to enter into such contracts under the following circumstances:

*Lock In.* When PIMCO desires to lock in the U.S. dollar price on the purchase or sale of a security denominated in a foreign currency.

*Cross Hedge.* If a particular currency is expected to decrease against another currency, the Fund may sell the currency expected to decrease and purchase a currency that is expected to increase against the currency sold in an amount approximately equal to some or all of the Fund's portfolio holdings denominated in the currency sold.

*Direct Hedge.* If PIMCO wants to eliminate substantially all of the risk of owning a particular currency, and/or if PIMCO believes that the Fund can benefit from price appreciation in a given country's debt obligations but does not want to hold the currency, it may employ a direct hedge back into the U.S. dollar. In either case, the Fund would enter into a forward contract to sell the currency in which a portfolio security is denominated and purchase U.S. dollars at an exchange rate established at the time it initiated a contract. The cost of the direct hedge transaction may offset most, if not all, of the yield advantage offered by the foreign security, but the Fund would hope to benefit from an increase (if any) in the value of the debt obligation.

*Proxy Hedge.* PIMCO might choose to use a proxy hedge, which may be less costly than a direct hedge. In this case, the Fund, having purchased a security, will sell a currency whose value is believed to be closely linked to the currency in which the security is denominated. Interest rates prevailing in the country whose currency was sold would be expected to be close to those in the United States and lower than those of securities denominated in the currency of the original

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holding. This type of hedging entails greater risk than a direct hedge because it is dependent on a stable relationship between the two currencies paired as proxies and the relationships can be very unstable at times.

*Costs of Hedging.* When the Fund purchases a foreign bond with a higher interest rate than is available on U.S. bonds of a similar maturity, the additional yield on the foreign bond could be substantially reduced or lost if the Fund were to enter into a direct hedge by selling the foreign currency and purchasing the U.S. dollar. This is what is known as the cost of hedging. Proxy hedging attempts to reduce this cost through an indirect hedge back to the U.S. dollar.

It is important to note that hedging costs are treated as capital transactions and are not, therefore, deducted from the Fund's dividend distribution and are not reflected in its yield.

*Tax Consequences of Hedging.* Under applicable tax law, the Fund's hedging activities may result in the application of the mark-to-market and straddle provisions of the Code. Those provisions could result in an increase (or decrease) in the amount of taxable dividends paid by the Fund and could affect whether dividends paid by the Fund are classified as capital gains or ordinary income.

## **Foreign Currency Exchange-Related Securities**

*Foreign Currency Warrants.* Foreign currency warrants, such as Currency Exchange Warrants<sup>SM</sup> (CEW<sup>SM</sup>), are warrants that entitle their holders to receive from their issuer an amount of cash (generally, for warrants issued in the United States, in U.S. dollars) that is calculated pursuant to a predetermined formula and based on the exchange rate between a specified foreign currency and the U.S. dollar as of the exercise date of the warrant. Foreign currency warrants generally are exercisable upon their issuance and expire as of a specific date and time. Foreign currency warrants have been issued in connection with U.S. dollar-denominated debt offerings by major issuers in an attempt to reduce the foreign currency exchange risk that, from the point of view of the prospective purchasers of the securities, is inherent in the international debt obligation marketplace. Foreign currency warrants may attempt to reduce the foreign exchange risk assumed by purchasers of a security by, for example, providing for a supplement payment in the event that the U.S. dollar depreciates against the value of a major foreign currency such as the Japanese yen. The formula used to determine the amount payable upon exercise of a foreign currency warrant may make the warrant worthless unless the applicable foreign currency exchange rate moves in a particular direction (e.g., unless the U.S. dollar appreciates or depreciates against the particular foreign currency to which the warrant is linked or indexed). Foreign currency warrants are severable from the debt obligations with which they may be offered, and may be listed on exchanges. Foreign currency warrants may be exercisable only in certain minimum amounts, and an investor wishing to exercise warrants who possesses less than the minimum number required for exercise may be required either to sell the warrants or to purchase additional warrants, thereby incurring additional transaction costs. In the case of any exercise of warrants, there may be a time delay between the time a holder of warrants gives instructions to exercise and the time the exchange rate relating to exercise is determined, during which time the exchange rate could change significantly, thereby affecting both the market and cash settlement values of the warrants being exercised. The expiration date of the warrants may be accelerated if the warrants should be delisted from an exchange or if their trading should be

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suspended permanently, which would result in the loss of any remaining time values of the warrants (i.e., the difference between the current market value and the exercise value of the warrants), and, if the warrants were out-of-the-money, in a total loss of the purchase price of the warrants. Warrants are generally unsecured obligations of their issuers and are not standardized foreign currency options issued by the Options Clearing Corporation ( OCC ). Unlike foreign currency options issued by the OCC, the terms of foreign exchange warrants generally will not be amended in the event of government or regulatory actions affecting exchange rates or in the event of the imposition of other regulatory controls affecting the international currency markets. The initial public offering price of foreign currency warrants is generally considerably in excess of the price that a commercial user of foreign currencies might pay in the interbank market for a comparable option involving significantly larger amounts of foreign currencies. Foreign currency warrants are subject to significant foreign exchange risk, including risks arising from complex political or economic factors.

*Principal Exchange Rate Linked Securities.* Principal exchange rate linked securities ( PERLS<sup>SM</sup> ) are debt obligations the principal on which is payable at maturity in an amount that may vary based on the exchange rate between the U.S. dollar and a particular foreign currency at or about that time. The return on standard principal exchange rate linked securities is enhanced if the foreign currency to which the security is linked appreciates against the U.S. dollar, and is adversely affected by increases in the foreign exchange value of the U.S. dollar; reverse principal exchange rate linked securities are like standard securities, except that their return is enhanced by increases in the value of the U.S. dollar and adversely impacted by increases in the value of foreign currency. Interest payments on the securities are generally made in U.S. dollars at rates that reflect the degree of foreign currency risk assumed or given up by the purchaser of the notes (i.e., at relatively higher interest rates if the purchaser has assumed some of the foreign exchange risk, or relatively lower interest rates if the issuer has assumed some of the foreign exchange risk, based on the expectations of the current market). Principal exchange rate linked securities may in limited cases be subject to acceleration of maturity (generally, not without the consent of the holders of the securities), which may have an adverse impact on the value of the principal payment to be made at maturity.

*Performance Indexed Paper.* Performance indexed paper ( PIP<sup>SM</sup> ) is U.S. dollar-denominated commercial paper the yield of which is linked to certain foreign exchange rate movements. The yield to the investor on performance indexed paper is established at maturity as a function of spot exchange rates between the U.S. dollar and a designated currency as of or about that time (generally, the index maturity two days prior to maturity). The yield to the investor will be within a range stipulated at the time of purchase of the obligation, generally with a guaranteed minimum rate of return that is below, and a potential maximum rate of return that is above, market yields on U.S. dollar-denominated commercial paper, with both the minimum and maximum rates of return on the investment corresponding to the minimum and maximum values of the spot exchange rate two business days prior to maturity.

**Derivative Instruments**

The Fund may, but is not required to, use a variety of derivative instruments for hedging or risk management purposes or as part of its investment strategies. Also, as part of its strategy to invest in floating rate assets, the Fund may enter into derivatives in connection with investments in

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fixed rate securities to effectively convert the fixed rate interest payments into floating rate payments. Generally, derivatives are financial contracts whose value depends upon, or is derived from, the value of an underlying asset, reference rate or index, and may relate to individual debt instruments, interest rates, currencies or currency exchange rates, commodities or related indexes. The Fund may use derivatives to gain exposure to floating rate or high yield securities and other securities in which the Fund may invest (including pending investment of the proceeds of this offering). Examples of derivative instruments that the Fund may use include, but are not limited to, options contracts, futures contracts, options on futures contracts, swap agreements (including total return and credit default swaps) and short sales. The Fund may also engage in credit spread trades. A credit spread trade is an investment position relating to a difference in the prices or interest rates of two bonds or other securities, where the value of the investment position is determined by changes in the difference between such prices or interest rates, as the case may be, of the respective securities. The Fund may also have exposure to derivatives, such as interest rate or credit-default swaps, through investment in credit-linked trust certificates and other securities issued by special purpose or structured vehicles. The Fund may also use derivatives to add leverage to the portfolio, but only as a substitute for leverage obtained through AMPS. If other types of financial instruments, including other types of options, futures contracts or futures options are traded in the future, the Fund may also use those instruments, provided that their use is consistent with the Fund's investment objective and policies.

Like the other investments of the Fund, the ability of the Fund to successfully utilize derivative instruments may depend in part upon the ability of PIMCO to assess the issuer's credit characteristics and other macro-economic factors correctly. If PIMCO incorrectly forecasts such factors and has taken positions in derivative instruments contrary to prevailing market trends, the Fund could be exposed to the risk of loss.

The Fund might not employ any of the strategies described below, and no assurance can be given that any strategy used will succeed. If PIMCO incorrectly forecasts market values or other economic factors in utilizing a derivatives strategy for the Fund, the Fund might have been in a better position if it had not entered into the transaction at all. Also, suitable derivative transactions may not be available in all circumstances. The use of these strategies involves certain special risks, including a possible imperfect correlation, or even no correlation, between price movements of derivative instruments and price movements of related investments. While some strategies involving derivative instruments can reduce the risk of loss, they can also reduce the opportunity for gain or even result in losses by offsetting favorable price movements in related investments or otherwise, due to the possible inability of the Fund to purchase or sell a portfolio security at a time that otherwise would be favorable or the possible need to sell a portfolio security at a disadvantageous time because the Fund is required to maintain asset coverage or offsetting positions in connection with transactions in derivative instruments, and the possible inability of the Fund to close out or to liquidate its derivatives positions. Income earned by the Fund from many derivative strategies will be treated as capital gain and, if not offset by net realized capital loss, will be distributed to shareholders in taxable distributions.

*Options on Securities, Swap Agreements and Indexes.* The Fund may purchase and sell both put and call options on securities, swap agreements or indexes in standardized contracts traded on domestic or other securities exchanges, boards of trade, or similar entities, or quoted on

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NASDAQ or on an over-the-counter market, and agreements, sometimes called cash puts, which may accompany the purchase of a new issue of debt obligations from a dealer.

An option on a security (or an index) is a contract that gives the holder of the option, in return for a premium, the right to buy from (in the case of a call) or sell to (in the case of a put) the writer of the option the security underlying the option (or the cash value of the index) at a specified exercise price at any time during the term of the option. The writer of an option on a security has the obligation upon exercise of the option to deliver the underlying security upon payment of the exercise price or to pay the exercise price upon delivery of the underlying security. Upon exercise, the writer of an option on an index is obligated to pay the difference between the cash value of the index and the exercise price multiplied by the specified multiplier for the index option. (An index is designed to reflect features of a particular securities market, a specific group of financial instruments or securities, or certain economic indicators.)

The Fund may (but is not required to) cover its obligations when it writes call options or put options. In the case of a call option on a debt obligation or other security, the option is covered if the Fund owns the security underlying the call or has an absolute and immediate right to acquire that security without additional cash consideration (or, if additional cash consideration is required, cash or other assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, in such amount are segregated by its custodian) upon conversion or exchange of other securities held by the Fund. For a call option on an index, the option is covered if the Fund maintains with its custodian assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, in an amount equal to the contract value of the index. A call option is also covered if the Fund holds a call on the same security or index as the call written where the exercise price of the call held is (i) equal to or less than the exercise price of the call written, or (ii) greater than the exercise price of the call written, provided the difference is maintained by the Fund in segregated assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees. A put option on a security or an index is covered if the Fund segregates assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees equal to the exercise price. A put option is also covered if the Fund holds a put on the same security or index as the put written where the exercise price of the put held is (i) equal to or greater than the exercise price of the put written, or (ii) less than the exercise price of the put written, provided the difference is maintained by the Fund in segregated assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees. Obligations under written call and put options so covered will not be construed to be senior securities for purposes of the Fund's investment restrictions concerning senior securities and borrowings.

If an option written by the Fund expires unexercised, the Fund realizes on the expiration date a capital gain equal to the premium the Fund received at the time the option was written. If an option purchased by the Fund expires unexercised, the Fund realizes a capital loss equal to the premium paid. Prior to the earlier of exercise or expiration, an exchange-traded option may be closed out by an offsetting purchase or sale of an option of the same series (type, exchange, underlying security or index, exercise price, and expiration). There can be no assurance, however, that a closing purchase or sale transaction can be effected when the Fund desires.

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The Fund may sell put or call options it has previously purchased, which could result in a net gain or loss depending on whether the amount realized on the sale is more or less than the premium and other transaction costs paid on the put or call option which is sold. Prior to exercise or expiration, an option may be closed out by an offsetting purchase or sale of an option of the same series. The Fund will realize a capital gain from a closing purchase transaction if the cost of the closing option is less than the premium received from writing the option, or, if it is more, the Fund will realize a capital loss. If the premium received from a closing sale transaction is more than the premium paid to purchase the option, the Fund will realize a capital gain or, if it is less, the Fund will realize a capital loss. The principal factors affecting the market value of a put or a call option include supply and demand, interest rates, the current market price of the underlying security or index in relation to the exercise price of the option, the volatility of the underlying security or index and the time remaining until the expiration date.

The premium paid for a put or call option purchased by the Fund is an asset of the Fund. The premium received for an option written by the Fund is recorded as a deferred credit. The value of an option purchased or written is marked to market daily and is valued at the closing price on the exchange on which it is traded or, if not traded on an exchange or no closing price is available, at the mean between the last bid and asked prices.

The Fund may write straddles (covered or uncovered) consisting of a combination of a call and a put written on the same underlying security. A straddle will be covered when sufficient assets are deposited to meet the Fund's immediate obligations. The Fund may use the same liquid assets to cover both the call and put options where the exercise price of the call and put are the same, or the exercise price of the call is higher than that of the put. In such cases, the Fund will also segregate liquid assets equivalent to the amount, if any, by which the put is in the money.

*Risks Associated with Options on Securities and Indexes.* There are several risks associated with transactions in options on securities and on indexes. For example, there are significant differences between the securities and options markets that could result in an imperfect correlation between these markets, causing a given transaction not to achieve its objective. A decision as to whether, when and how to use options involves the exercise of skill and judgment, and even a well-conceived transaction may be unsuccessful to some degree because of market behavior or unexpected events.

During the option period, the covered call writer has, in return for the premium on the option, given up the opportunity to profit from a price increase in the underlying security above the exercise price, but, as long as its obligation as a writer continues, has retained the risk of loss should the price of the underlying security decline. The writer of an option has no control over the time when it may be required to fulfill its obligation as a writer of the option. Once an option writer has received an exercise notice, it cannot effect a closing purchase transaction in order to terminate its obligation under the option and must deliver the underlying security at the exercise price. If a put or call option purchased by the Fund is not sold when it has remaining value, and if the market price of the underlying security remains equal to or greater than the exercise price (in the case of a put), or remains less than or equal to the exercise price (in the case of a call), the Fund will lose its entire investment in the option. Also, where a put or call option on a particular security is purchased to hedge against price movements in a related security, the price of the put or call option may move more or less than the price of the related security.

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There can be no assurance that a liquid market will exist when the Fund seeks to close out an option position. If the Fund were unable to close out an option that it had purchased on a security, it would have to exercise the option in order to realize any profit or the option may expire worthless. If the Fund were unable to close out a covered call option that it had written on a security, it would not be able to sell the underlying security unless the option expired without exercise. As the writer of a covered call option, the Fund forgoes, during the option's life, the opportunity to profit from increases in the market value of the security covering the call option above the sum of the premium and the exercise price of the call.

If trading were suspended in an option purchased by the Fund, the Fund would not be able to close out the option. If restrictions on exercise were imposed, the Fund might be unable to exercise an option it has purchased. Except to the extent that a call option on an index written by the Fund is covered by an option on the same index purchased by the Fund, movements in the index may result in a loss to the Fund; however, such losses may be mitigated by changes in the value of the Fund's securities during the period the option was outstanding.

*Foreign Currency Options.* The Fund may buy or sell put and call options on foreign currencies for investment purposes or as a hedge against changes in the value of the U.S. dollar (or another currency) in relation to a foreign currency in which the Fund's securities may be denominated. The Fund may buy or sell put and call options on foreign currencies either on exchanges or in the over-the-counter market. A put option on a foreign currency gives the purchaser of the option the right to sell a foreign currency at the exercise price until the option expires. A call option on a foreign currency gives the purchaser of the option the right to purchase the currency at the exercise price until the option expires. Currency options traded on U.S. or other exchanges may be subject to position limits which may limit the ability of the Fund to reduce foreign currency risk using such options.

*Futures Contracts and Options on Futures Contracts.* The Fund may invest in futures contracts and options thereon ( futures options ), including with respect to interest rates, securities indexes, currencies, debt obligations (to the extent they are available) and U.S. Government and agency securities, as well as purchase put and call options on such futures contracts.

A futures contract provides for the future sale by one party and purchase by another party of a specified quantity of the security or other financial instrument at a specified price and time. A futures contract on an index is an agreement pursuant to which two parties agree to take or make delivery of an amount of cash equal to the difference between the value of the index at the close of the last trading day of the contract and the price at which the index contract was originally written. Although the value of an index might be a function of the value of certain specified securities, physical delivery of these securities is not always made. A public market exists in futures contracts covering a number of indexes as well as financial instruments, including, without limitation: U.S. Treasury bonds; U.S. Treasury notes; GNMA Certificates; three-month U.S. Treasury bills; 90-day commercial paper; bank certificates of deposit; Eurodollar certificates of deposit; the Australian dollar; the Canadian dollar; the British pound; the Japanese yen; the Swiss franc; the Mexican peso; and certain multinational currencies, such as the euro. It is expected that other futures contracts will be developed and traded in the future.

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The Fund may purchase and write call and put futures options. Futures options possess many of the same characteristics as options on securities and indexes (discussed above). A futures option gives the holder the right, in return for the premium paid, to assume a long position (call) or short position (put) in a futures contract at a specified exercise price at any time during the period of the option. Upon exercise of a call option, the holder acquires a long position in the futures contract and the writer is assigned the opposite short position. In the case of a put option, the opposite is true.

The Fund may enter into futures contracts and futures options that are standardized and traded on a U.S. or other exchange, board of trade, or similar entity, or quoted on an automated quotation system, and the Fund may also enter into OTC options on futures contracts.

When a purchase or sale of a futures contract is made by the Fund, the Fund is required to deposit with its custodian (or broker, if legally permitted) a specified amount of assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees ( initial margin ). The margin required for a futures contract is set by the exchange on which the contract is traded and may be modified during the term of the contract. The initial margin is in the nature of a performance bond or good faith deposit on the futures contract that is returned to the Fund upon termination of the contract, assuming all contractual obligations have been satisfied. The Fund expects to earn taxable interest income on its initial margin deposits. A futures contract held by the Fund is valued daily at the official settlement price of the exchange on which it is traded. Each day the Fund pays or receives cash, called variation margin, equal to the daily change in value of the futures contract. This process is known as marking to market. Variation margin does not represent a borrowing or loan by the Fund but is instead a settlement between the Fund and the broker of the amount one would owe the other if the futures contract expired. In computing weekly net asset value, the Fund will mark to market its open futures positions.

The Fund is also required to deposit and maintain margin with respect to put and call options on futures contracts written by it. Such margin deposits will vary depending on the nature of the underlying futures contract (and the related initial margin requirements), the current market value of the option, and other futures positions held by the Fund.

Although some futures contracts call for making or taking delivery of the underlying securities, generally these obligations are closed out prior to delivery by offsetting purchases or sales of matching futures contracts (involving the same exchange, underlying security or index, and delivery month). If an offsetting purchase price is less than the original sale price, the Fund realizes a capital gain, or if it is more, the Fund realizes a capital loss. Conversely, if an offsetting sale price is more than the original purchase price, the Fund realizes a capital gain, or if it is less, the Fund realizes a capital loss. The transaction costs must also be included in these calculations.

The Fund may write straddles (covered or uncovered) consisting of a call and a put written on the same underlying futures contract. A straddle will be covered when sufficient assets are deposited to meet the Fund's immediate obligations. The Fund may use the same liquid assets to cover both the call and put options where the exercise price of the call and put are the same, or the exercise price of the call is higher than that of the put. In such cases, the Fund will also segregate liquid assets equivalent to the amount, if any, by which the put is in the money.



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The Fund is operated by a person who has claimed an exclusion from the definition of the term "commodity pool operator" under the Commodity Exchange Act (the "CEA"), and, therefore, such person is not subject to registration or regulation as a pool operator under the CEA.

*Limitations on Use of Futures and Futures Options.* When purchasing a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that, when added to the amounts deposited with a futures commission merchant as margin, are equal to the market value of the futures contract. Alternatively, the Fund may cover its position by purchasing a put option on the same futures contract with a strike price as high as or higher than the price of the contract held by the Fund.

When selling a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that are equal to the market value of the instruments underlying the contract. Alternatively, the Fund may cover its position by owning the instruments underlying the contract (or, in the case of an index futures contract, a portfolio with a volatility substantially similar to that of the index on which the futures contract is based), or by holding a call option permitting the Fund to purchase the same futures contract at a price no higher than the price of the contract written by the Fund (or at a higher price if the difference is maintained in liquid assets with the Fund's custodian).

When selling a call option on a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that, when added to the amounts deposited with a futures commission merchant as margin, equal the total market value of the futures contract underlying the call option. Alternatively, the Fund may cover its position by entering into a long position in the same futures contract at a price no higher than the strike price of the call option, by owning the instruments underlying the futures contract, or by holding a separate call option permitting the Fund to purchase the same futures contract at a price not higher than the strike price of the call option sold by the Fund.

When selling a put option on a futures contract, the Fund will maintain with its custodian (and mark to market on a daily basis) assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, that equal the purchase price of the futures contract, less any margin on deposit. Alternatively, the Fund may cover the position either by entering into a short position in the same futures contract, or by owning a separate put option permitting it to sell the same futures contract so long as the strike price of the purchased put option is the same as or higher than the strike price of the put option sold by the Fund.

To the extent that securities with maturities greater than one year are used to segregate assets to cover the Fund's obligations under futures contracts and related options, such use will not eliminate the leverage risk arising from such use, which may tend to exaggerate the effect on net asset value of any increase or decrease in the market value of the Fund's portfolio, and may require liquidation of portfolio positions when it is not advantageous to do so.

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The requirements for qualification as a regulated investment company also may limit the extent to which the Fund may enter into futures, futures options or forward contracts. See Tax Matters.

*Risks Associated with Futures and Futures Options.* There are several risks associated with the use of futures contracts and futures options as hedging techniques. A purchase or sale of a futures contract may result in losses in excess of the amount invested in the futures contract. There can be no guarantee that there will be a correlation between price movements in the hedging vehicle and in the Fund securities being hedged. In addition, there are significant differences between the securities and futures markets that could result in an imperfect correlation between the markets, causing a given hedge not to achieve its objective. The degree of imperfection of correlation depends on circumstances such as variations in speculative market demand for futures and futures options on securities, including technical influences in futures trading and futures options, and differences between the financial instruments being hedged and the instruments underlying the standard contracts available for trading in such respects as interest rate levels, maturities, and creditworthiness of issuers. A decision as to whether, when and how to hedge involves the exercise of skill and judgment, and even a well-conceived hedge may be unsuccessful to some degree because of market behavior or unexpected interest rate trends.

Futures contracts on U.S. Government securities historically have reacted to an increase or decrease in interest rates in a manner similar to that in which the underlying U.S. Government securities reacted. To the extent, however, that the Fund enters into such futures contracts, the value of such futures will not vary in direct proportion to the value of the Fund's holdings of debt obligations. Thus, the anticipated spread between the price of the futures contract and the hedged security may be distorted due to differences in the nature of the markets. The spread also may be distorted by differences in initial and variation margin requirements, the liquidity of such markets and the participation of speculators in such markets.

Futures exchanges may limit the amount of fluctuation permitted in certain futures contract prices during a single trading day. The daily limit establishes the maximum amount that the price of a futures contract may vary either up or down from the previous day's settlement price at the end of the current trading session. Once the daily limit has been reached in a futures contract subject to the limit, no more trades may be made on that day at a price beyond that limit. The daily limit governs only price movements during a particular trading day and therefore does not limit potential losses because the limit may work to prevent the liquidation of unfavorable positions. For example, futures prices have occasionally moved to the daily limit for several consecutive trading days with little or no trading, thereby preventing prompt liquidation of positions and subjecting some holders of futures contracts to substantial losses.

There can be no assurance that a liquid market will exist at a time when the Fund seeks to close out a futures contract or a futures option position, and the Fund would remain obligated to meet margin requirements until the position is closed. In addition, many of the contracts discussed above are relatively new instruments without a significant trading history. As a result, there can be no assurance that an active secondary market will develop or continue to exist.

*Additional Risks of Options on Securities, Futures Contracts, Options on Futures Contracts and Forward Currency Exchange Contracts and Options thereon.* Options on

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securities, futures contracts, options on futures contracts, and options on currencies may be traded on foreign exchanges. Such transactions may not be regulated as effectively as similar transactions in the United States, may not involve a clearing mechanism and related guarantees, and are subject to the risk of governmental actions affecting trading in, or the prices of, foreign securities. Some foreign exchanges may be principal markets so that no common clearing facility exists and a trader may look only to the broker for performance of the contract. The value of such positions also could be adversely affected by (i) other complex foreign political, legal and economic factors, (ii) lesser availability than in the United States of data on which to make trading decisions, (iii) delays in the Fund's ability to act upon economic events occurring in foreign markets during non-business hours in the United States, (iv) the imposition of different exercise and settlement terms and procedures and margin requirements than in the United States and (v) lesser trading volume. In addition, unless the Fund hedges against fluctuations in the exchange rate between the U.S. dollar and the currencies in which trading is done on foreign exchanges, any profits that the Fund might realize in trading could be eliminated by adverse changes in the exchange rate, or the Fund could incur losses as a result of those changes. The Fund's use of such instruments may cause the Fund to realize higher amounts of short-term capital gains (generally taxed to shareholders at ordinary income tax rates) than if the Fund had not used such instruments.

*Swap Agreements.* The Fund may enter into total return swap agreements, credit default swap agreements and other swap agreements made with respect to interest rates, currencies, indexes of securities and other assets or measures of risk or return. The Fund may also enter into options on swap agreements (swaptions). These transactions are entered into in an attempt to obtain a particular return when it is considered desirable to do so, possibly at a lower cost to the Fund than if the Fund had invested directly in an instrument that yielded that desired return. Swap agreements are two-party contracts entered into primarily by institutional investors for periods ranging from a few weeks to more than one year. In a standard swap transaction, two parties agree to exchange the returns (or differentials in rates of return) earned or realized on particular predetermined investments or instruments, which may be adjusted for an interest factor. The gross returns to be exchanged or swapped between the parties are generally calculated with respect to a notional amount, i.e., the return on or increase in value of a particular dollar amount invested at a particular interest rate or in a basket of securities representing a particular index. Forms of swap agreements include interest rate caps, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates exceed a specified rate, or cap; interest rate floors, under which, in return for a premium, one party agrees to make payments to the other to the extent that interest rates fall below a specified rate, or floor; and interest rate collars, under which a party sells a cap and purchases a floor or vice versa in an attempt to protect itself against interest rate movements exceeding given minimum or maximum levels. The Fund may use interest rate caps, floors and collars to a substantial degree in connection with its leveraging strategies. See Certain Interest Rate Transactions below and Investment Objective and Strategies Certain Interest Rate Transactions in the Prospectus. A swaption is a contract that gives a counterparty the right (but not the obligation) to enter into a new swap agreement or to shorten, extend, cancel or otherwise modify an existing swap agreement, at some designated future time on specified terms. The Fund may write (sell) and purchase put and call swaptions.

Most swap agreements entered into by the Fund would calculate the obligations of the parties to the agreement on a net basis. Consequently, the Fund's current obligations (or rights)

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under a swap agreement will generally be equal only to the net amount to be paid or received under the agreement based on the relative values of the positions held by each party to the agreement (the net amount). The Fund's current obligations under a swap agreement will be accrued daily (offset against any amounts owed to the Fund). The Fund may (but is not required to) cover any accrued but unpaid net amounts owed to a swap counterparty through the segregation of assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees. Obligations under swap agreements so covered will not be construed to be senior securities for purposes of the Fund's investment restriction concerning senior securities and borrowings.

Whether the Fund's use of swap agreements or swaptions will be successful in furthering its investment objective will depend on PIMCO's ability to predict correctly whether certain types of investments are likely to produce greater returns than other investments. Because they are two-party contracts and because they may have terms of greater than seven days, swap agreements may be considered to be illiquid. Moreover, the Fund bears the risk of loss of the amount expected to be received under a swap agreement in the event of the default or bankruptcy of a swap agreement counterparty. The Fund will enter into swap agreements only with counterparties that meet certain standards of creditworthiness. The swaps market is a relatively new market and is largely unregulated. It is possible that developments in the swaps market, including potential government regulation, could adversely affect the Fund's ability to terminate existing swap agreements or to realize amounts to be received under such agreements.

Depending on the terms of the particular option agreement, the Fund will generally incur a greater degree of risk when it writes a swaption than it will incur when it purchases a swaption. When the Fund purchases a swaption, it risks losing only the amount of the premium it has paid should it decide to let the option expire unexercised. However, when the Fund writes a swaption, upon exercise of the option the Fund will become obligated according to the terms of the underlying agreement.

Certain swap agreements are exempt from most provisions of the CEA and, therefore, are not regulated as futures or commodity option transactions under the CEA.

## **Credit Default Swaps**

The Fund may enter into credit default swap contracts for both investment and risk management purposes. As the seller in a credit default swap contract, the Fund would be required to pay the par (or other agreed-upon) value of a referenced debt obligation to the counterparty in the event of a default by a third party, such as a U.S. or foreign issuer, on the debt obligation. In return, the Fund would receive from the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would keep the stream of payments and would have no payment obligations. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its total net assets, the Fund would be subject to investment exposure on the notional amount of the swap.

The Fund may also purchase credit default swap contracts in order to hedge against the risk of default of debt securities held in its portfolio, in which case the Fund would function as the counterparty referenced in the preceding paragraph. This would involve the risk that the

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investment may expire worthless and would generate income only in the event of an actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial instability). It would also involve credit risk that the seller may fail to satisfy its payment obligations to the Fund in the event of a default.

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### **Credit-Linked Trust Certificates**

Among the income-producing securities in which the Fund may invest are credit-linked trust certificates, which are investments in a limited purpose trust or other vehicle formed under State law which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to provide exposure to the high yield or another fixed income market. For instance, the Fund may invest in credit-linked trust certificates as a cash management tool in order to gain exposure to the high yield markets and/or to remain fully invested when more traditional income-producing securities are not available, including during the period when the net proceeds of this offering and any offering of AMPS are being invested.

Like an investment in a bond, investments in these credit-linked trust certificates represent the right to receive periodic income payments (in the form of distributions) and payment of principal at the end of the term of the certificate. However, these payments are conditioned on the trust's receipt of payments from, and the trust's potential obligations to, the counterparties to the derivative instruments and other securities in which the trust invests. For instance, the trust may sell one or more credit default swaps, under which the trust would receive a stream of payments over the term of the swap agreements provided that no event of default has occurred with respect to the referenced debt obligation upon which the swap is based. If a default occurs, the stream of payments may stop and the trust would be obligated to pay to the counterparty the par (or other agreed upon value) of the referenced debt obligation. This, in turn, would reduce the amount of income and principal that the Fund would receive as an investor in the trust. Please see **Investment Objective and Policies Credit Default Swaps** in this Statement of Additional Information for additional information about credit default swaps. The Fund's investments in these instruments are indirectly subject to the risks associated with derivative instruments, including, among others, credit risk, default or similar event risk, counterparty risk, interest rate risk, leverage risk and management risk. It is expected that the trusts which issue credit-linked trust certificates will constitute private investment companies, exempt from registration under the Investment Company Act of 1940, as amended (the **1940 Act**). Therefore, the certificates will be subject to the risks described under **Other Investment Companies** below, and will not be subject to applicable investment limitations and other regulation imposed by the 1940 Act (although the Fund will remain subject to such limitations and regulation, including with respect to its investments in the certificates). Although the trusts are typically private investment companies, they are generally not actively managed such as a hedge fund might be. It is also expected that the certificates will be exempt from registration under the 1933 Act. Accordingly, there may be no established trading market for the certificates and they may constitute illiquid investments. See **Risks General Risks of Investing in the Fund Liquidity Risk** in the Prospectus. If market quotations are not readily available for the certificates, they will be valued by the Fund at fair value as determined by the Board of Trustees or persons acting at its direction. See **Net Asset Value** in the Prospectus.

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### **Structured Notes and Other Hybrid Instruments**

The Fund may invest in structured notes, which are privately negotiated debt obligations where the principal and/or interest is determined by reference to the performance of a benchmark asset, market or interest rate, such as selected securities, an index of securities or specified interest rates, or the differential performance of two assets or markets, such as indexes reflecting bonds. Depending on the terms of the note, the Fund may forgo all or part of the interest and principal that would be payable on a comparable conventional note. The rate of return on structured notes may be determined by applying a multiplier to the performance or differential performance of the referenced index(es) or other asset(s). Application of a multiplier involves leverage which will serve to magnify the potential for gain and the risk of loss. The Fund may use structured notes to add leverage to the portfolio (as a substitute for AMPS) and for investment as well as risk management purposes. Like other sophisticated strategies, the Fund's use of structured notes may not work as intended. Although structured instruments are not necessarily illiquid, PIMCO believes that currently most structured instruments are illiquid.

The Fund may invest in other types of hybrid instruments which combine the characteristics of securities, futures, and options. For example, the principal amount or interest rate of a hybrid could be tied (positively or negatively) to the price of some commodity, currency or securities index or another interest rate (each a benchmark). The interest rate or (unlike most debt obligations) the principal amount payable at maturity of a hybrid security may be increased or decreased, depending on changes in the value of the benchmark. Hybrids can be used as an efficient means of pursuing a variety of investment goals, including duration management and increased total return. Hybrids may not bear interest or pay dividends. The value of a hybrid or its interest rate may be a multiple of a benchmark and, as a result, may be leveraged and move (up or down) more steeply and rapidly than the benchmark. These benchmarks may be sensitive to economic and political events that cannot be readily foreseen by the purchaser of a hybrid. Under certain conditions, the redemption value of a hybrid could be zero. Thus, an investment in a hybrid may entail significant market risks that are not associated with a similar investment in a traditional, U.S. dollar-denominated bond that has a fixed principal amount and pays a floating rate or fixed rate of interest. The purchase of hybrids also exposes the Fund to the credit risk of the issuer of the hybrids. These risks may cause significant fluctuations in the net asset value of the Fund.

Certain issuers of structured products such as hybrid instruments may be deemed to be investment companies as defined in the 1940 Act. As a result, the Fund's investments in these products may be subject to limits applicable to investments in investment companies and may be subject to restrictions contained in the 1940 Act. See [Other Investment Companies](#) below.

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### **Reverse Repurchase Agreements**

The Fund may enter into reverse repurchase agreements and economically similar transactions in order to add leverage to the portfolio (as a substitute for AMPS) or for hedging or cash management purposes. A reverse repurchase agreement involves the sale of a portfolio-eligible security by the Fund, coupled with its agreement to repurchase the instrument at a specified time and price. Under a reverse repurchase agreement, the Fund continues to receive any principal and interest payments on the underlying security during the term of the agreement. Reverse repurchase agreements involve leverage risk and the risk that the market value of securities retained by the Fund may decline below the repurchase price of the securities sold by the Fund which it is obligated to repurchase. The Fund may (but is not required to) segregate assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, equal (on a daily mark-to-market basis) to its obligations under reverse repurchase agreements. To the extent that positions in reverse repurchase agreements are not so covered, such transactions would be subject to the Fund's limitations on borrowings, which would, among other things, restrict the aggregate of such transactions (plus any other borrowings) to one-third of the Fund's total assets.

The Fund also may effect simultaneous purchase and sale transactions that are known as sale-buybacks. A sale-buyback is similar to a reverse repurchase agreement, except that in a sale-buyback, the counterparty who purchases the security is entitled to receive any principal or interest payments made on the underlying security pending settlement of the Fund's repurchase of the underlying security.

### **Mortgage Dollar Rolls**

A mortgage dollar roll is similar to a reverse repurchase agreement in certain respects. In a dollar roll transaction, the Fund sells a mortgage-related security, such as a security issued by GNMA, to a dealer and simultaneously agrees to repurchase a similar security (but not the same security) in the future at a pre-determined price. A dollar roll can be viewed, like a reverse repurchase agreement, as a collateralized borrowing in which the Fund pledges a mortgage-related security to a dealer to obtain cash. However, unlike reverse repurchase agreements, the dealer with which the Fund enters into a dollar roll transaction is not obligated to return the same securities as those originally sold by the Fund, but only securities which are substantially identical. To be considered substantially identical, the securities returned to the Fund generally must: (1) be collateralized by the same types of underlying mortgages; (2) be issued by the same agency and be part of the same program; (3) have a similar original stated maturity; (4) have identical net coupon rates; (5) have similar market yields (and therefore price); and (6) satisfy good delivery requirements, meaning that the aggregate principal amounts of the securities delivered and received back must be within 2.5% of the initial amount delivered.

As with reverse repurchase agreements, to the extent that positions in dollar roll agreements are not covered by segregated liquid assets at least equal to the amount of any forward purchase commitment, such transactions would be subject to the Fund's restrictions on borrowings. Furthermore, because dollar roll transactions may be for terms ranging between one and six months, dollar roll transactions may be deemed illiquid.



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### **Repurchase Agreements**

For the purposes of maintaining liquidity and achieving income, the Fund may enter into repurchase agreements with domestic commercial banks or registered broker/dealers. A repurchase agreement is a contract under which the Fund would acquire a security for a relatively short period (usually not more than one week) subject to the obligation of the seller to repurchase and the Fund to resell such security at a fixed time and price (representing the Fund's cost plus interest). In the case of repurchase agreements with broker-dealers, the value of the underlying securities (or collateral) will be at least equal at all times to the total amount of the repurchase obligation, including the interest factor. The Fund bears a risk of loss in the event that the other party to a repurchase agreement defaults on its obligations and the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities. This risk includes the risk of procedural costs or delays in addition to a loss on the securities if their value should fall below their repurchase price. PIMCO will monitor the creditworthiness of the counter parties.

### **When-Issued, Delayed Delivery and Forward Commitment Transactions**

The Fund may purchase or sell securities on a when-issued, delayed delivery, or forward commitment basis. When such purchases are outstanding, the Fund will segregate until the settlement date assets determined to be liquid by PIMCO in accordance with procedures established by the Board of Trustees, in an amount sufficient to meet the purchase price. Typically, no income accrues on securities the Fund has committed to purchase prior to the time delivery of the securities is made, although the Fund may earn income on securities it has segregated.

When purchasing a security on a when-issued, delayed delivery, or forward commitment basis, the Fund assumes the rights and risks of ownership of the security, including the risk of price and yield fluctuations, and takes such fluctuations into account when determining its net asset value. Because the Fund is not required to pay for the security until the delivery date, these risks are in addition to the risks associated with the Fund's other investments. If the Fund remains substantially fully invested at a time when when-issued, delayed delivery, or forward commitment purchases are outstanding, the purchases may result in a form of leverage.

When the Fund has sold a security on a when-issued, delayed delivery, or forward commitment basis, the Fund does not participate in future gains or losses with respect to the security. If the other party to a transaction fails to deliver or pay for the securities, the Fund could miss a favorable price or yield opportunity or could suffer a loss. The Fund may dispose of or renegotiate a transaction after it is entered into, and may sell when-issued, delayed delivery or forward commitment securities before they are delivered, which may result in a capital gain or loss. There is no percentage limitation on the extent to which the Fund may purchase or sell securities on a when-issued, delayed delivery, or forward commitment basis.

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### **Borrowing**

The Fund may borrow money to the extent permitted under the 1940 Act as interpreted, modified or otherwise permitted by regulatory authority having jurisdiction, from time to time. The Fund may from time to time borrow money to add leverage to the portfolio as a substitute for the leverage obtained with AMPS. The Fund may also borrow money for temporary administrative purposes.

Under the 1940 Act, the Fund generally is not permitted to engage in borrowings unless immediately after a borrowing the value of the Fund's total assets less liabilities (other than the borrowing) is at least 300% of the principal amount of such borrowing (i.e., such principal amount may not exceed 33 1/3% of the Fund's total assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on Common Shares unless, at the time of such declaration, the value of the Fund's total assets, less liabilities other than borrowing, is at least 300% of such principal amount. If the Fund borrows it intends, to the extent possible, to prepay all or a portion of the principal amount of the borrowing to the extent necessary in order to maintain the required asset coverage. Failure to maintain certain asset coverage requirements could result in an event of default and entitle the holders of AMPS or any other preferred shares of beneficial interest ( Preferred Shareholders ) and holders of any other senior securities of the Fund to elect a majority of the Trustees of the Fund.

As described elsewhere in this Statement of Additional Information and in the Prospectus, the Fund may also enter into other transactions that may give rise to a form of leverage. Such transactions may include, among others, issuing debt securities or using reverse repurchase agreements, loans of portfolio securities, credit default swap contracts and other derivatives, as well as when-issued, delayed delivery or forward commitment transactions. However, these forms of leverage will only be used, if at all, as a substitute for, rather than in addition to, the leverage obtained through the issuance of AMPS. See Risks General Risks of Investing in the Fund Leverage Risk in the Prospectus.

As described above, the Fund will, under certain circumstances, cover its commitment under these instruments by the segregation of assets determined to be liquid by PIMCO in accordance with procedures adopted by the Trustees, equal in value to the amount of the Fund's commitment, or by entering into offsetting transactions or owning positions covering its obligations. In such cases, the instruments will not be considered senior securities under the 1940 Act for purposes of the asset coverage requirements otherwise applicable to borrowings by the Fund or the Fund's issuance of AMPS. Borrowing will tend to exaggerate the effect on net asset value of any increase or decrease in the market value of the Fund's portfolio. Money borrowed will be subject to interest costs which may or may not be recovered by appreciation of the securities purchased. The Fund also may be required to maintain minimum average balances in connection with such borrowing or to pay a commitment or other fee to maintain a line of credit; either of these requirements would increase the cost of borrowing over the stated interest rate.

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### **Short Sales**

The Fund may make short sales of securities as part of its overall portfolio management strategy and to offset potential declines in long positions in securities in the Fund's portfolio. 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 on a security, 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 may have to pay a fee to borrow particular securities and is often obligated to pay over any accrued interest and dividends on such borrowed securities.

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; conversely, if the price declines, the Fund will realize a capital gain. Any gain will be decreased, and any loss increased, by the transaction costs described above. The successful use of short selling may be adversely affected by imperfect correlation between movements in the price of the security sold short and the securities being hedged.

To the extent that the Fund engages in short sales, it will provide collateral to the broker-dealer. A short sale is against the box to the extent that the Fund contemporaneously owns, or has the right to obtain at no added cost, securities identical to those sold short. The Fund may engage in so-called naked short sales where it does not own or have the immediate right to acquire the security sold short at no additional cost, in which case the Fund's losses could theoretically be unlimited.

### **Rule 144A Securities**

The Fund may invest without limit in securities that are eligible for purchase and sale pursuant to Rule 144A under the 1933 Act ( Rule 144A Securities ). Rule 144A permits certain qualified institutional buyers, such as the Fund, to trade in privately placed securities that have not been registered for sale under the 1933 Act. Rule 144A Securities may be subject to liquidity risk.

### **Illiquid Securities**

The Fund may invest without limit in illiquid securities (determined using the Securities and Exchange Commission's standard applicable to open-end investment companies, i.e., securities that cannot be disposed of within seven days in the ordinary course of business at approximately the value at which the Fund has valued the securities). Illiquid securities are considered to include, among other things, written over-the-counter options, securities or other liquid assets being used as cover for such options, repurchase agreements with maturities in excess of seven days, certain loan participation interests, fixed time deposits which are not subject to prepayment or provide for withdrawal penalties upon prepayment (other than overnight deposits), and other securities whose disposition is restricted under the federal securities laws (other than securities issued pursuant to Rule 144A under the 1933 Act and certain commercial paper that PIMCO has determined to be liquid under procedures approved by the Board of Trustees).



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PIMCO will determine the liquidity of the Fund's investments by reference to market conditions and contractual provisions.

Illiquid securities may include privately placed securities, which are sold directly to a small number of investors, usually institutions. Unlike public offerings, such securities are not registered under the federal securities laws. Although certain of these securities may be readily sold, others may be illiquid, and their sale may involve substantial delays and additional costs.

## **Portfolio Trading and Turnover Rate**

Portfolio trading may be undertaken to accomplish the investment objective of the Fund. In addition, a security may be sold and another of comparable quality purchased at approximately the same time to take advantage of what PIMCO believes to be a temporary price disparity between the two securities. Temporary price disparities between two comparable securities may result from supply and demand imbalances where, for example, a temporary oversupply of certain bonds may cause a temporarily low price for such bonds, as compared with other bonds of like quality and characteristics. The Fund may also engage in short-term trading consistent with its investment objective. Securities may be sold in anticipation of a market decline (a rise in interest rates) or purchased in anticipation of a market rise (a decline in interest rates) and later sold, or to recognize a gain.

A change in the securities held by the Fund is known as portfolio turnover. PIMCO manages the Fund without regard generally to restrictions on portfolio turnover. The use of certain derivative instruments with relatively short maturities may tend to exaggerate the portfolio turnover rate for the Fund. Trading in debt obligations does not generally involve the payment of brokerage commissions, but does involve indirect transaction costs. The use of futures contracts may involve the payment of commissions to futures commission merchants. High portfolio turnover (e.g., greater than 100%) involves correspondingly greater expenses to the Fund, including brokerage commissions or dealer mark-ups and other transaction costs on the sale of securities and reinvestments in other securities. The higher the rate of portfolio turnover of the Fund, the higher these transaction costs borne by the Fund generally will be. Transactions in the Fund's portfolio securities may result in realization of taxable capital gains (including short-term capital gains which are generally taxed to shareholders at ordinary income tax rates). The trading costs and tax effects associated with portfolio turnover may adversely affect the Fund's performance.

The portfolio turnover rate of the Fund is calculated by dividing (a) the lesser of purchases or sales of portfolio securities for the particular fiscal year by (b) the monthly average of the value of the portfolio securities owned by the Fund during the particular fiscal year. In calculating the rate of portfolio turnover, there is excluded from both (a) and (b) all securities, including options, whose maturities or expiration dates at the time of acquisition were one year or less.

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### **Warrants to Purchase Securities**

The Fund may invest in warrants to purchase debt securities. Debt obligations with warrants attached to purchase equity securities have many characteristics of convertible bonds and their prices may, to some degree, reflect the performance of the underlying stock. Debt obligations also may be issued with warrants attached to purchase additional debt securities at the same coupon rate. A decline in interest rates would permit the Fund to buy additional bonds at the favorable rate or to sell the warrants at a profit. If interest rates rise, the warrants would generally expire with no value.

### **Other Investment Companies**

The Fund may invest in securities of open- or closed-end investment companies to the extent that such investments are consistent with the Fund's investment objective and policies and permissible under the 1940 Act. The Fund may invest in other investment companies either during periods when it has large amounts of uninvested cash, such as the period shortly after the Fund receives the proceeds of the offering of its Common Shares or AMPS, during periods when there is a shortage of attractive variable rate and other debt instruments available in the market, or when PIMCO believes share prices of other investment companies offer attractive values. The Fund may invest in investment companies that are advised by PIMCO or its affiliates to the extent permitted by applicable law and/or pursuant to exemptive relief from the SEC. As a stockholder in an investment company, the Fund will bear its ratable share of that investment company's expenses and would remain subject to payment of the Fund's management fees with respect to assets so invested. Holders of the Common Shares would therefore be subject to duplicative expenses to the extent the Fund invests in other investment companies. PIMCO will take expenses into account when evaluating the investment merits of an investment in an investment company relative to available debt instruments. In addition, the securities of other investment companies may also be leveraged and will therefore be subject to the same leverage risks described in the Prospectus and herein. As described in the Prospectus in the section entitled "Risks General Risks of Investing in the Fund Leverage Risk," the net asset value and market value of leveraged shares will be more volatile and the yield to shareholders will tend to fluctuate more than the yield generated by unleveraged shares.

### **Securities Loans**

Subject to the Fund's Investment Restrictions listed below, the Fund may make secured loans of its portfolio securities to brokers, dealers and other financial institutions amounting to no more than one-third of its total assets. The risks in lending portfolio securities, as with other extensions of credit, consist of possible delay in recovery of the securities or possible loss of rights in the collateral should the borrower fail financially. However, such loans will be made only to broker-dealers that are believed by PIMCO to be of relatively high credit standing. Securities loans are made to broker-dealers pursuant to agreements requiring that loans be continuously secured by collateral consisting of U.S. Government securities, cash or cash equivalents (negotiable certificates of deposit, bankers' acceptances or letters of credit) maintained on a daily mark-to-market basis in an amount at least equal at all times to the market value of the securities lent. The borrower pays to the Fund, as the lender, an amount equal to any dividends or interest received on the securities lent. The Fund may invest only the cash collateral received in interest-

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bearing, short-term securities or receive a fee from the borrower. In the case of cash collateral, the Fund typically pays a rebate to the lender. Although voting rights or rights to consent with respect to the loaned securities pass to the borrower, the Fund, as the lender, retains the right to call the loans and obtain the return of the securities loaned at any time on reasonable notice, and it will do so in order that the securities may be voted by the Fund if the holders of such securities are asked to vote upon or consent to matters materially affecting the investment. The Fund may also call such loans in order to sell the securities involved. When engaged in securities lending, the Fund's performance will continue to reflect changes in the value of the securities loaned and will also reflect the receipt of either interest, through investment of cash collateral by the Fund in permissible investments, or a fee, if the collateral is U.S. Government securities.

## **Participation on Creditors Committees**

The Fund may from time to time participate on committees formed by creditors to negotiate with the management of financially troubled issuers of securities held by the Fund. Such participation may subject the Fund to expenses such as legal fees and may make the Fund an insider of the issuer for purposes of the federal securities laws, and therefore may restrict the Fund's ability to trade in or acquire additional positions in a particular security when it might otherwise desire to do so. Participation by the Fund on such committees also may expose the Fund to potential liabilities under the federal bankruptcy laws or other laws governing the rights of creditors and debtors. The Fund would participate on such committees only when PIMCO believes that such participation is necessary or desirable to enforce the Fund's rights as a creditor or to protect the value of securities held by the Fund.

## **Short-Term Investments / Temporary Defensive Strategies**

Upon PIMCO's recommendation, for temporary defensive purposes and in order to keep the Fund's cash fully invested, including the period during which the net proceeds of the offering are being invested, the Fund may invest up to 100% of its net assets in other than floating rate assets, including longer-term, fixed rate investment grade debt securities, credit-linked trust certificates and/or index futures contracts or similar derivative instruments. Such investments may prevent the Fund from achieving its investment objective.

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**INVESTMENT RESTRICTIONS**

**Fundamental Investment Restrictions**

Except as described below, the Fund, as a fundamental policy, may not, without the approval of the holders of a majority of the outstanding Common Shares and any outstanding preferred shares of beneficial interest (including the AMPS) voting together as a single class, and of the holders of a majority of any outstanding preferred shares of beneficial interest (including the AMPS) voting as a separate class:

- (1) Concentrate its investments in a particular industry, as that term is used in the 1940 Act, and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time.
  
- (2) With respect to 75% of the Fund's total assets, purchase the securities of any issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities or securities issued by other investment companies, if, as a result, (i) more than 5% of the Fund's total assets would be invested in the securities of that issuer, or (ii) the Fund would hold more than 10% of the outstanding voting securities of that issuer.
  
- (3) Purchase or sell real estate, although it may purchase securities secured by real estate or interests therein, or securities issued by companies which invest in real estate, or interests therein.
  
- (4) Purchase or sell commodities or commodities contracts or oil, gas or mineral programs. This restriction shall not prohibit the Fund, subject to restrictions described in the Prospectus and elsewhere in this Statement of Additional Information, from purchasing, selling or entering into futures contracts, options on futures contracts, forward contracts, or any interest rate, securities-related or other hedging instrument, including swap agreements and other derivative instruments, subject to compliance with any applicable provisions of the federal securities or commodities laws.
  
- (5) Borrow money or issue any senior security, except to the extent permitted under the 1940 Act and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time.
  
- (6) Make loans, except to the extent permitted under the 1940 Act, and as interpreted, modified, or otherwise permitted by regulatory authority having jurisdiction, from time to time.
  
- (7) Act as an underwriter of securities of other issuers, except to the extent that in connection with the disposition of portfolio securities, it may be deemed to be an underwriter under the federal securities laws.





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Currently, under the 1940 Act, the Fund generally is not permitted to engage in borrowings unless immediately after a borrowing the value of the Fund's total assets less liabilities (other than the borrowing) is at least 300% of the principal amount of such borrowing (i.e., such principal amount may not exceed  $33\frac{1}{3}\%$  of the Fund's total assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on Common Shares unless, at the time of such declaration, the value of the Fund's total assets, less liabilities other than the borrowing, is at least 300% of such principal amount.

Currently, under the 1940 Act, the Fund may generally not lend money or property to any person, directly or indirectly, if such person controls or is under common control with the Fund, except for a loan from the Fund to a company which owns all of the outstanding securities of the Fund, except directors' and qualifying shares.

For purposes of the foregoing, majority of the outstanding, when used with respect to particular shares of the Fund (whether voting together as a single class or voting as separate classes), means (i) 67% or more of such shares present at a meeting, if the holders of more than 50% of such shares are present or represented by proxy, or (ii) more than 50% of such shares, whichever is less.

Unless otherwise indicated, all limitations applicable to the Fund's investments (as stated above and elsewhere in this Statement of Additional Information) apply only at the time a transaction is entered into. Any subsequent change in a rating assigned by any rating service to a security (or, if unrated, deemed by PIMCO to be of comparable quality), or change in the percentage of the Fund's total assets invested in certain securities or other instruments, or change in the average maturity or duration of the Fund's investment portfolio, resulting from market fluctuations or other changes in the Fund's total assets, will not require the Fund to dispose of an investment until PIMCO determines that it is practicable to sell or close out the investment without undue market or tax consequences to the Fund. In the event that rating agencies assign different ratings to the same security, PIMCO will determine which rating it believes best reflects the security's quality and risk at that time, which may be the higher of the several assigned ratings.

Under the 1940 Act, a senior security does not include any promissory note or evidence of indebtedness where such loan is for temporary purposes only and in an amount not exceeding 5% of the value of the total assets of the issuer at the time the loan is made. A loan is presumed to be for temporary purposes if it is repaid within sixty days and is not extended or renewed.

The Fund would be deemed to concentrate in a particular industry if it invested 25% or more of its total assets in that industry. The Fund's industry concentration policy does not preclude it from focusing investments in issuers in a group of related industrial sectors (such as different types of utilities).

The Fund may not change its policy to normally invest at least 80% of its net assets (plus any borrowings for investment purposes) in a diversified portfolio of floating rate debt instruments, securities with durations of less than or equal to one year, and fixed rate securities with respect to which the Fund has entered into derivative instruments to effectively convert the fixed rate interest payments into floating rate interest payments without providing Fund shareholders with at least 60 days' written notice of such change.

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To the extent the Fund covers its commitment under a reverse repurchase agreement, credit default swap or other derivative instrument by the segregation of assets determined by PIMCO to be liquid in accordance with procedures adopted by the Trustees, equal in value to the amount of the Fund's commitment, such instrument will not be considered a senior security for purposes of the asset coverage requirements otherwise applicable to borrowings by the Fund or the Fund's issuance of AMPS.

The Fund interprets its policies with respect to borrowing and lending to permit such activities as may be lawful for the Fund, to the full extent permitted by the 1940 Act or by exemption from the provisions thereof pursuant to exemptive order of the SEC.

It is a condition of the issuance of the AMPS that they be issued with a credit quality rating of Aaa from Moody's and AAA from Fitch. To obtain and maintain the required ratings, the Fund will be required to comply with investment quality, diversification and other guidelines established by Moody's and Fitch. Such guidelines will likely be more restrictive than the restrictions set forth above. The Fund does not anticipate that such guidelines would have a material adverse effect on the Fund's ability to achieve its investment objective. Moody's and Fitch receive fees in connection with their ratings issuances.

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**MANAGEMENT OF THE FUND**

**Trustees and Officers**

The business of the Fund is managed under the direction of the Fund's Board of Trustees. Subject to the provisions of the Fund's Agreement and Declaration of Trust (the Declaration), its Bylaws and Massachusetts law, the Trustees have all powers necessary and convenient to carry out this responsibility, including the election and removal of the Fund's officers.

The Trustees and officers of the Fund, their ages, the position they hold with the Fund, their term of office and length of time served, a description of their principal occupations during the past five years, the number of portfolios in the fund complex (as defined in SEC regulations) that the Trustee oversees and any other directorships held by the Trustee are listed in the two tables immediately following. Except as shown, each Trustee's and officer's principal occupation and business experience for the last five years have been with the employer(s) indicated, although in some cases the Trustee may have held different positions with such employer(s). Unless otherwise indicated, the business address of the persons listed below is *c/o* PA Fund Management LLC, 1345 Avenue of the Americas, New York, New York 10105.

**Table of Contents****Independent Trustees**

| <b>Name, Address and Age</b> | <b>Position(s)<br/>Held with Fund</b> | <b>Term of Office and Length of Time Served</b> | <b>Principal Occupation(s) During the Past 5 Years</b>  | <b>Number of Portfolios in Fund Complex Overseen by Trustee</b> | <b>Other Directorships Held by Trustee</b> |
|------------------------------|---------------------------------------|---|---|---|--|
| Robert E. Connor*<br>Age 70  | Trustee,<br>Chairman                  | Since<br>September,<br>2004.                    | Trustee, Fixed Income Shares, Nicholas-Applegate Convertible & Income Fund, Nicholas Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO Corporate Income Fund, PIMCO High Income Fund, PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund III, PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund; Director, Municipal Advantage Fund, Inc.; Corporate Affairs Consultant. Formerly, Senior Vice President, Corporate Office, Smith Barney. | 21  | None.                                      |

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| <b>Name, Address and Age</b>        | <b>Position(s) Held with Fund</b> | <b>Term of Office and Length of Time Served</b> | <b>Principal Occupation(s) During the Past 5 Years</b>  | <b>Number of Portfolios in Fund Complex Overseen by Trustee</b> | <b>Other Directorships Held by Trustee</b> |
|-------------------------------------|-----------------------------------|---|---|---|--|
| John J. Dalessandro<br>II<br>Age 67 | Trustee                           | Since<br>September,<br>2004.                    | Trustee, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO Corporate Income Fund, PIMCO High Income Fund, PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund III, PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund. Formerly, President and Director, J.J. Dalessandro II Ltd., registered broker-dealer and member of the New York Stock Exchange. | 16  | None.                                      |
| Hans W. Kertess<br>Age 65           | Trustee                           | Since<br>September,<br>2004                     | President, H. Kertess & Co.; Trustee, PIMCO Corporate Income Fund, PIMCO High Income Fund, Nicholas Applegate Convertible & Income Fund II, PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund III, PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund; Formerly, Managing Director and Consultant, Royal Bank of Canada Capital Markets.  | 16  | None.                                      |

\* In addition to the positions noted, Mr. Connor formerly provided occasional editorial consulting services, as an independent contractor, of Smith Barney an affiliate of Citigroup Inc.

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In accordance with the Fund's staggered board (see Anti-Takeover and Other Provisions in the Declaration of Trust), the Common Shareholders of the Fund will elect Trustees to fill the vacancies of Trustees whose terms expire at each annual meeting of shareholders, unless any AMPS or any other preferred shares of beneficial interest are outstanding, in which event Preferred Shareholders (including holders of AMPS) and Common Shareholders, voting together as a single class shall elect the Trustees; provided, that, so long as any AMPS or other preferred shares of beneficial interest are outstanding, the Preferred Shareholders, voting as a separate class, will elect two Trustees in the aggregate (i.e., at any meeting at which such Trustees are standing for election in accordance with the staggered board structure). Preferred Shareholders (including holders of AMPS) will be entitled to elect a majority of the Fund's Trustees under certain circumstances.

Officers

| Name, Address and Age  | Position(s)<br>Held with<br>Fund                      | Term of<br>Office<br>and Length<br>of<br>Time<br>Served | Principal Occupation(s) During the Past 5 Years  |
|--|---|---|--|
| Brian S. Shlissel<br><br>1345 Avenue of the Americas<br><br>New York, NY 10105<br><br>Age 40     | President and Chief Executive Officer                 | Since inception<br><br>(July, 2004).                    | Executive Vice President and Chief Administrative Officer, PA Fund Management LLC; President and Chief Executive Officer, PIMCO Advisors VIT (formerly OCC Accumulation Trust); President and Chief Executive Officer, Fixed Income Shares, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO Corporate Income Fund, PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund III, Municipal Advantage Fund, Inc., PIMCO High Income Fund, PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund. |
| Lawrence G. Altadonna<br><br>1345 Avenue of the Americas<br><br>New York, NY 10105<br><br>Age 38 | Treasurer; Principal Financial and Accounting Officer | Since inception<br><br>(July, 2004).                    | Senior Vice President, PA Fund Management LLC; Treasurer and Principal Financial and Accounting Officer, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO Corporate Income Fund, PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund III, Municipal   |

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| Name, Address and Age   | Position(s)<br>Held with<br>Fund | Term of<br>Office and<br>Length of<br>Time Served | Principal Occupation(s) During the Past 5 Years   |
|---|----------------------------------|---|---|
| Newton B. Schott, Jr.<br>2187 Atlantic Street<br>Stamford, CT 06902<br>Age 61           | Vice<br>President,<br>Secretary  | Since<br>inception<br>(July, 2004).               | Advantage Fund, Inc., PIMCO High Income Fund, PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund; Treasurer, Fixed Income SHares; Assistant Treasurer, PIMCO Advisors VIT (formerly OCC Accumulation Trust). Formerly, Director of Fund Administration, Prudential Investments.<br>Managing Director, Chief Administrative Officer, Secretary and General Counsel, PAD; Managing Director, Chief Legal Officer and Secretary, PA Fund Management LLC; Vice President and Secretary, PIMCO Funds: Multi-Manager Series, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO Corporate Income Fund, PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III, PIMCO New York Municipal Income Fund III, Municipal Advantage Fund, Inc., PIMCO High Income Fund and PIMCO Floating Rate Income Fund; Secretary, Fixed Income SHares. |
| Raymond Kennedy<br>840 Newport Center<br>Drive<br>Newport Beach, CA<br>92660<br>Age 42  | Vice<br>President                | Since<br>inception<br>(July,<br>2004).            | Managing Director, PIMCO; co-portfolio manager of the Fund and other investment vehicles managed by PIMCO; joined PIMCO in 1996; Vice President, PIMCO Floating Rate Income Fund and PIMCO Floating Rate Strategy Fund.   |
| Youse Guia<br>888 San Clemente Drive,<br>Suite 100 Newport<br>Beach, CA 92660<br>Age 32 | Chief<br>Compliance<br>Officer   | Since<br>October,<br>2004.                        | Senior Vice President, Group Compliance Manager, Allianz Global Investors of America L.P. Formerly, Vice President, Group Compliance Manager (since 2002). Audit Manager, PricewaterhouseCoopers LLP (1996-2002).   |



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For interested Trustees and officers, positions held with affiliated persons or principal underwriters of the Fund are listed in the following table:

| <u>Name</u>           | <u>Positions Held with Affiliated Persons or<br/>Principal Underwriters of the Fund</u> |
|-----------------------|---|
| Brian S. Shlissel     | See above.  |
| Lawrence Altadonna    | See above.  |
| Newton B. Schott, Jr. | See above.  |
| Raymond Kennedy       | See above.  |
| Youse Guia            | See above.  |

**Committees of the Board of Trustees**

**Audit Oversight Committee**

The Fund has established an Audit Oversight Committee in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The Fund's Audit Oversight Committee provides oversight with respect to the internal and external accounting and auditing procedures of the Fund and, among other things, determines the selection of the independent registered public accounting firm for the Fund and considers the scope of the audit, approves all audit and permitted non-audit services proposed to be performed by the independent registered public accounting firm on behalf of the Fund, and services to be performed by the independent registered public accounting firm for certain affiliates, including the Manager and PIMCO, and the entities in a control relationship with the Manager or PIMCO that provide services to the Fund where the engagement relates directly to the operations and financial reporting of the Fund. Messrs. Connor and Kertess, each of whom is an Independent Trustee, serve on this committee.

**Nominating Committee**

The Nominating Committee is responsible for reviewing and recommending qualified candidates to the Board in the event that a position is vacated or created. The Nominating Committee will review and consider nominees recommended by shareholders to serve as Trustee, provided any such recommendation is submitted in writing to the Fund, c/o Newton B. Schott, Jr., Secretary, at the address of the principal executive offices of the Fund. The Nominating Committee has full discretion to reject nominees recommended by shareholders, and there is no assurance that any such person so recommended and considered by a committee will be nominated for election to the Board. Messrs. Connor and Kertess, each of whom is an Independent Trustee, serve on this committee.

**Valuation Committee**

The Board has a Valuation Committee, to which the Board has delegate the responsibility to determine or cause to be determined the fair value of the Fund's portfolio securities and other assets when market quotations are not readily available. The Valuation Committee reviews and approves procedures for the fair valuation of the Fund's portfolio securities and periodically reviews information from the Manager and PIMCO regarding fair value and liquidity determinations made pursuant to the Board-approved procedures, and makes related



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recommendations to the full Board and assists the full Board in resolving particular fair valuation and other valuation matters. Messrs. Connor and Kertess, each of whom is an Independent Trustee, serve on this committee.

**Compensation Committee**

The Compensation Committee meets as the Board deems necessary to review and make recommendations regarding compensation payable to the Trustees of the Fund who are not directors, officers, partners or employees of the Manager, PIMCO or any entity controlling, controlled by or under common control with the Manager or PIMCO. Messrs. Connor and Kertess, each of whom is an Independent Trustee, serve on this committee.

**Securities Ownership**

For each Trustee, the following table discloses the dollar range of equity securities beneficially owned by the Trustee in the Fund and, on an aggregate basis, in any registered investment companies overseen by the Trustee within the Fund's family of investment companies as of December 31, 2003:

| <u>Name of Trustee</u> | <u>Dollar Range of Equity Securities in the Fund</u> | <u>Aggregate Dollar Range of Equity Securities in All Registered Investment Companies Overseen by Trustee in Family of Investment Companies</u> |
|------------------------|--|---|
| Robert E. Connor       | None.  | None.   |
| John J. Dalessandro II | None.  | None.   |
| Hans W. Kertess        | None.  | None.   |

For independent Trustees and their immediate family members, the following table provides information regarding each class of securities owned beneficially in an investment adviser or principal underwriter of the Fund, or a person (other than a registered investment company) directly or indirectly controlling, controlled by, or under common control with an investment adviser or principal underwriter of the Fund as of December 31, 2003:

| <u>Name of Trustee</u> | <u>Name of Owners and Relationships to Trustee</u> | <u>Company</u> | <u>Title of Class</u> | <u>Value of Securities</u> | <u>Percent of Class</u> |
|------------------------|--|----------------|-----------------------|----------------------------|-------------------------|
| Robert E. Connor       | None.  |                |                       |                            |                         |
| John J. Dalessandro II | None.  |                |                       |                            |                         |
| Hans W. Kertess        | None.  |                |                       |                            |                         |

As of December 14, 2004, the Fund's officers and Trustees as a group owned less than 1% of the outstanding Common Shares.

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As of December 6, 2004, the following persons owned of record the number of Common Shares noted below, representing the indicated percentage of the Fund's outstanding equity securities as of such date. Many of these shares are believed to be held only as nominee. To the knowledge of the Fund, no other person owned of record or beneficially 5% or more of the Fund's outstanding equity securities on such date.

| <u>Shareholder</u>   | <u>Number of Common<br/>Shares</u> | <u>Percentage of the<br/>Fund's outstanding<br/>shares as of<br/>December 6, 2004</u> |
|--|------------------------------------|---|
| First Clearing, LLC<br>901 E. Byrd St., Richmond, VA 23219<br>UBS Financial Services | 2,523,081                          | 6.47%   |
| 1200 Harbor Blvd., Weehawken, NJ 07086   | 7,921,643                          | 20.31%  |

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**Compensation**

Messrs. Connor, Dalessandro and Kertess also serve as Trustees of PIMCO Municipal Income Fund, PIMCO California Municipal Income Fund, PIMCO New York Municipal Income Fund, PIMCO Municipal Income Fund II, PIMCO California Municipal Income Fund II, PIMCO New York Municipal Income Fund II, PIMCO Municipal Income Fund III, PIMCO California Municipal Income Fund III and PIMCO New York Municipal Income Fund III (together, the Municipal Funds ), Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO High Income Fund, PIMCO Corporate Income Fund and PIMCO Floating Rate Income Fund, fifteen closed-end funds for which the Manager serves as investment manager and PIMCO or Nicholas-Applegate Capital Management LLC, each an affiliate of the Manager, serves as portfolio manager. Mr. Connor is a director or trustee, as the case may be, of one open-end investment company (comprising four separate investment portfolios) and one closed-end investment company advised by the Manager. As indicated above, certain of the officers of the Fund are affiliated with the Manager and/or PIMCO.

The Municipal Funds, Nicholas-Applegate Convertible & Income Fund, Nicholas-Applegate Convertible & Income Fund II, PIMCO Corporate Opportunity Fund, PIMCO High Income Fund, PIMCO Corporate Income Fund, PIMCO Floating Rate Income Fund and the Fund (together, the PA Closed-End Funds ) are expected to hold joint meetings of their Boards of Trustees whenever possible. Each Trustee, other than any Trustee who is a director, officer, partner or employee of the Manager, PIMCO or any entity controlling, controlled by or under common control with the Manager or PIMCO, receives compensation for their attendance at joint meetings and their service on Board committees. For their service as Trustees of the PA Closed-End Funds, Messrs. Connor, Dalessandro and Kertess receive \$25,000 for each joint meeting for the first four joint meetings in each year and \$5,000 for each additional joint meeting in such year if the meetings are attended in person. Messrs. Connor, Dalessandro and Kertess receive \$1,000 per joint meeting if the meetings are attended telephonically. For their services as members of various Audit Oversight Committees, Messrs. Connor and Kertess will each receive \$1,000, respectively, per meeting for each of those PA Closed-End Funds for which they serve as Trustee. Mr. Kertess receives \$500 per fund for each of the PA Closed-End Funds for which he serves as Co-chair of the Audit Committee. Trustees will also be reimbursed for meeting-related expenses.

Each Trustee's compensation and other costs of joint meetings will be allocated pro rata among the PA Closed-End Funds for which such Trustee serves as Trustee based on each such Fund's relative net assets, including assets attributable to any AMPS.

It is estimated that the Trustees will receive the amounts set forth in the following table from the Fund for its initial fiscal year ending August 31, 2005. For the calendar year ended December 31, 2003, the Trustees received the compensation set forth in the following table for serving as trustees of other funds in the Fund Complex. Each officer or Trustee who is a director, officer, partner or employee of the Manager, PIMCO or any entity controlling, controlled by or under common control with the Manager or PIMCO serves without any compensation from the Fund.

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| <u>Name of Trustee</u> | <u>Estimated Compensation<br/>from the Fund for<br/>the<br/>Fiscal Year Ending<br/>August 31, 2005*</u> | <u>Total<br/>Compensation<br/>from<br/>the Fund<br/>Complex<br/>Paid to the Trustees<br/>for the Calendar<br/>Year Ending<br/>December 31,<br/>2003</u> |
|------------------------|---|---|
| Robert E. Connor       | \$ 12,000   | \$ 142,350  |
| John J. Dalessandro II | \$ 12,000   | \$ 124,000  |
| Hans W. Kertess        | \$ 12,000   | \$ 84,445   |

\* Since the Fund has not completed its first full fiscal year, compensation is estimated based upon future payments to be made by the Fund during the current fiscal year and upon estimated relative net assets of the PA Closed-End Funds for which the particular Trustee serves.

The Fund has no employees. Its officers are compensated by the Manager and/or PIMCO.

**Codes of Ethics**

The Fund, the Manager and PIMCO have each adopted a separate code of ethics governing personal trading activities of, as applicable, all Trustees and officers of the Fund, and directors, officers and employees of the Manager and PIMCO, who, in connection with their regular functions, play a role in the recommendation of any purchase or sale of a security by the Fund or obtain information pertaining to such purchase or sale or who have the power to influence the management or policies of the Fund, the Manager or PIMCO, as applicable. Such persons are prohibited from effecting certain transactions, allowed to effect certain exempt transactions (including with respect to securities that may be purchased or held by the Fund), and are required to preclear certain security transactions with the applicable compliance officer or his designee and to report certain transactions on a regular basis. The Fund, the Manager and PIMCO have each developed procedures for administration of their respective codes. Text-only versions of the codes of ethics can be viewed online or downloaded from the EDGAR Database on the SEC's internet web site at [www.sec.gov](http://www.sec.gov). You may also review and copy those documents by visiting the SEC's Public Reference Room in Washington, DC. Information on the operation of the Public Reference Room may be obtained by calling the SEC at (202) 942-8090. In addition, copies of the codes of ethics may be obtained, after mailing the appropriate duplicating fee, by writing to the SEC's Public Reference Section, 450 5th Street, N.W., Washington, DC 20549-0102 or by e-mail request at [publicinfo@sec.gov](mailto:publicinfo@sec.gov).

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**INVESTMENT MANAGER AND PORTFOLIO MANAGER**

**Investment Manager**

The Manager serves as investment manager to the Fund pursuant to an investment management agreement (the Investment Management Agreement) between it and the Fund. The Manager is a wholly-owned indirect subsidiary of Allianz Global Investors of America L.P. (AGI). AGI was organized as a limited partnership under Delaware law in 1987. AGI's sole general partner is Allianz-Paclife Partners LLC. Allianz-Paclife Partners LLC is a Delaware limited liability company with three members, ADAM U.S. Holding LLC, a Delaware limited liability company, Pacific Asset Management LLC, a Delaware limited liability company, and Pacific Life Insurance Company (Pacific Life), a California stock life insurance company. Pacific Asset Management LLC is a wholly-owned subsidiary of Pacific Life, which is a wholly-owned subsidiary of Pacific Mutual Holding Company. Pacific Life owns an indirect minority equity interest in AGI. The sole member of ADAM U.S. Holding LLC is Allianz Dresdner Asset Management of America LLC. Allianz Dresdner Asset Management of America LLC has two members, Allianz of America, Inc. (Allianz of America), a Delaware corporation which owns a 99.9% non-managing interest, and Allianz Dresdner Asset Management of America Holding Inc., a Delaware corporation which owns a 0.01% managing interest. Allianz of America is a wholly-owned subsidiary of Allianz Aktiengesellschaft (Allianz AG). Allianz Dresdner Asset Management of America Holding Inc. is a wholly-owned subsidiary of Allianz Dresdner Asset Management Aktiengesellschaft, which is a wholly-owned subsidiary of Allianz AG. Allianz AG indirectly holds a controlling interest in AGI. Allianz AG is a European-based, multinational insurance and financial services holding company. Allianz AG's address is Koeniginstrasse 28, D-80802, Munich, Germany. Pacific Life's address is 700 Newport Center Drive, Newport Beach, California 92660. AGI's address is 888 San Clemente Drive, Suite 100, Newport Beach, California 92660.

The general partner of AGI has substantially delegated its management and control of AGI to an Executive Committee. The Executive Committee of AGI is comprised of William S. Thompson, Jr. and David C. Flattum.

The Manager is located at 1345 Avenue of the Americas, New York, New York 10105. As of September 30, 2004, the Manager had approximately \$33.6 billion in assets under management. As of September 30, 2004, AGI and its subsidiaries, including PIMCO, had approximately \$502 billion in assets under management.

Allianz of America, Inc. (AZOA) has entered into a put/call arrangement for the possible disposition of Pacific Life's indirect interest in AGI. Pursuant to this agreement, in any month subsequent to March 2004, Pacific Life and AZOA can put or call, respectively, all of the Class E Units. The repurchase price for the remaining Class E Units is calculated based on the financial performance of Pacific Investment Management Company over the preceding four calendar quarters prior to repurchase, but the amount can increase or decrease in value by a maximum of 2% per year from the per unit amount as defined in the agreement, calculated as of December 31 of the preceding calendar year.

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As of the date of this Statement of Additional Information, significant institutional shareholders of Allianz AG currently include Munchener Ruckversicherungs-Gesellschaft AG ( Munich Re ). Allianz AG in turn owns Dresdner Bank AG. Munich Re, as well as certain broker-dealers that might be controlled by or affiliated with these entities or Dresdner Bank AG, such as Dresdner Klienwort Wasserstein and Dresdner Kleinwort Benson, may be considered to be affiliated persons of the Manager and PIMCO. (Broker-dealer affiliates of such significant institutional shareholders are sometimes referred to herein as Affiliated Brokers. ) Absent an SEC exemption or other relief, the Fund generally is precluded from effecting principal transactions with the Affiliated Brokers, and its ability to purchase securities being underwritten by an Affiliated Broker or a syndicate including an Affiliated Broker is subject to restrictions. Similarly, the Fund's ability to utilize the Affiliated Brokers for agency transactions is subject to the restrictions of Rule 17e-1 under the 1940 Act. PIMCO does not believe that the restrictions on transactions with the Affiliated Brokers described above will materially adversely affect its ability to provide services to the Fund, the Fund's ability to take advantage of market opportunities, or the Fund's overall performance.

The Manager, subject to the supervision of the Board of Trustees, is responsible for managing, either directly or through others selected by the Manager, the investments of the Fund. The Manager also furnishes to the Board of Trustees periodic reports on the investment performance of the Fund. As more fully discussed below, the Manager has retained PIMCO to serve as the Fund's portfolio manager.

Under the terms of the Investment Management Agreement, subject to such policies as the Trustees of the Fund may determine, the Manager, at its expense, will furnish continuously an investment program for the Fund and will make investment decisions on behalf of the Fund and place all orders for the purchase and sale of portfolio securities subject always to the Fund's investment objective, policies and restrictions; provided that, so long as PIMCO serves as the portfolio manager for the Fund, the Manager's obligation under the Investment Management Agreement with respect to the Fund is, subject always to the control of the Trustees, to determine and review with PIMCO the investment policies of the Fund.

Subject to the control of the Trustees, the Manager also manages, supervises and conducts the other affairs and business of the Fund, furnishes office space and equipment, provides bookkeeping and certain clerical services (excluding determination of the net asset value of the Fund, shareholder accounting services and the accounting services for the Fund) and pays all salaries, fees and expenses of officers and Trustees of the Fund who are affiliated with the Manager. As indicated under Portfolio Transactions Brokerage and Research Services, the Fund's portfolio transactions may be placed with broker-dealers which furnish the Manager and PIMCO, without cost, certain research, statistical and quotation services of value to them or their respective affiliates in advising the Fund or their other clients. In so doing, the Fund may incur greater brokerage commissions and other transactions costs than it might otherwise pay.

Pursuant to the Investment Management Agreement, the Fund has agreed to pay the Manager an annual management fee, payable on a monthly basis, at the annual rate of .75% of the Fund's average weekly total managed assets for the services and facilities it provides. Total managed assets means the total assets of the Fund (including any assets attributable to AMPS and any borrowings that may be outstanding) minus accrued liabilities (other than liabilities



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representing borrowings). All fees and expenses are accrued daily and deducted before payment of dividends to investors.

Except as otherwise described in the Prospectus, the Fund pays, in addition to the investment management fee described above, all expenses not assumed by the Manager, including, without limitation, fees and expenses of Trustees who are not interested persons of the Manager or the Fund, interest charges, taxes, brokerage commissions, expenses of issue of shares, fees and expenses of registering and qualifying the Fund and its classes of shares for distribution under federal and state laws and regulations, charges of custodians, auditing and legal expenses, expenses of determining net asset value of the Fund, reports to shareholders, expenses of meetings of shareholders, expenses of printing and mailing prospectuses, proxy statements and proxies to existing shareholders, and its proportionate share of insurance premiums and professional association dues or assessments. The Fund is also responsible for such nonrecurring expenses as may arise, including litigation in which the Fund may be a party, and other expenses as determined by the Trustees. The Fund may have an obligation to indemnify its officers and Trustees with respect to such litigation.

## **Portfolio Manager**

PIMCO serves as portfolio manager for the Fund pursuant to a portfolio management agreement (the Portfolio Management Agreement) between PIMCO and the Manager. Under the Portfolio Management Agreement, subject always to the control of the Trustees and the supervision of the Manager, PIMCO's obligation is to furnish continuously an investment program for the Fund, to make investment decisions on behalf of the Fund and to place all orders for the purchase and sale of portfolio securities and all other investments for the Fund.

The Manager (and not the Fund) will pay a portion of the fees it receives to PIMCO in return for PIMCO's services. For the period from the commencement of Fund operations through October 31, 2009 (i.e., roughly the first five years of Fund operations), the fee will be paid monthly at the annual rate of .39% of the Fund's average weekly total managed assets, provided, however, that the amounts payable for each month shall be reduced to reflect that PIMCO will bear 65% of the fees payable by the Manager to certain underwriters (other than Merrill Lynch, Pierce, Fenner & Smith Incorporated) for such month. Beginning November 1, 2009 and thereafter, the Manager will pay a monthly fee to PIMCO at the annual rate of .55% of the Fund's average weekly total managed assets, provided, however, that the amounts payable for each month shall be reduced by the amount of all fees payable by the Manager to certain underwriters other than Merrill Lynch, Pierce, Fenner & Smith Incorporated) for such month (such that the Manager retains from its management fee, on an annual basis, .05% of the Fund's average weekly total managed assets, after having paid PIMCO and the underwriters).

Originally organized in 1971, reorganized as a Delaware general partnership in 1994 and reorganized as a Delaware limited liability company in 2000, PIMCO provides investment management and advisory services to private accounts of institutional and individual clients and to mutual funds. The membership interests of PIMCO as of December 1, 2002, were held 91% by AGI and 9% by the managing directors of PIMCO. As of September 30, 2004, PIMCO had approximately \$415 billion in assets under management. PIMCO is located at 840 Newport Center Drive, Newport Beach, California 92660.

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### **Certain Terms of the Investment Management and Portfolio Management Agreements**

The Investment Management Agreement and the Portfolio Management Agreement were each approved by the Trustees of the Fund (including all of the Trustees who are not interested persons of the Manager or PIMCO). The Investment Management Agreement and Portfolio Management Agreement will each continue in force with respect to the Fund for two years from their respective dates, and from year to year thereafter, but only so long as their continuance is approved at least annually by (i) vote, cast in person at a meeting called for that purpose, of a majority of those Trustees who are not interested persons of the Manager, PIMCO or the Fund, and (ii) the majority vote of either the full Board of Trustees or the vote of a majority of the outstanding shares of all classes of the Fund. Each of the Investment Management Agreement and Portfolio Management Agreement automatically terminates on assignment. The Investment Management Agreement may be terminated on not less than 60 days notice by the Manager to the Fund or by the Fund to the Manager. The Portfolio Management Agreement may be terminated on not less than 60 days notice by the Manager to PIMCO or by PIMCO to the Manager, or by the Fund at any time by notice to the Manager and PIMCO.

The Investment Management Agreement and the Portfolio Management Agreement each provide that the Manager or PIMCO, as applicable, shall not be subject to any liability in connection with the performance of its services thereunder in the absence of willful misfeasance, bad faith, gross negligence or reckless disregard of its obligations and duties.

### **Basis for Approval of the Investment Management and Portfolio Management Agreements**

In determining to approve the Investment Management Agreement and the Portfolio Management Agreement, the Trustees met with the relevant investment advisory personnel from the Manager and PIMCO and considered information relating to the education, experience and number of investment professionals and other personnel who would provide services under the applicable agreement. See Management of the Fund in the Prospectus and this Statement of Additional Information. The Trustees also took into account the time and attention to be devoted by senior management to the Fund and the other funds in the complex. The Trustees evaluated the level of skill required to manage the Fund and concluded that the human resources to be available at the Manager and PIMCO were appropriate to fulfill effectively the duties of the Manager and PIMCO on behalf of the Fund under the applicable agreement. The Trustees also considered the business reputation of the Manager and PIMCO, their financial resources and professional liability insurance coverage and concluded that they would be able to meet any reasonably foreseeable obligations under the applicable agreement.

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The Trustees received information concerning the investment philosophy and investment process to be applied by PIMCO in managing the Fund. In this connection, the Trustees considered PIMCO's in-house research capabilities as well as other resources available to PIMCO's personnel, including research services available to PIMCO as a result of securities transactions effected for the Fund and other investment advisory clients. The Trustees concluded that PIMCO's investment process, research capabilities and philosophy were well suited to the Fund, given the Fund's investment objective and policies.

The Trustees considered the scope of the services provided by the Manager and PIMCO to the Fund under the Investment Management Agreement and Portfolio Management Agreement, respectively, relative to services provided by third parties to other mutual funds. The Trustees noted that the Manager's and PIMCO's standard of care was comparable to that found in most investment company advisory agreements. See

Certain Terms of the Investment Management and Portfolio Management Agreements above. The Trustees concluded that the scope of the Manager's and PIMCO's services to be provided to the Fund was consistent with the Fund's operational requirements, including, in addition to its investment objective, compliance with the Fund's investment restrictions, tax and reporting requirements and related shareholder services.

The Trustees considered the quality of the services to be provided by the Manager and PIMCO to the Fund. The Trustees also evaluated the procedures of the Manager and PIMCO designed to fulfill their fiduciary duty to the Fund with respect to possible conflicts of interest, including their codes of ethics (regulating the personal trading of their officers and employees) (see Management of the Fund Code of Ethics above), the procedures by which PIMCO allocates trades among its various investment advisory clients, the integrity of the systems in place to ensure compliance with the foregoing and the record of PIMCO in these matters. The Trustees also received information concerning standards of the Manager and PIMCO with respect to the execution of portfolio transactions. See Portfolio Transactions below.

In approving the agreements, the Trustees also gave substantial consideration to the fees payable under the agreements. The Trustees reviewed information concerning fees paid to investment advisers of similar bond funds. The Trustees also considered the fees of the Fund as a percentage of assets at different asset levels and possible economies of scale to the Manager. The Trustees evaluated the Manager's profitability with respect to the Fund, concluding that such profitability was not inconsistent with levels of profitability that had been determined by courts not to be excessive. In evaluating the Fund's advisory fees, the Trustees also took into account the complexity of investment management for the Fund relative to other types of funds.

## **Proxy Voting Policies**

The Fund and its Board of Trustees have delegated to the Manager, and the Manager has in turn delegated to PIMCO, responsibility for voting any proxies relating to portfolio securities held by the Fund in accordance with PIMCO's proxy voting policies and procedures. A copy of the proxy voting policies and procedures to be followed by PIMCO on behalf of the Fund, including procedures to be used when a vote represents a conflict of interest, is attached hereto as Appendix B ( Proxy Voting Policies ). Information regarding how the Fund voted proxies relating to

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portfolio securities during the 12 months ending June 30 will be available without charge upon request and on the SEC's website ([www.sec.gov](http://www.sec.gov)).

**PORTFOLIO TRANSACTIONS**

**Investment Decisions and Portfolio Transactions**

Investment decisions for the Fund and for the other investment advisory clients of the Manager and PIMCO are made with a view to achieving their respective investment objective. Investment decisions are the product of many factors in addition to basic suitability for the particular client involved (including the Fund). Some securities considered for investments by the Fund may also be appropriate for other clients served by the Manager and PIMCO. Thus, a particular security may be bought or sold for certain clients even though it could have been bought or sold for other clients at the same time. If a purchase or sale of securities consistent with the investment policies of the Fund and one or more of these clients served by the Manager or PIMCO is considered at or about the same time, transactions in such securities will be allocated among the Fund and clients in a manner deemed fair and reasonable by the Manager or PIMCO, as applicable. The Manager or PIMCO may aggregate orders for the Fund with simultaneous transactions entered into on behalf of its other clients so long as price and transaction expenses are averaged either for that transaction or for the day. Likewise, a particular security may be bought for one or more clients when one or more clients are selling the security. In some instances, one client may sell a particular security to another client. It also sometimes happens that two or more clients simultaneously purchase or sell the same security, in which event each day's transactions in such security are, insofar as possible, averaged as to price and allocated between such clients in a manner which the Manager or PIMCO believes is equitable to each and in accordance with the amount being purchased or sold by each. There may be circumstances when purchases or sales of portfolio securities for one or more clients will have an adverse effect on other clients.

**Brokerage and Research Services**

There is generally no stated commission in the case of debt securities, which are traded in the over-the-counter markets, but the price paid by the Fund usually includes an undisclosed dealer commission or mark-up. In underwritten offerings, the price paid by the Fund includes a disclosed, fixed commission or discount retained by the underwriter or dealer. Transactions on U.S. stock exchanges and other agency transactions involve the payment by the Fund of negotiated brokerage commissions. Such commissions vary among different brokers. Also, a particular broker may charge different commissions according to such factors as the difficulty and size of the transaction.

Subject to the supervision of the Manager, PIMCO places all orders for the purchase and sale of portfolio securities, options, futures contracts and other instruments for the Fund and buys and sells such securities, options, futures contracts and other instruments for the Fund through a substantial number of brokers and dealers. In so doing, PIMCO uses its best efforts to obtain for the Fund the most favorable price and execution available, except to the extent it may be permitted to pay higher brokerage commissions as described below. In seeking the most favorable price and

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execution, PIMCO, having in mind the Fund's best interests, considers all factors it deems relevant, including, by way of illustration, price, the size of the transaction, the nature of the market for the security, the amount of the commission, the timing of the transaction taking into account market prices and trends, the reputation, experience and financial stability of the broker-dealer involved and the quality of service rendered by the broker-dealer in other transactions.

Subject to the supervision of the Manager, PIMCO places orders for the purchase and sale of portfolio investments for the Fund's account with brokers or dealers selected by it in its discretion. In effecting purchases and sales of portfolio securities for the account of the Fund, PIMCO will seek the best price and execution of the Fund's orders. In doing so, the Fund may pay higher commission rates than the lowest available when PIMCO believes it is reasonable to do so in light of the value of the brokerage and research services provided by the broker effecting the transaction, as discussed below.

It has for many years been a common practice in the investment advisory business for advisers of investment companies and other institutional investors to receive research services from broker-dealers which execute portfolio transactions for the clients of such advisers. Consistent with this practice, PIMCO may receive research services from many broker-dealers with which PIMCO places the Fund's portfolio transactions. PIMCO may also receive research or research credits from brokers which are generated from underwriting commissions when purchasing new issues of debt securities or other assets for the Fund. These services, which in some cases may also be purchased for cash, include such matters as general economic and security market reviews, industry and company reviews, evaluations of securities and recommendations as to the purchase and sale of securities. Some of these services are of value to PIMCO in advising various of its clients (including the Fund), although not all of these services are necessarily useful and of value in managing the Fund. Neither the management fee paid by the Fund to the Manager nor the portfolio management fee paid by the Manager to PIMCO is reduced because PIMCO and its affiliates receive such services.

As permitted by Section 28(e) of the Securities Exchange Act of 1934, PIMCO may cause the Fund to pay a broker-dealer which provides brokerage and research services (as defined in such Act) to PIMCO an amount of disclosed commission for effecting a securities transaction for the Fund in excess of the commission which another broker-dealer would have charged for effecting that transaction.

The Fund may use broker-dealers that are affiliates (or affiliates of affiliates) of the Fund, the Manager and/or PIMCO, subject to certain restrictions discussed above under "Investment Manager and Portfolio Manager" Investment Manager.

References to PIMCO in this section would apply equally to the Manager if the Manager were to assume portfolio management responsibilities for the Fund and place orders for the purchase and sale of the Fund's portfolio investments.

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**DISTRIBUTIONS**

See **Description of AMPS Dividends and Rate Periods** and **Description of Capital Structure** in the Prospectus for information relating to distributions made to Fund shareholders.

For tax purposes, the Fund is currently required to allocate net capital gain and other taxable income, if any, between and among Common Shares, the Series M AMPS, the Series T AMPS, the Series W AMPS, the Series TH AMPS and the Series F AMPS in proportion to total distributions paid to each class for the year in which such net capital gain or other taxable income is realized.

While any AMPS are outstanding, the Fund may not declare any cash dividend or other distribution on its Common Shares unless at the time of such declaration (1) all accumulated dividends on the AMPS have been paid and (2) the net asset value of the Fund's portfolio (determined after deducting the amount of such dividend or other distribution) is at least 200% of the liquidation value of any outstanding AMPS. This latter limitation on the Fund's ability to make distributions on its Common Shares could cause the Fund to incur income and excise tax and, under certain circumstances, impair the ability of the Fund to maintain its qualification for taxation as a regulated investment company. See **Tax Matters**.

The Board of Trustees has declared a dividend of \$0.09125 per Common Share payable on January 7, 2005.

**DESCRIPTION OF SHARES**

**Common Shares**

The Fund's Declaration authorizes the issuance of an unlimited number of Common Shares. The Common Shares currently outstanding have been issued with a par value of \$0.00001 per share. All Common Shares of the Fund have equal rights as to the payment of dividends and the distribution of assets upon liquidation of the Fund. The Common Shares currently outstanding have been fully paid and, subject to matters discussed in **Anti-Takeover and Other Provisions in the Declaration of Trust Shareholder Liability** below, are non-assessable, and have no pre-emptive or conversion rights or rights to cumulative voting. At any time when the Fund's AMPS or any other preferred shares of beneficial interest are outstanding, Common Shareholders will not be entitled to receive any distributions from the Fund unless all accrued dividends on AMPS and any other preferred shares of beneficial interest have been paid, and unless asset coverage (as defined in the 1940 Act) with respect to AMPS and any other preferred shares of beneficial interest would be at least 200% after giving effect to such distributions. See **AMPS** below and **Description of AMPS Dividends and Dividend Periods Restrictions on Dividends and Other Distributions** and **Description of Capital Structure** in the Prospectus.

The Common Shares are listed on the New York Stock Exchange. The Fund intends to hold annual meetings of shareholders so long as the Common Shares are listed on a national securities exchange and such meetings are required as a condition to such listing.

## Edgar Filing: PIMCO Floating Rate Strategy Fund - Form 497

Shares of closed-end investment companies may frequently trade at prices lower than net asset value. Shares of closed-end investment companies have during some periods traded at prices

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higher than net asset value and during other periods traded at prices lower than net asset value. There can be no assurance that Common Shares or shares of other similar funds will trade at a price higher than net asset value in the future. Net asset value will be reduced immediately following any offering of AMPS by the costs of that offering paid by the Fund. Net asset value generally increases when interest rates decline, and decreases when interest rates rise, and these changes are likely to be greater in the case of a fund, such as the Fund, having a leveraged capital structure. Whether investors will realize gains or losses upon the sale of Common Shares will not depend upon the Fund's net asset value but will depend entirely upon whether the market price of the Common Shares at the time of sale is above or below the original purchase price for such Common Shares. Since the market price of the Fund's Common Shares will be determined by factors beyond the control of the Fund, the Fund cannot predict whether the Common Shares will trade at, below, or above net asset value or at, below or above the initial public offering price. Accordingly, the Common Shares are designed primarily for long-term investors, and investors in the Common Shares should not view the Fund as a vehicle for trading purposes. See Repurchase of Common Shares; Conversion to Open-End Fund.

**AMPS**

See Description of AMPS and Description of Capital Structure in the Prospectus for information relating to the AMPS.

As used in this Statement of Additional Information and in the Prospectus, unless otherwise noted, the Fund's net assets include assets of the Fund attributable to any outstanding AMPS, with no deduction for the liquidation preference of the AMPS. Solely for financial reporting purposes, however, the Fund is required to exclude the liquidation preference of AMPS from net assets, so long as the AMPS have redemption features that are not solely within the control of the Fund. For all regulatory and tax purposes, the Fund's AMPS will be treated as stock (rather than indebtedness).



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**ADDITIONAL INFORMATION CONCERNING**

**THE AUCTIONS FOR PREFERRED SHARES**

**General**

*Auction Agency Agreement.* The Fund will enter into an auction agency agreement with the auction agent (currently Deutsche Bank Trust Company Americas) which provides, among other things, that the auction agent will follow the auction procedures set forth in the Bylaws for purposes of determining the applicable rate for AMPS whenever the applicable rate for such shares is to be based on the results of an auction.

*Broker-Dealer Agreements.* Each auction requires the participation of one or more broker-dealers that have entered into separate agreements with the auction agent. The auction agent will enter into broker-dealer agreements with one or more broker-dealers selected by the Fund that provide for the participation of those broker-dealers in auctions for AMPS.

*Securities Depository.* The Depository Trust Company ( DTC ) will act as securities depository for the agent members (defined below) with respect to the AMPS. One certificate for the AMPS will be registered in the name of Cede & Co., as nominee of DTC. Such certificate will bear a legend to the effect that such certificate is issued subject to the provisions restricting transfers of AMPS contained in the Bylaws. Cede & Co. will be the holder of record of all AMPS, and owners of the AMPS will not be entitled to receive certificates representing their ownership interest in the AMPS.

DTC, a New York-chartered limited purpose trust company, performs services for its participants, some of whom (and/or their representatives) own DTC. DTC maintains lists of its participants and will maintain the positions (ownership interests) held by each applicable participant (the agent member ) in AMPS, whether for its own account or as a nominee for another person. A copy of the Fund's agreement with DTC is included as an Exhibit to the Registration Statement of which this Statement of Additional Information forms a part.

**Auction Agent**

The auction agent will act as agent for the Fund in connection with auctions. In the absence of bad faith or negligence on its part, the auction agent will not be liable for any action taken, suffered, or omitted or for any error of judgment made by it in the performance of its duties under the auction agency agreement.

The auction agent shall maintain a current registry of the existing holders of the AMPS for purposes of each individual auction. The auction agent may rely upon, as evidence of the identities of the existing holders, the list of the initial existing holders of AMPS and the broker-dealer of each such existing holder through which such existing holder purchased such shares, supplied to it by the Fund. The auction agent may also rely upon, as evidence of the identities of the existing holders the results of each auction and notices from any existing holder, the agent member of any existing holder or the broker-dealer of any existing holder with respect to such existing holder's transfer of any AMPS to another person.



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The auction agent may terminate the auction agency agreement upon notice to the Fund on a date no earlier than 60 days after such notice. If the auction agent should resign, the Fund will attempt to appoint a successor auction agent. The Fund may remove the auction agent provided that prior to such removal the Fund shall have entered into an agreement with a successor auction agent.

**Broker-Dealers**

After each auction for the AMPS, the auction agent will pay to each broker-dealer, from funds provided by the Fund, a service charge that will generally be at the annual rate of 1/4 of 1% of the stated value (\$25,000) of the AMPS held by such broker-dealer's customers upon settlement in such auction.

The broker-dealer agreement provides that a broker-dealer may submit orders in auctions for its own account. If a broker-dealer submits an order for its own account in any auction, it might have an advantage over other bidders because it would have knowledge of all orders submitted by it in that auction; such broker-dealer, however, would not have knowledge of orders submitted by other broker-dealers in that auction.

The Fund may request the auction agent to terminate one or more broker-dealer agreements at any time, provided that at least one broker-dealer agreement is in effect after such termination.

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**ANTI-TAKEOVER AND OTHER PROVISIONS IN THE DECLARATION OF  
TRUST**

**Shareholder Liability**

Under Massachusetts law, shareholders could, under certain circumstances, be held personally liable for the obligations of the Fund. However, the Declaration contains an express disclaimer of shareholder liability for acts or obligations of the Fund and requires that notice of such disclaimer be given in each agreement, obligation or instrument entered into or executed by the Fund or the Trustees. The Declaration also provides for indemnification out of the Fund's property for all loss and expense of any shareholder held personally liable on account of being or having been a shareholder. Thus, the risk of a shareholder incurring financial loss on account of shareholder liability is limited to circumstances in which such disclaimer is inoperative or the Fund is unable to meet its obligations, and thus should be considered remote.

**Anti-Takeover Provisions**

As described below, the Declaration includes provisions that could have the effect of limiting the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Trustees, and could have the effect of depriving shareholders of opportunities to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund.

The Fund's Trustees are divided into three classes (Class I, Class II and Class III), having initial terms of one, two and three years, respectively. At each annual meeting of shareholders, the term of one class will expire and each Trustee elected to that class will hold office for a term of three years. The classification of the Board of Trustees in this manner could delay for an additional year the replacement of a majority of the Board of Trustees. In addition, the Declaration provides that a Trustee may be removed only for cause and only (i) by action of at least seventy-five percent (75%) of the outstanding shares of the classes or series of shares entitled to vote for the election of such Trustee, or (ii) by at least seventy-five percent (75%) of the remaining Trustees.

Except as provided in the next paragraph, the affirmative vote or consent of at least seventy-five percent (75%) of the Board of Trustees and at least seventy-five percent (75%) of the shares of the Fund outstanding and entitled to vote thereon are required to authorize any of the following transactions (each a "Material Transaction"): (1) a merger, consolidation or share exchange of the Fund or any series or class of shares of the Fund with or into any other person or company, or of any such person or company with or into the Fund or any such series or class of shares; (2) the issuance or transfer by the Fund or any series or class of shares (in one or a series of transactions in any twelve-month period) of any securities of the Fund or such series or class to any other person or entity for cash, securities or other property (or combination thereof) having an aggregate fair market value of \$1,000,000 or more, excluding sales of securities of the Fund or such series or class in connection with a public offering, issuances of securities of the Fund or such series or class pursuant to a dividend reinvestment plan adopted by the Fund and issuances of securities of the Fund or such series or class upon the exercise of any stock subscription rights distributed by the Fund; or (3) a sale, lease, exchange, mortgage, pledge, transfer or other disposition by the Fund or any series or class of shares (in one or a series of transactions in any

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twelve-month period) to or with any person of any assets of the Fund or such series or class having an aggregate fair market value of \$1,000,000 or more, except for transactions in securities effected by the Fund or such series or class in the ordinary course of its business. The same affirmative votes are required with respect to any shareholder proposal as to specific investment decisions made or to be made with respect to the Fund's assets or the assets of any series or class of shares of the Fund.

Notwithstanding the approval requirements specified in the preceding paragraph, the Declaration requires no vote or consent of the Fund's shareholders to authorize a Material Transaction if the transaction is approved by a vote of both a majority of the Board of Trustees and seventy-five percent (75%) of the Continuing Trustees (as defined below), so long as all other conditions and requirements, if any, provided for in the Fund's Bylaws and applicable law (including any shareholder voting rights under the 1940 Act) have been satisfied.

In addition, the Declaration provides that the Fund may be terminated at any time by vote or consent of at least seventy-five percent (75%) of the Fund's shares or, alternatively, by vote or consent of both a majority of the Board of Trustees and seventy-five percent (75%) of the Continuing Trustees (as defined below).

In certain circumstances, the Declaration also imposes shareholder voting requirements that are more demanding than those required under the 1940 Act in order to authorize a conversion of the Fund from a closed-end to an open-end investment company. See *Repurchase of Common Shares; Conversion to Open-End Fund* below.

As noted, the voting provisions described above could have the effect of depriving Common Shareholders of an opportunity to sell their Common Shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund in a tender offer or similar transaction. In the view of the Fund's Board of Trustees, however, these provisions offer several possible advantages, including: (1) requiring persons seeking control of the Fund to negotiate with its management regarding the price to be paid for the amount of Common Shares required to obtain control; (2) promoting continuity and stability; and (3) enhancing the Fund's ability to pursue long-term strategies that are consistent with its investment objective and management policies. The Board of Trustees has determined that the voting requirements described above, which are generally greater than the minimum requirements under the 1940 Act, are in the best interests of the Fund's Common Shareholders generally.

A Continuing Trustee, as used in the discussion above, is any member of the Fund's Board of Trustees who either (i) has been a member of the Board for a period of at least thirty-six months (or since the commencement of the Fund's operations, if less than thirty-six months) or (ii) was nominated to serve as a member of the Board of Trustees by a majority of the Continuing Trustees then members of the Board.

The foregoing is intended only as a summary and is qualified in its entirety by reference to the full text of the Declaration and the Fund's Bylaws, both of which have been filed as exhibits to the Fund's registration statement on file with the SEC.

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### **Liability of Trustees**

The Declaration provides that the obligations of the Fund are not binding upon the Trustees of the Fund individually, but only upon the assets and property of the Fund, and that the Trustees shall not be liable for errors of judgment or mistakes of fact or law. Nothing in the Declaration, however, protects a Trustee against any liability to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard of the duties involved in the conduct of his office.

### **REPURCHASE OF COMMON SHARES; CONVERSION TO OPEN-END FUND**

The Fund is a closed-end investment company and as such its shareholders will not have the right to cause the Fund to redeem their shares. Instead, the Fund's Common Shares will trade in the open market at a price that will be a function of several factors, including dividend levels (which are in turn affected by changes in the floating rates of interest on the Fund's investments and expenses), net asset value, call protection, price, relative demand for and supply of such shares in the market, general market and economic conditions and other factors. Shares of a closed-end investment company may frequently trade at prices lower than net asset value. The Fund's Board of Trustees regularly monitors the relationship between the market price and net asset value of the Common Shares. If the Common Shares were to trade at a substantial discount to net asset value for an extended period of time, the Board may consider the repurchase of its Common Shares on the open market or in private transactions, or the making of a tender offer for such shares. There can be no assurance, however, that the Board of Trustees will decide to take or propose any of these actions, or that share repurchases or tender offers, if undertaken, will reduce market discount. The Fund has no present intention to repurchase its Common Shares and would do so only in the circumstances described in this section.

Notwithstanding the foregoing, at any time when the Fund's AMPS are outstanding, the Fund may not purchase, redeem or otherwise acquire any of its Common Shares unless (1) all accrued dividends on AMPS have been paid and (2) at the time of such purchase, redemption or acquisition, the net asset value of the Fund's portfolio (determined after deducting the acquisition price of the Common Shares) is at least 200% of the liquidation value of the outstanding AMPS (expected to equal the original purchase price per share plus any accrued and unpaid dividends thereon).

Subject to its investment limitations, the Fund may borrow to finance the repurchase of shares or to make a tender offer. Interest on any borrowings to finance share repurchase transactions or the accumulation of cash by the Fund in anticipation of share repurchases or tenders will reduce the Fund's net income. Any share repurchase, tender offer or borrowing that might be approved by the Board of Trustees would have to comply with the Securities Exchange Act of 1934, as amended, and the 1940 Act and the rules and regulations thereunder.

The Fund's Board of Trustees may also from time to time consider submitting to the holders of the shares of beneficial interest of the Fund a proposal to convert the Fund to an open-end investment company. In determining whether to exercise its sole discretion to submit this issue to shareholders, the Board of Trustees would consider all factors then relevant, including the relationship of the market price of the Common Shares to net asset value, the extent to which the

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Fund's capital structure is leveraged and the possibility of re-leveraging, the spread, if any, between the yields on securities in the Fund's portfolio and interest and dividend charges on AMPS issued by the Fund and general market and economic conditions.

The Declaration requires the affirmative vote or consent of holders of at least seventy-five percent (75%) of each class of the Fund's shares entitled to vote on the matter to authorize a conversion of the Fund from a closed-end to an open-end investment company, unless the conversion is authorized by both a majority of the Board of Trustees and seventy-five percent (75%) of the Continuing Trustees (as defined above under "Anti-Takeover and Other Provisions in the Declaration of Trust" "Anti-Takeover Provisions"). This seventy-five percent (75%) shareholder approval requirement is higher than is required under the 1940 Act. In the event that a conversion is approved by the Trustees and the Continuing Trustees as described above, the minimum shareholder vote required under the 1940 Act would be necessary to authorize the conversion. Currently, the 1940 Act would require approval of the holders of a majority of the outstanding Common Shares and, if issued, AMPS voting together as a single class, and the holders of a majority of the outstanding AMPS voting as a separate class, in order to authorize a conversion.

If the Fund converted to an open-end company, it would be required to redeem all AMPS then outstanding (requiring in turn that it liquidate a portion of its investment portfolio), and the Fund's Common Shares likely would no longer be listed on the New York Stock Exchange. Shareholders of an open-end investment company may require the company to redeem their shares on any business day (except in certain circumstances as authorized by or under the 1940 Act) at their net asset value, less such redemption charge, if any, as might be in effect at the time of redemption. In order to avoid maintaining large cash positions or liquidating favorable investments to meet redemptions, open-end companies typically engage in a continuous offering of their shares. Open-end companies are thus subject to periodic asset in-flows and out-flows that can complicate portfolio management.

The repurchase by the Fund of its shares at prices below net asset value will result in an increase in the net asset value of those shares that remain outstanding. However, there can be no assurance that share repurchases or tenders at or below net asset value will result in the Fund's shares trading at a price equal to their net asset value. Nevertheless, the fact that the Fund's shares may be the subject of repurchase or tender offers at net asset value from time to time, or that the Fund may be converted to an open-end company, may reduce any spread between market price and net asset value that might otherwise exist.

In addition, a purchase by the Fund of its Common Shares will decrease the Fund's total assets. This would likely have the effect of increasing the Fund's expense ratio. Any purchase by the Fund of its Common Shares at a time when AMPS are outstanding will increase the leverage applicable to the outstanding Common Shares then remaining. See the Prospectus under "Risks" "General Risks of Investing in the Fund" "Leverage Risk."

Before deciding whether to take any action if the Fund's Common Shares trade below net asset value, the Board of Trustees would consider all relevant factors, including the extent and duration of the discount, the liquidity of the Fund's portfolio, the impact of any action that might be taken on the Fund or its shareholders and market considerations. Based on these

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considerations, even if the Fund's shares should trade at a discount, the Board of Trustees may determine that, in the interest of the Fund and its shareholders, no action should be taken.

**TAX MATTERS**

*Taxation of the Fund.* The Fund intends to elect to be treated and to qualify each year as a regulated investment company under Subchapter M of the Code. In order to qualify for the special tax treatment accorded regulated investment companies and their shareholders, the Fund must, among other things:

(a) derive at least 90% of its gross income for each taxable year from dividends, interest, payments with respect to certain securities loans, and gains from the sale or other disposition of stock, securities or foreign currencies, or other income (including but not limited to gains from options, futures, or forward contracts) derived with respect to its business of investing in such stock, securities, or currencies;

(b) distribute with respect to each taxable year at least 90% of the sum of its investment company taxable income (as that term is defined in the Code without regard to the deduction for dividends paid generally, taxable ordinary income and the excess, if any, of net short-term capital gains over net long-term capital losses) and net tax-exempt interest income, for such year; and

(c) diversify its holdings so that, at the end of each quarter of the Fund's taxable year, (i) at least 50% of the market value of the Fund's total assets is represented by cash and cash items, U.S. Government securities, securities of other regulated investment companies, and other securities limited in respect of any one issuer to a value not greater than 5% of the value of the Fund's total assets and not more than 10% of the outstanding voting securities of such issuer, and (ii) not more than 25% of the value of the Fund's total assets is invested (x) in the securities (other than those of the U.S. Government or other regulated investment companies) of any one issuer or of two or more issuers which the Fund controls and which are engaged in the same, similar, or related trades or businesses, or (y) in the securities of one or more qualified publicly traded partnerships (as defined below). In the case of the Fund's investments in loan participations, the Fund shall treat a financial intermediary as an issuer for the purposes of meeting this diversification requirement.

In general, for purposes of the 90% gross income requirement described in paragraph (a) above, income derived from a partnership will be treated as qualifying income only to the extent such income is attributable to items of income of the partnership which would be qualifying income if realized by the regulated investment company. However, the American Jobs Creation Act of 2004 (the 2004 Act), provides that for taxable years of a regulated investment company beginning after October 22, 2004, 100% of the net income derived from an interest in a qualified publicly traded partnership (defined as a partnership (i) interests in which are traded on an established securities market or readily tradable on a secondary market or the substantial equivalent thereof and (ii) that derives less than 90% of its income from the qualifying income described in paragraph (a) above) will be treated as qualifying income. In addition, although in general the passive loss rules of the Code do not apply to regulated investment companies, such rules do apply



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to a regulated investment company with respect to items attributable to an interest in a qualified publicly traded partnership. Finally, for purposes of paragraph (c) above, the term outstanding voting securities of such issuer will include the equity securities of a qualified publicly traded partnership.

If the Fund qualifies as a regulated investment company that is accorded special tax treatment, the Fund will not be subject to federal income tax on income distributed in a timely manner to its shareholders in the form of dividends (including Capital Gain Dividends, as defined below).

If the Fund failed to qualify as a regulated investment company accorded special tax treatment in any taxable year, the Fund would be subject to tax on its taxable income at corporate rates, and all distributions from earnings and profits, including any distributions of net tax-exempt income and net long-term capital gains, would be taxable to shareholders as ordinary income. Some portions of such distributions may be eligible for the dividends received deduction in the case of corporate shareholders and reduced rates of taxation on qualified dividend income in the case of individuals. In addition, the Fund could be required to recognize unrealized gains, pay substantial taxes and interest and make substantial distributions before requalifying as a regulated investment company that is accorded special tax treatment.

The Fund intends to distribute at least annually to its shareholders all or substantially all of its investment company taxable income and any net tax-exempt interest, and may distribute its net capital gain. The Fund may also retain for investment its net capital gain. If the Fund does retain any net capital gain or any investment company taxable income, it will be subject to tax at regular corporate rates on the amount retained. If the Fund retains any net capital gain, it may designate the retained amount as undistributed capital gains in a notice to its shareholders who, if subject to federal income tax on long-term capital gains, (i) will be required to include in income for federal income tax purposes, as long-term capital gain, their shares of such undistributed amount, and (ii) will be entitled to credit their proportionate shares of the tax paid by the Fund on such undistributed amount against their federal income tax liabilities, if any, and to claim refunds to the extent the credit exceeds such liabilities. For federal income tax purposes, the tax basis of shares owned by a shareholder of the Fund will be increased by an amount equal under current law to the difference between the amount of undistributed capital gains included in the shareholder's gross income and the tax deemed paid by the shareholder under clause (ii) of the preceding sentence.

Treasury regulations permit a regulated investment company, in determining its investment company taxable income and net capital gain, to elect to treat all or part of any net capital loss, any net long-term capital loss or any net foreign currency loss incurred after October 31 as if it had been incurred in the succeeding year.

If the Fund fails to distribute in a calendar year at least an amount equal to the sum of 98% of its ordinary income for such year and 98% of its capital gain net income for the one-year period ending on October 31 of such year, plus any retained amount from the prior year, the Fund will be subject to a nondeductible 4% excise tax on the undistributed amounts. For these purposes, the Fund will be treated as having distributed any amount for which it is subject to income tax. A dividend paid to shareholders in January of a year generally is deemed to have been paid by the Fund on December 31 of the preceding year, if the dividend was declared and payable to

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shareholders of record on a date in October, November or December of that preceding year. The Fund intends generally to make distributions sufficient to avoid imposition of the 4% excise tax.

*Fund Distributions.* For federal income tax purposes, distributions of investment income are generally taxable as ordinary income to the extent of the Fund's current and accumulated earnings and profits. Taxes on distributions of capital gains are determined by how long the Fund owned the investments that generated them, rather than how long a shareholder has owned his or her shares. Distributions of net capital gains from the sale of investments that the Fund owned for more than one year and that are properly designated by the Fund as capital gain dividends ( Capital Gain Dividends ) will be taxable as long-term capital gains. Distributions from capital gains are generally made after applying any available capital loss carryovers. Capital losses may be carried forward to each of the eight taxable years succeeding the loss year. Distributions of gains from the sale of investments that the Fund owned for one year or less will be taxable as ordinary income.

For taxable years beginning on or before December 31, 2008, the Fund may designate distributions of investment income derived from dividends of U.S. corporations and certain qualified foreign corporations as qualified dividend income, provided holding period and other requirements are met by the Fund. Qualified dividend income will be taxed in the hands of individuals at the rates applicable to long-term capital gain, provided the shareholder meets the same holding period and other requirements with respect to qualified dividend income. Fund dividends representing distributions of interest income and short-term capital gains cannot be designated as qualified dividend income and will not qualify for the reduced rates. In light of this, the Fund does not expect a significant portion of Fund distributions to be derived from qualified dividend income.

Distributions are taxable to shareholders even if they are paid from income or gains earned by the Fund before a shareholder's investment (and thus were included in the price the shareholder paid). Distributions are taxable whether shareholders receive them in cash or reinvest them in additional shares through the Dividend Reinvestment Plan. A shareholder whose distributions are reinvested in shares will be treated as having received a dividend equal to either (i) the fair market value of the new shares issued to the shareholder, or (ii) if the shares are trading below net asset value, the amount of cash allocated to the shareholder for the purchase of shares on its behalf in the open market. Any gain resulting from the sale or exchange of Fund shares generally will be taxable as capital gains.

The long-term capital gain rates applicable to most individual shareholders will be 15% (with lower rates applying to taxpayers in the 10% and 15% ordinary income tax brackets) for taxable years beginning on or before December 31, 2008.

Dividends of net investment income designated by the Fund and received by corporate shareholders of the Fund will qualify for the 70% dividends received deduction generally available to corporations to the extent of the amount of qualifying dividends received by the Fund from domestic corporations for the taxable year. It is not expected that any significant percentage of the Fund's distributions will so qualify.

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The Internal Revenue Service currently requires that a regulated investment company that has two or more classes of stock allocate to each such class proportionate amounts of each type of its income (such as ordinary income and capital gains) based upon the percentage of total dividends distributed to each class for the tax year. Accordingly, the Fund intends each year to allocate Capital Gain Dividends between and among its Common Shares, Series M AMPS, Series T AMPS, Series W AMPS, Series TH AMPS and Series F AMPS in proportion to the total dividends paid to each class with respect to such tax year. Dividends qualifying and not qualifying for the dividends received deduction or reduced rates applicable to qualified dividend income will similarly be allocated between and among any such classes.

Existing authorities do not specifically address whether dividends that are paid following the close of a taxable year, but that are treated for tax purposes as derived from the income of such prior taxable year, are treated as dividends paid during such prior taxable year or the taxable year of payment for purposes of determining each class proportionate share of a particular type of income. The Fund currently intends to treat such dividends as having been paid in taxable year of payment for purposes of determining each class proportionate share of a particular type of income with respect to such prior taxable year. Existing authorities also do not specifically address the allocation of taxable income among the dividends paid to holders of a class of shares during or with respect to a taxable year. It is possible that the IRS could disagree with the Fund's position concerning the treatment of dividends paid after the close of a taxable year or with the Fund's method of allocation, in which case the IRS could attempt to recharacterize a portion of the dividends paid to the holders of AMPS. If the IRS were to prevail with respect to any such attempted recharacterization, holders of AMPS could be subject to additional tax on amounts so recharacterized and the Fund could be subject to federal income and excise tax.

*Return of Capital Distributions.* If the Fund makes a distribution to a shareholder in excess of the Fund's current and accumulated earnings and profits (including earnings and profits arising from tax-exempt income) in any taxable year, the excess distribution will be treated as a return of capital to the extent of such shareholder's tax basis in its shares, and thereafter as capital gain. A return of capital is not taxable, but it reduces a shareholder's tax basis in its shares, thus reducing any loss or increasing any gain on a subsequent taxable disposition by the shareholder of its shares. Where one or more such distributions occur in any taxable year of the Fund, the available earnings and profits will be allocated, first, to the distributions made to the holders of AMPS, and only thereafter to distributions made to holders of Common Shares. As a result, the holders of AMPS will receive a disproportionate share of the distributions treated as dividends, and the holders of the Common Shares will receive a disproportionate share of the distributions treated as a return of capital. Although the Fund may generate tax-exempt income, it does not expect to satisfy the criteria necessary to pass through the tax-free nature of the income to its shareholders.

Dividends and distributions on the Fund's shares are generally subject to federal income tax as described herein to the extent they do not exceed the Fund's realized income and gains, even though such dividends and distributions may economically represent a return of a particular shareholder's investment. Such distributions are likely to occur in respect of shares purchased at a time when the Fund's net asset value reflects gains that are either unrealized, or realized but not distributed. Such realized gains may be required to be distributed even when the Fund's net asset value also reflects unrealized losses.

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*Sale or Redemption of Shares.* The sale, exchange or redemption of Fund shares may give rise to a gain or loss. In general, any gain or loss realized upon a taxable disposition of shares will be treated as long-term capital gain or loss if the shares have been held for more than one year. Otherwise, the gain or loss on the taxable disposition of Fund shares will be treated as short-term capital gain or loss. However, any loss realized upon a taxable disposition of shares held for six months or less will be treated as long-term, rather than short-term, to the extent of any long-term capital gain distributions received (or deemed received) by the shareholder with respect to the shares. All or a portion of any loss realized upon a taxable disposition of Fund shares will be disallowed if other substantially identical shares of the Fund are purchased within 30 days before or after the disposition. In such a case, the basis of the newly purchased shares will be adjusted to reflect the disallowed loss.

From time to time the Fund may make a tender offer for its Common Shares. It is expected that the terms of any such offer will require a tendering shareholder to tender all Common Shares and dispose of all AMPS held, or considered under certain attribution rules of the Code to be held, by such shareholder. Shareholders who tender all Common Shares and dispose of all AMPS held, or considered to be held, by them will be treated as having sold their shares and generally will realize a capital gain or loss. If a shareholder tenders fewer than all of its Common Shares, or retains a substantial portion of its AMPS, such shareholder may be treated as having received a taxable dividend upon the tender of its Common Shares. In such a case, there is a remote risk that non-tendering shareholders will be treated as having received taxable distributions from the Fund. Likewise, if the Fund redeems some but not all of the AMPS held by a Preferred Shareholder and such shareholder is treated as having received a taxable dividend upon such redemption, there is a remote risk that Common Shareholders and non-redeeming Preferred Shareholders will be treated as having received taxable distributions from the Fund. To the extent that the Fund recognizes net gains on the liquidation of portfolio securities to meet such tenders of Common Shares, the Fund will be required to make additional distributions to its Common Shareholders.

*Original Issue Discount and Payment-in-Kind Securities.* Some of the debt obligations (with a fixed maturity date of more than one year from the date of issuance) that may be acquired by the Fund may be (and all zero-coupon debt obligations acquired by the Fund will be) treated as debt obligations that are issued originally at a discount. Generally, the amount of the original issue discount (OID) is treated as interest income and is included in taxable income (and required to be distributed) over the term of the debt security, even though payment of that amount is not received until a later time, usually when the debt security matures. Increases in the principal amount of an inflation indexed bond will be treated as OID. In addition, payment-in-kind securities will give rise to income which is required to be distributed and is taxable even though the Fund holding the security receives no interest payment in cash on the security during the year.

Some of the debt obligations (with a fixed maturity date of more than one year from the date of issuance) that may be acquired by the Fund in the secondary market may be treated as having market discount. Generally, any gain recognized on the disposition of, and any partial payment of principal on, a debt security having market discount is treated as ordinary income to the extent the gain, or principal payment, does not exceed the accrued market discount on such debt security. Market discount generally accrues in equal daily installments. The Fund may make

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one or more of the elections applicable to debt obligations having market discount, which could affect the character and timing of recognition of income.

Some debt obligations (with a fixed maturity date of one year or less from the date of issuance) that may be acquired by the Fund may be treated as having acquisition discount, or OID in the case of certain types of debt obligations. Generally, the Fund will be required to include the acquisition discount, or OID, in income over the term of the debt security, even though payment of that amount is not received until a later time, usually when the debt security matures. The Fund may make one or more of the elections applicable to debt obligations having acquisition discount, or OID, which could affect the character and timing of recognition of income.

If the Fund holds the foregoing kinds of securities, it may be required to pay out as an income distribution each year an amount which is greater than the total amount of cash interest the Fund actually received. Such distributions may be made from the cash assets of the Fund or by liquidation of portfolio securities, if necessary. The Fund may realize gains or losses from such liquidations. In the event the Fund realizes net capital gains from such transactions, its shareholders may receive a larger capital gain distribution than they would in the absence of such transactions.

*Higher-Risk Securities.* The Fund may invest to a significant extent in debt obligations that are in the lowest rating categories or are unrated, including debt obligations of issuers not currently paying interest or who are in default. Investments in debt obligations that are at risk of or in default present special tax issues for the Fund. Tax rules are not entirely clear about issues such as when the Fund may cease to accrue interest, original issue discount or market discount, when and to what extent deductions may be taken for bad debts or worthless securities and how payments received on obligations in default should be allocated between principal and income. These and other related issues will be addressed by the Fund when, as and if it invests in such securities, in order to seek to ensure that it distributes sufficient income to preserve its status as a regulated investment company and does not become subject to U.S. federal income or excise tax.

*Issuer Deductibility of Interest.* A portion of the interest paid or accrued on certain high yield discount obligations owned by the Fund may not be deductible to the issuer. If a portion of the interest paid or accrued on certain high yield discount obligations is not deductible, that portion will be treated as a dividend for purposes of the corporate dividends received deduction. In such cases, if the issuer of the high yield discount obligations is a domestic corporation, dividend payments by the Fund may be eligible for the dividends received deduction to the extent of the deemed dividend portion of such accrued interest.

Interest paid on debt obligations owned by the Fund, if any, that are considered for tax purposes to be payable in the equity of the issuer or a related party will not be deductible to the issuer, possibly affecting the cash flow of the issuer.

*Certain Investments in REITs.* The Fund may invest in REITs that hold residual interests in real estate mortgage investment conduits ( REMICs ). Under Treasury regulations that have not yet been issued, but may apply retroactively, a portion of the Fund's income from a REIT that is attributable to the REIT's residual interest in a REMIC (referred to in the Code as an excess inclusion ) will be subject to federal income tax in all events. These regulations are also expected

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to provide that excess inclusion income of a regulated investment company, such as the Fund, will be allocated to shareholders of the regulated investment company in proportion to the dividends received by such shareholders, with the same consequences as if the shareholders held the related REMIC residual interest directly.

In general, excess inclusion income allocated to shareholders (i) cannot be offset by net operating losses (subject to a limited exception for certain thrift institutions), (ii) will constitute unrelated business taxable income to entities (including a qualified pension plan, an individual retirement account, a 401(k) plan, a Keogh plan or other tax-exempt entity) subject to tax on unrelated business income, thereby potentially requiring such an entity that is allocated excess inclusion income, and otherwise might not be required to file a tax return, to file a tax return and pay tax on such income, and (iii) in the case of a non-U.S. shareholder, will not qualify for any reduction in U.S. federal withholding tax (discussed below). In addition, if at any time during any taxable year a disqualified organization (as defined in the Code) is a record holder of a share in a regulated investment company, then the regulated investment company will be subject to a tax equal to that portion of its excess inclusion income for the taxable year that is allocable to the disqualified organization, multiplied by the highest federal income tax rate imposed on corporations. The Fund does not intend to invest directly in residual interests in REMICs or to invest in REITS in which a substantial portion of the assets will consist of residual interests in REMICs.

Dividends paid by REITs generally will not be eligible to be treated as qualified dividend income.

*Options, Futures, Forward Contracts and Swap Agreements.* The Fund's transactions in options, futures contracts, hedging transactions, forward contracts, swap agreements, straddles and foreign currencies will be subject to special tax rules (including mark-to-market, constructive sale, straddle, wash sale and short sale rules), the effect of which may be to accelerate income to the Fund, defer losses to the Fund, cause adjustments in the holding periods of the Fund's securities, convert long-term capital gains into short-term capital gains and convert short-term capital losses into long-term capital losses. These rules could therefore affect the amount, timing and character of distributions to shareholders. The Fund will monitor its transactions, will make appropriate tax elections and will make appropriate entries in its books and records in order to mitigate the effect of these rules.

Certain of the Fund's hedging activities (including its transactions, if any, in foreign currencies or foreign currency-denominated instruments) are likely to produce a difference between its book income and its taxable income. If the Fund's book income exceeds its taxable income, the distribution (if any) of such excess generally will be treated as described under Return of Capital Distributions. If the Fund's book income is less than taxable income, the Fund could be required to make distributions exceeding book income to qualify as a regulated investment company that is accorded special tax treatment.

*Foreign Currency Transactions.* The Fund's transactions in foreign currencies, foreign currency-denominated debt obligations and certain foreign currency options, futures contracts and forward contracts (and similar instruments) may give rise to ordinary income or loss to the extent such income or loss results from fluctuations in the value of the foreign currency concerned.

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*Foreign Taxation.* Income received by the Fund from sources within foreign countries may be subject to withholding and other taxes imposed by such countries. Tax conventions between certain countries and the U.S. may reduce or eliminate such taxes. As the Fund may not pass through its foreign taxes to shareholders, shareholders generally will not be entitled to claim a credit or deduction with respect to foreign taxes.

*Shares Purchased Through Tax-Qualified Plans.* Special tax rules apply to investments through defined contribution plans and other tax-qualified plans. Shareholders should consult their tax advisers to determine the suitability of shares of the Fund as an investment through such plans and the precise effect of an investment on their particular tax situation.

*Non-U.S. Shareholders.* In general, dividends (other than Capital Gain Dividends) paid by the Fund to a shareholder that is not a U.S. person within the meaning of the Code (a foreign person) are subject to withholding of U.S. federal income tax at a rate of 30% (or lower applicable treaty rate) even if they are funded by income or gains (such as portfolio interest, short-term capital gains, or foreign-source dividend and interest income) that, if paid to a foreign person directly, would not be subject to withholding. However, under the 2004 Act, effective for taxable years of the Fund beginning after December 31, 2004 and before January 1, 2008, the Fund will not be required to withhold any amounts (i) with respect to distributions (other than distributions to a foreign person (w) that has not provided a satisfactory statement that the beneficial owner is not a U.S. person, (x) to the extent that the dividend is attributable to certain interest on an obligation if the foreign person is the issuer or is a 10% shareholder of the issuer, (y) that is within certain foreign countries that have inadequate information exchange with the United States, or (z) to the extent the dividend is attributable to interest paid by a person that is a related person of the foreign person and the foreign person is a controlled foreign corporation) from U.S. source interest income that would not be subject to U.S. federal income tax if earned directly by an individual foreign person, to the extent such distributions are properly designated by the Fund, and (ii) with respect to distributions (other than distributions to an individual foreign person who is present in the United States for a period or periods aggregating 183 days or more during the year of the distribution) of net short-term capital gains in excess of net long-term capital losses, to the extent such distributions are properly designated by the Fund. This provision will first apply to the Fund in its taxable year beginning September 1, 2005. In addition, as indicated above, Capital Gain Dividends will not be subject to withholding of U.S. federal income tax.

If a beneficial holder who is a foreign person has a trade or business in the United States, and the dividends are effectively connected with the conduct by the beneficial holder of a trade or business in the United States, the dividend will be subject to U.S. federal net income taxation at regular income tax rates.

The 2004 Act modifies the tax treatment of distributions from the Fund that are paid to a foreign person and are attributable to gain from U.S. real property interests (USRPIs), which the Code defines to include direct holdings of U.S. real property and interests (other than solely as a creditor) in U.S. real property holding corporations such as certain REITs. The Code deems any corporation that holds (or held during the previous five-year period) USRPIs with a fair market value equal to 50% or more of the fair market value of the corporation's U.S. and foreign real property assets and other assets used or held for use in a trade or business to be a U.S. real property holding corporation; however, if any class of stock of a corporation is traded on an

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established securities market, stock of such class shall be treated as a USRPI only in the case of a person who holds more than 5% of such class of stock at any time during the previous five-year period. Under the 2004 Act, which is generally effective for taxable years of RICs beginning after December 31, 2004 and which applies to dividends paid or deemed paid on or before December 31, 2007, distributions to foreign persons attributable to gains from the sale or exchange of USRPIs will give rise to an obligation for those foreign persons to file a U.S. tax return and pay tax, and may well be subject to withholding under future regulations.

Under U.S. federal tax law, a beneficial holder of shares who is a foreign person is not, in general, subject to U.S. federal income tax on gains (and is not allowed a deduction for losses) realized on the sale of shares of the Fund or on Capital Gain Dividends unless (i) such gain or Capital Gain Dividend is effectively connected with the conduct of a trade or business carried on by such holder within the United States, (ii) in the case of an individual holder, the holder is present in the United States for a period or periods aggregating 183 days or more during the year of the sale or Capital Gain Dividend and certain other conditions are met, or (iii) the shares constitute USRPIs or (effective for taxable years of the Fund beginning on September 1, 2005) the Capital Gain Dividends are paid or deemed paid on or before December 31, 2007 and are attributable to gains from the sale or exchange of USRPIs. Effective after December 31, 2004, and before January 1, 2008, if the Fund is a U.S. real property holding corporation (as described above) the Fund's shares will nevertheless not constitute USRPIs if the Fund is a domestically controlled qualified investment entity, which is defined to include a RIC that, at all times during the shorter of the 5-year period ending on the date of the disposition or the period during which the RIC was in existence, had less than 50 percent in value of its stock held directly or indirectly by foreign persons.

If you are eligible for the benefits of a tax treaty, any effectively connected income or gain will generally be subject to U.S. federal income tax on a net basis only if it is also attributable to a permanent establishment maintained by you in the United States.

A beneficial holder of shares who is a foreign person may be subject to state and local tax and to the U.S. federal estate tax in addition to the federal tax on income referred to above.

*Backup Withholding.* The Fund generally is required to withhold and remit to the U.S. Treasury a percentage of the taxable distributions and redemption proceeds paid to any individual shareholder who fails to properly furnish the Fund with a correct taxpayer identification number, who has under-reported dividend or interest income, or who fails to certify to the Fund that he or she is not subject to such withholding. The backup withholding tax rate is 28% for amounts paid through 2010. The backup withholding tax rate will be 31% for amounts paid after December 31, 2010.

In order for a foreign investor to qualify for exemption from the backup withholding tax rates under income tax treaties, the foreign investor must comply with special certification and filing requirements. Foreign investors in the Fund should consult their tax advisers in this regard. Backup withholding is not an additional tax. Any amounts withheld may be credited against the shareholder's U.S. federal income tax liability, provided the appropriate information is furnished to the Internal Revenue Service.



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*Tax Shelter Reporting Regulations.* Under recently promulgated Treasury regulations, if a shareholder recognizes a loss with respect to Fund shares of \$2 million or more for an individual shareholder or \$10 million or more for a corporate shareholder, the shareholder must file with the Internal Revenue Service a disclosure statement on Form 8886. Direct shareholders of portfolio securities are in many cases excepted from this reporting requirement, but under current guidance, shareholders of a regulated investment company are not excepted. Future guidance may extend the current exception from this reporting requirement to shareholders of most or all regulated investment companies. The fact that a loss is reportable under these regulations does not affect the legal determination of whether the taxpayer's treatment of the loss is proper. Shareholders should consult their tax advisers to determine the applicability of these regulations in light of their individual circumstances.

*General.* The federal income tax discussion set forth above is for general information only. Prospective investors should consult their tax advisers regarding the specific federal tax consequences of purchasing, holding, and disposing of shares of the Fund, as well as the effects of state, local and foreign tax law and any proposed tax law changes.

## **PERFORMANCE RELATED AND COMPARATIVE INFORMATION**

The Fund may quote certain performance-related information and may compare certain aspects of its portfolio and structure to other substantially similar closed-end funds as categorized by Lipper, Inc. ( Lipper ), Morningstar Inc. or other independent services. Comparison of the Fund to an alternative investment should be made with consideration of differences in features and expected performance. The Fund may obtain data from sources or reporting services, such as Bloomberg Financial ( Bloomberg ) and Lipper, that the Fund believes to be generally accurate.

The Fund, in its advertisements, may refer to pending legislation from time to time and the possible impact of such legislation on investors, investment strategy and related matters. At any time in the future, yields and total return may be higher or lower than past yields and there can be no assurance that any historical results will continue.

Past performance is not indicative of future results.

For the period from October 29, 2004 (the commencement of the Fund's operations) through November 30, 2004, the Fund's net increase in net assets resulting from investment operations was \$4,153,306.

## **CUSTODIAN, TRANSFER AGENT AND DIVIDEND PAYING AGENT**

State Street Bank and Trust Co., 801 Pennsylvania Avenue, Kansas City, Missouri 64105, serves as custodian for assets of the Fund. The custodian performs custodial and fund accounting services.

PFPC Inc., 400 Bellevue Parkway, Wilmington, Delaware 19809, serves as the transfer agent, registrar and dividend disbursement agent for the Common Shares, as well as agent for the Dividend Reinvestment Plan relating to the Common Shares.



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Deutsche Bank Trust Company Americas, 280 Park Avenue, 9th Floor, New York, New York 10017, serves as auction agent, transfer agent, registrar, dividend paying agent and redemption agent for the AMPS.

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**INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

PricewaterhouseCoopers LLP, 300 Madison Avenue, New York, New York 10017, serves as the independent registered public accounting firm for the Fund. PricewaterhouseCoopers LLP provides audit services, tax return preparation and assistance and consultation in connection with review of SEC filings to the Fund.

**COUNSEL**

Ropes & Gray LLP, One International Place, Boston, Massachusetts 02110, passes upon certain legal matters in connection with shares offered by the Fund, and also acts as counsel to the Fund.

**REGISTRATION STATEMENT**

A Registration Statement on Form N-2, including any amendments thereto (the "Registration Statement"), relating to the shares of the Fund offered hereby, has been filed by the Fund with the SEC, Washington, D.C. The Prospectus and this Statement of Additional Information are parts of, but do not contain all of the information set forth in, the Registration Statement, including any exhibits and schedules thereto. For further information with respect to the Fund and the shares offered or to be offered hereby, reference is made to the Fund's Registration Statement. Statements contained in the Prospectus and this Statement of Additional Information as to the contents of any contract or other document referred to are not necessarily complete and in each instance reference is made to the copy of such contract or other document filed as an exhibit to the Registration Statement, each such statement being qualified in all respects by such reference. Copies of the Registration Statement may be inspected without charge at the SEC's principal office in Washington, D.C., and copies of all or any part thereof may be obtained from the SEC upon the payment of certain fees prescribed by the SEC.

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**FINANCIAL STATEMENTS**

The Statement of Net Assets of the Fund dated as of October 19, 2004, including the Notes thereto, and the report of PricewaterhouseCoopers LLP thereon dated October 20, 2004, as included in the Fund's Statement of Additional Information dated October 26, 2004, relating to the Common Shares, is hereby incorporated by reference into this Statement of Additional Information, which means that such Statement of Net Assets and the Notes thereto are considered to be a part of this Statement of Additional Information. The Statement of Additional Information for the Common Shares was filed electronically with the SEC on October 28, 2004 (Accession No. 0001193125-04-180595).

Below are the unaudited financials for the Floating Rate Strategy Fund. They include as follows: Statement of Assets and Liabilities as of November 30, 2004, Statement of Operations for the period October 29, 2004 through November 30, 2004, Statement of Changes in Net Assets for the period October 29, 2004 through November 30, 2004, Financial Highlights for the period October 29, 2004 through November 30, 2004, Statement of Cash Flows for the period October 29, 2004 through November 30, 2004, Schedule of Investments as of November 30, 2004 and accompanying Notes.

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****STATEMENT OF ASSETS AND LIABILITIES****November 30, 2004****(unaudited)**

|  |                       |
|--|-----------------------|
| <b>Assets:</b>   |                       |
| Investments, at value (cost - \$898,561,485)   | \$ 899,451,826        |
| Cash (including foreign currency of \$3,731,687 with a cost of \$3,656,998)  | 16,072,713            |
| Receivable for investments sold  | 3,015,000             |
| Unrealized appreciation on swaps   | 1,761,169             |
| Interest receivable  | 1,528,364             |
| Premiums for swaps purchased   | 621,625               |
| Periodic payments receivable on swaps  | 569,954               |
| Unrealized appreciation on unfunded loan commitments   | 6,650                 |
| Prepaid expenses   | 3,555                 |
| <b>Total Assets</b>  | <b>923,030,856</b>    |
| <b>Liabilities:</b>  |                       |
| Payable for investments purchased  | 173,292,590           |
| Common stock offering costs payable  | 754,264               |
| Investment management fee payable  | 486,737               |
| Options written, at value (premiums received \$301,146)  | 298,375               |
| Unrealized depreciation on forward foreign currency contracts  | 103,645               |
| Unrealized depreciation on swaps   | 56,554                |
| Premiums for swaps sold  | 30,000                |
| Unrealized depreciation on unfunded loan commitments   | 18,136                |
| Accrued expenses   | 37,241                |
| <b>Total Liabilities</b>   | <b>175,077,542</b>    |
| <b>Net Assets</b>  | <b>\$ 747,953,314</b> |
| <b>Composition of Net Assets:</b>  |                       |
| Par value (\$0.00001 per share)  | \$ 390                |
| Paid-in-capital in excess of par   | 743,799,618           |
| Undistributed net investment income  | 1,155,022             |
| Net realized gain  | 566,059               |
| Net unrealized appreciation of investments, swaps, futures contracts, options written, unfunded loan commitments and foreign currency transactions | 2,432,225             |
| <b>Net Assets</b>  | <b>\$ 747,953,314</b> |
| <b>Shares Outstanding</b>  | <b>39,005,236</b>     |
| <b>Net Asset Value</b>   | <b>\$ 19.18</b>       |

*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****STATEMENT OF OPERATIONS**

For the period October 29, 2004\* through November 30, 2004

(unaudited)

|   |              |
|---|--------------|
| <b>Investment Income:</b>   |              |
| Interest  | \$ 1,681,046 |
| <b>Expenses:</b>  |              |
| Investment management fees  | 486,717      |
| Custodian and accounting agent fees   | 21,424       |
| Audit and tax services fees   | 9,900        |
| Reports to shareholders   | 6,600        |
| Trustees' fees  | 3,465        |
| Transfer agent fees   | 3,003        |
| New York Stock Exchange listing fees  | 1,720        |
| Legal fees  | 1,353        |
| Investor relations expense  | 825          |
| Miscellaneous   | 165          |
| Total expenses  | 535,172      |
| Less: custody credit earned on cash balances  | (9,148)      |
| Net expenses  | 526,024      |
| Net Investment Income   | 1,155,022    |
| <b>Realized and Unrealized Gain (Loss):</b>   |              |
| Net realized gain on :  |              |
| Investments   | 158,476      |
| Swaps   | 378,804      |
| Foreign currency transactions   | 28,779       |
| Net unrealized appreciation (depreciation) of:  |              |
| Investments   | 890,341      |
| Swaps   | 1,704,615    |
| Futures contracts   | (125,060)    |
| Options written   | 2,771        |
| Unfunded loan commitments   | (11,486)     |
| Foreign currency transactions   | (28,956)     |
| Net realized and unrealized gain on investments, swaps, futures contracts, options written, unfunded loan commitments and foreign currency transactions | 2,998,284    |
| Net increase in net assets resulting from investment operations   | \$ 4,153,306 |

See accompanying notes to financial statements.





**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****STATEMENT OF CHANGES IN NET ASSETS**

For the period October 29, 2004\* through November 30, 2004

(unaudited)

**Investment Operations:**

|  |              |
|--|--------------|
| Net investment income  | \$ 1,155,022 |
| Net realized gain on investments, swaps & foreign currency transactions  | 566,059      |
| Net unrealized appreciation of investments, swaps, futures contracts, options written, unfunded loan commitments and foreign currency transactions | 2,432,225    |
|  | <hr/>        |
| Net increase in net assets resulting from investment operations  | 4,153,306    |
|  | <hr/>        |

**Capital Share Transactions:**

|  |             |
|--|-------------|
| Net proceeds from the sale of common stock                                 | 744,900,000 |
| Common stock offering expenses charged to paid-in-capital in excess of par | (1,200,000) |
|  | <hr/>       |
| Total capital share transactions   | 743,700,000 |
|  | <hr/>       |
| Total increase in net assets   | 747,853,306 |

**Net Assets:**

|  |                |
|--|----------------|
| Beginning of period  | 100,008        |
|  | <hr/>          |
| End of period (including undistributed net investment income of \$1,155,022) | \$ 747,953,314 |
|  | <hr/>          |

**Common Shares Issued:**

39,000,000

\* Commencement of operations

*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****FINANCIAL HIGHLIGHTS****(unaudited)**

For a share of common stock outstanding for the period October 29, 2004\* through November 30, 2004:

|   |              |
|---|--------------|
| Net asset value, beginning of period**  | \$ 19.10     |
| <b>Investment Operations:</b>   |              |
| Net investment income   | 0.03         |
| Net realized and unrealized gain on investments, swaps, futures contracts, written options, unfunded loan commitments and foreign currency transactions | 0.08         |
| Net increase in net assets resulting from investment operations   | 0.11         |
| <b>Capital Share Transactions:</b>  |              |
| Common stock offering costs charged to paid-in capital in excess of par   | (0.03)       |
| Net asset value, end of period  | \$ 19.18     |
| Market price, end of period   | \$ 20.00     |
| <b>Total Investment Return (1)</b>  | <b>0.00%</b> |
| <b>Ratios/Supplemental Data:</b>  |              |
| Net assets, end of period (000)   | \$ 747,953   |
| Ratio of expenses to average net assets (2)   | 0.82%        |
| Ratio of net investment income to average net assets (2)  | 1.78%        |
| Portfolio Turnover  | 5%           |

\* Commencement of operations.

\*\* Initial public offering price of \$20.00 per share less underwriting discount of \$0.90 per share.

(1) Total investment return is calculated assuming a purchase of common stock at the current market price on the first day of the period and a sale at the current market price on the last day of the period reported. Total investment return does not reflect brokerage commissions or sales charges. Total investment return for a period of less than one year is not annualized.

(2) Annualized.

*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****STATEMENT OF CASH FLOWS**

For the period October 29, 2004\* through November 30, 2004

(unaudited)

**Cash Flows used for Operating Activities**

|   |               |
|---|---------------|
| Purchases of long-term investments                      | (401,941,947) |
| Proceeds from sales of long-term investments            | 15,428,915    |
| Interest received                                       | 152,682       |
| Swap premium paid                                       | (621,625)     |
| Swap premium sold                                       | 30,000        |
| Amortization of discounts on investments                | (322,222)     |
| Realized loss on swaps                                  | (191,150)     |
| Premium received for options written                    | 301,146       |
| Operating expenses paid                                 | (5,601)       |
| Unrealized depreciation on futures contracts            | (125,060)     |
| Net realized gain/loss on foreign currency transactions | 103,468       |
| Net increase in short-term investments                  | (341,290,165) |

|   |                      |
|---|----------------------|
| <b>Net cash used for operating activities</b> | <b>(728,481,559)</b> |
|---|----------------------|

**Cash Flows From Financing Activities**

|                           |             |
|---------------------------|-------------|
| Proceeds from shares sold | 744,900,000 |
| Offering costs paid       | (445,736)   |

|  |                    |
|--|--------------------|
| <b>Net cash for financing activities</b> | <b>744,454,264</b> |
|--|--------------------|

|                             |                   |
|-----------------------------|-------------------|
| <b>Net increase in cash</b> | <b>15,972,705</b> |
|-----------------------------|-------------------|

|                                    |                |
|------------------------------------|----------------|
| <b>Cash at beginning of period</b> | <b>100,008</b> |
|------------------------------------|----------------|

|                              |                   |
|------------------------------|-------------------|
| <b>Cash at end of period</b> | <b>16,072,713</b> |
|------------------------------|-------------------|

**Reconciliation of Net Increase in Net Assets From Investment Operations to Net Cash Used for Operating Activities**

|   |              |
|---|--------------|
| Net increase in net assets from operations                                | \$ 4,153,306 |
| Increase in receivable for investments sold                               | (3,015,000)  |
| Increase in interest receivable   | (1,528,364)  |
| Increase in periodic payments receivable on swaps                         | (569,954)    |
| Increase in premium for swaps purchased                                   | (621,625)    |
| Increase in premium for swaps sold  | 30,000       |
| Increase in prepaid expenses  | (3,555)      |
| Increase in payable to Investment Manager                                 | 486,737      |
| Increased in net unrealized appreciation on swaps                         | (1,704,615)  |
| Increase in unrealized depreciation on forward foreign currency contracts | 103,645      |
| Increase in unrealized appreciation on unfunded loan commitments          | (6,650)      |
| Increase in unrealized depreciation on unfunded loan commitments          | 18,136       |
| Increase in options written   | 298,375      |
| Increase in accrued expenses  | 37,241       |
| Increase in payable for investments purchased                             | 173,292,590  |

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|   |                         |
|---|-------------------------|
| Net increase in investments                   | (899,451,826)           |
| <b>Net cash used for operating activities</b> | <b>(\$ 728,481,559)</b> |

\* Commencement of operations

*See accompanying notes to financial statements.*

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**PIMCO FLOATING RATE STRATEGY FUND**

**NOTES TO FINANCIAL STATEMENTS**

**November 30, 2004**

**(unaudited)**

**1. Organization and Significant Accounting Policies**

PIMCO Floating Rate Strategy Fund (the Fund) was organized as a Massachusetts business trust on June 30, 2004. Prior to commencing operations on October 29, 2004, the Fund had no operations other than matters relating to its organization and registration as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended, and the sale and issuance of 5,236 shares of beneficial interest at an aggregate purchase price of \$100,008 to Allianz Global Investors of America L.P. (AGI), formerly, Allianz Dresdner Asset Management of America, L.P. PA Fund Management LLC (the Investment Manager) serves as the Fund's investment manager and is an indirect, wholly-owned subsidiary of AGI and an indirect, majority-owned subsidiary of Allianz AG, a publicly traded insurance and financial services company. The Fund invests substantially all of its assets in a diversified portfolio of floating rate debt instruments, a substantial portion of which will be senior floating rate loans. There is an unlimited number of \$0.00001 per share par value common stock authorized.

The Investment Manager agreed to pay the Fund's organizational expenses of approximately \$25,000, except the Fund has agreed to reimburse the Investment Manager for such organizational expenses to the extent that the aggregate of all such organizational expenses and all offering costs (other than the sales load) does not exceed \$0.04 per common share issued.

The Fund issued 37,000,000 shares of common stock in its initial public offering. An additional 2,000,000 shares were issued in connection with the underwriter's over-allotment option. These shares were all issued at \$20.00 per share less an underwriting discount of \$0.90 per share. Aggregate offering costs of \$1,200,000 (representing \$0.031 per share) were offset against the proceeds of the initial offering and over-allotment option and have been charged to paid-in capital in excess of par.

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from these estimates. In the normal course of business, the Fund enters into contracts that contain a variety of representations which provide general indemnifications. The Fund's maximum exposure under these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet been asserted. However, the Fund expects the risk of any loss to be remote.

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The following is a summary of significant accounting policies followed by the Fund:

### **(a) Valuation of Investments**

Portfolio securities and other financial instruments for which market quotations are readily available are stated at market value. Portfolio securities and other financial instruments for which market quotations are not readily available or if a development/event occurs that may impact the value of the security or financial instrument, may be fair valued pursuant to procedures established by the Board of Trustees. The Fund's investments in senior floating rate loans ( Senior Loans ) for which a secondary market exists are valued by an independent pricing source. Other Senior Loans are valued at fair value by Pacific Investment Management Company LLC (the Sub-Adviser), an affiliate of the Investment Manager, pursuant to procedures approved by the Board of Trustees. Such procedures may include consideration and evaluation of: (1) the creditworthiness of the borrower and any other intermediate participants; (2) the term of the Senior Loan; (3) recent prices in the market for similar loans, if any; (4) recent prices in the market for loans of similar quality, coupon rate, and period until next interest rate reset and maturity, and (5) general economic and market conditions affecting the fair value of the Senior Loan. Other portfolio securities and financial instruments are valued by an independent pricing service, dealer quotations or are valued at the last sales price on the exchange that is the primary market for such securities, or the last quoted bid price for those securities which the over-the-counter market is the primary market or for listed securities in which there were no sales. The independent pricing service uses information provided by market makers or estimates of market values obtained from yield data relating to investments or securities with similar characteristics. Short-term investments maturing in 60 days or less are valued at amortized cost, if their original term to maturity was 60 days or less, or by amortizing their value on the 61<sup>st</sup> day prior to maturity, if the original term to maturity exceeded 60 days. The prices used by the Fund may differ from the value that would be realized if the portfolio securities and other financial instruments were sold and the differences could be material to the financial statements. The Fund's net asset value is determined on the last business day of the week at the close of regular trading (normally 4:00 p.m. Eastern time) on the New York Stock Exchange.

### **(b) Investment Transactions and Investment Income**

Investment transactions are accounted for on the trade date. Realized gains and losses on investments are determined on the identified cost basis. Interest income is recorded on an accrual basis. Discounts or premiums on debt securities purchased are accreted or amortized daily to interest income over the lives of the respective securities using the effective interest method. Facility fees and other fees (such as origination fees) received by the Fund are amortized as income over the expected term of the loan. Commitment Fees received by the Fund relating to unfunded purchase commitments are deferred and amortized to facility fee income over the period of the commitment.

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**(c) Senior Loans**

The Fund purchases assignments of Senior Loans originated, negotiated and structured by a U.S. or foreign commercial bank, insurance company, finance company or other financial institution for a lending syndicate of financial institutions ( Lenders ). When purchasing an assignment, the Fund assumes all the rights and obligations under the loan agreement with the same rights and obligations as the assigning Lender. Assignments, may, however, be arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an assignment may differ from, and be more limited than, those held by the assigning Lender.

**(d) Interest Rate/Credit Default Swaps**

The Fund enters into interest rate and credit default swaps ( swaps ) for investment purposes, to manage its interest rate and credit risk or to add leverage.

As a seller in a credit default swap, the Fund would be required to pay the notional or other agreed upon value to the counterparty in the event of default by a third party, such as a U.S. or foreign corporate issuer, on the referenced debt obligation. In return, the Fund would receive from the counterparty a periodic stream of payments over the term of the contract provided that no event of default has occurred. If no default occurs, the Fund would keep the stream of payments and would have no payment obligations. Such periodic payments are accrued daily and charged to realized gain (loss).

The Fund may also purchase credit default swaps in order to hedge against the risk of default of debt securities held, in which case the Fund would function as the counterparty referenced in the preceding paragraph. As a purchaser of a credit default swap contract, the Fund would receive the notional amount or other agreed upon value from the counterparty in the event of default by a third party, such as a U.S. or foreign corporate issuer on the referenced debt obligation. In return, the Fund would make periodic payments to the counterparty over the term of the contract provided no event of default has occurred. Such periodic payments are accrued daily and charged to realized gain (loss).

Interest rate swap contracts involve the exchange by the Fund with a counterparty of their respective commitments to pay or receive interest, e.g., an exchange of floating rate payments for fixed rate payments with respect to a notional amount of principal. Net periodic payments received by the Fund are included as part of net realized gain (loss) on the Statement of Operations.



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Swaps are marked to market daily by the Fund's Sub-Adviser based upon quotations from market makers and the change in value, if any, is recorded as unrealized appreciation or depreciation in the Fund's Statement of Operations. For a credit default swap sold by the Fund, payment of the agreed upon amount made by the Fund in the event of default of the referenced debt obligation is recorded as the cost of the referenced debt obligation purchased/received. For a credit default swap purchased by the Fund, the agreed upon amount received by the Fund in the event of default of the referenced debt obligation is recorded as proceeds from the sale/delivery of the referenced debt obligation and the resulting gain or loss realized on the referenced debt obligation is recorded as such by the Fund.

Entering into swaps involves, to varying degrees, elements of credit, market and documentation risk in excess of the amounts recognized in the Statement of Assets and Liabilities. Such risks involve the possibility that there will be no liquid markets for these agreements, that the counterparty to the agreements may default on its obligation to perform or disagree as to the meaning of the contractual terms in the agreements, and that there will be unfavorable changes in net interest rates.

### **(e) Futures Contracts**

A futures contract is an agreement between two parties to buy and sell a financial instrument at a set price on a future date. Upon entering into such a contract, the Fund is required to pledge to the broker an amount of cash or securities equal to the minimum initial margin requirements of the exchange. Pursuant to the contracts, the Fund agrees to receive from or pay to the broker an amount of cash equal to the daily fluctuation in the value of the contracts. Such receipts or payments are known as variation margin and are recorded by the Fund as unrealized appreciation or depreciation. When the contracts are closed, the Fund records a realized gain or loss equal to the difference between the value of the contracts at the time they were opened and the value at the time they were closed. Any unrealized appreciation or depreciation recorded is simultaneously reversed. The use of futures transactions involves the risk of an imperfect correlation in the movements in the price of the futures contracts, interest rate and the underlying hedged assets, and the possibility of the counterparties to meet the terms of their contracts.

### **(f) Option Transactions**

The Fund may purchase or write (sell) put and call options for hedging purposes, risk management purposes or as part of its investment strategy. The risk associated with purchasing an option is that the Fund pays a premium whether or not the option is exercised. Additionally, the Fund bears the risk of loss of premium and change in market value should the counterparty not perform under the contract. Put and call options purchased are accounted for in the same manner as portfolio securities. The cost of securities acquired through the exercise of call options is increased by the premiums paid. The proceeds from the securities sold through the exercise of put options are decreased by the premiums paid.

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When an option is written, the premium received is recorded as a liability and subsequently marked to market to reflect the current value of the option written. These liabilities are reflected as options written in the Statement of Assets and Liabilities. Premiums received from writing options which expire unexercised are recorded on the expiration date as a realized gain. The difference between the premium received and the amount paid on effecting a closing purchase transaction, including brokerage commissions, is also treated as a realized gain, or if the premium is less than the amount paid for the closing purchase transactions, as a realized loss. If a call option is exercised, the premium is added to the proceeds from the sale of the underlying security in determining whether there has been a realized gain or loss. If a put option is exercised, the premium reduces the cost basis of the security. In writing an option, the Fund bears the market risk of an unfavorable change in the price of the security underlying the written option. Exercise of a written option, could result in the Fund purchasing a security at a price different from the current market.

### **(g) Forward Foreign Currency Contracts**

The Fund enters into forward foreign currency contracts ( FX contracts ) for the purpose of hedging against foreign currency risk arising from the investment or anticipated investment in securities denominated in foreign currencies. The Fund may also enter into these contracts for purposes of increasing exposure to a foreign currency or to shift exposure to foreign currency fluctuations from one country to another. An FX contract is an agreement between two parties to buy and sell a currency at a set exchange rate on a future date. The market value of an FX contract fluctuates with changes in forward currency exchange rates. All commitments are marked to market daily at the applicable exchange rates and any resulting unrealized appreciation or depreciation is recorded. Realized gains or losses are recorded at the time the FX contract matures or by delivery of the currency. Risks may arise upon entering into FX contracts from the potential inability of the counterparties to meet the terms of their contracts and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar.

### **(h) Repurchase Agreements**

The Fund may enter transactions with its custodian bank or securities brokerage firm approved by the Board of Trustees, whereby it purchases securities under agreements to resell at an agreed upon price and date ( repurchase agreements ). Such agreements are carried at the contract amount in the financial statements. Collateral pledged (the securities received), which consists primarily of U.S. government obligations and asset-backed securities are held by the custodian bank until maturity of the repurchase agreement. Provisions of the repurchase agreements and the procedures adopted by the Fund require that the market value of the collateral, including accrued interest thereon, is sufficient in the event of default by the counterparty. If the counterparty defaults and the value of the collateral declines or if the counterparty enters an insolvency proceeding, realization of the collateral by the Fund may be delayed or limited.

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### **(i) Custody Credits on Cash Balances**

The Fund benefits from an expense offset arrangement with its custodian bank whereby uninvested cash balances earn credits which reduce monthly custodian and accounting agent fees. Had these cash balances been invested in income producing securities, they would have generated income for the Fund.

### **2. Investment Manager and Sub-Adviser**

The Fund has entered into an Investment Management Agreement (the "Agreement"), with the Investment Manager to serve as investment manager to the Fund. Subject to the supervision of the Board of Trustees, the Investment Manager is responsible for managing, either directly or through others selected by it, the investment activities of the Fund and the Fund's business affairs and other administrative matters. Pursuant to the Agreement, the Fund will pay the Investment Manager an annual management fee, payable monthly, at the annual rate of 0.75% of the Fund's average weekly total managed assets. Total managed assets refers to the total assets of the Fund (including any assets attributable to any Preferred Shares or other forms of leverage that may be outstanding) minus accrued liabilities (other than liabilities representing leverage).

The Investment Manager has retained the Sub-Adviser to manage the Fund's investments. Subject to the supervision of the Investment Manager, the Sub-Adviser is responsible for making all investment decisions. The Investment Manager (not the Fund) pays a portion of the fees it receives as Investment Manager to the Sub-Adviser in return for its services, at the maximum annual rate of 0.39% of the Fund's average weekly total managed assets, for the period from the commencement of operations through October 31, 2009. Commencing November 1, 2009, the Investment Manager will pay the Sub-Adviser a monthly fee at the annual rate of 0.55% of the Fund's average weekly total managed assets. The Investment Manager informed the Fund that it paid the Sub-Adviser, \$253,104 in connection with its sub-advisory services for the period ended November 30, 2004.

### **3. Federal Income Taxes**

The Fund intends to comply with the requirements of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies. Accordingly, no provision for U.S. federal income taxes is required. In addition, by distributing substantially all of its ordinary income and long-term capital gains, if any, during each calendar year, the Fund intends not to be subject to U. S. federal excise tax.

### **4. Investments in Securities**

For the period October 29, 2004 through November 30, 2004, purchases and sales of investments, other than short-term securities, aggregated \$575,232,487 and \$13,519,122, respectively.

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(a) Credit default swaps outstanding at November 30, 2004 were:

| <b>Swap Counterparty/Referenced Debt Obligation</b> | <b>Notional Amount Payable on Default<br/>(000)</b> | <b>Termination Date</b> | <b>Fixed Payments received by the Fund</b> | <b>Unrealized Appreciation (Depreciation)</b> |
|---|---|-------------------------|--|---|
| Bank of America                                     |   |                         |  |   |
| CMS Energy Credit                                   | \$ 5,000  | 12/20/09                | 2.15%                                      | \$ 43,827                                     |
| Bank of America                                     |   |                         |  |   |
| Nextel Credit                                       | 5,000   | 12/20/09                | 0.95%                                      | (648)   |
| Bank of America                                     |   |                         |  |   |
| Royal Caribbean Credit                              | 5,000   | 12/20/09                | 1.12%                                      | 3,787   |
| Bank of America                                     |   |                         |  |   |
| Williams Co. Inc. Credit                            | 5,000   | 12/20/09                | 1.65%                                      | 55,857  |
| Bear Stearns  |   |                         |  |   |
| Dura Operating Credit                               | 4,500   | 12/20/09                | 4.15%                                      | (16,849)                                      |
| Bear Stearns  |   |                         |  |   |
| MGM Mirage Credit                                   | 5,000   | 12/20/09                | 1.54%                                      | 41,478  |
| Bear Stearns  |   |                         |  |   |
| Smurfit Stone Credit                                | 5,000   | 12/20/09                | 1.87%                                      | (28,836)                                      |
| Citibank  |   |                         |  |   |
| Host Marriott Credit                                | 5,000   | 12/20/09                | 1.70%                                      | 11,855  |
| Citibank  |   |                         |  |   |
| Reliant Resources Credit                            | 5,000   | 12/20/09                | 3.20%                                      | 95,778  |
| Credit Suisse                                       |   |                         |  |   |
| Dow Jones CDX                                       | 12,000  | 12/20/09                | 3.75%                                      | 43,900  |
| Credit Suisse                                       |   |                         |  |   |
| Equistar Credit                                     | 5,000   | 12/20/09                | 2.25%                                      | 32,062  |
| Credit Suisse                                       |   |                         |  |   |
| SAMI  | 10,000  | 9/20/08                 | 2.45%                                      | 111,396                                       |
| Credit Suisse                                       | 10,000  | 12/20/09                | 2.15%                                      | 70,445  |



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| Swap<br>Counterparty/Referenced<br>Debt Obligation | Notional<br>Amount Payable<br>on Default<br><br>(000) | Termination<br>Date | Fixed<br>Payments<br>received by<br>the Fund | Unrealized<br>Appreciation<br>(Depreciation) |
|--|---|---------------------|--|--|
| Credit Suisse                                      |   |                     |  |  |
| Vintage Petroleum Credit                           | \$ 5,000  | 12/20/09            | 1.95%  | \$ 274                                       |
| Goldman Sachs                                      |   |                     |  |  |
| Georgia Pacific Credit                             | 5,000   | 12/20/09            | 1.15%  | 46,730                                       |
| JP Morgan Chase Bank                               |   |                     |  |  |
| Ceasars Entertainment                              |   |                     |  |  |
| Credit   | 5,000   | 12/20/09            | 0.78%  | 29,193                                       |
| JP Morgan Chase Bank                               |   |                     |  |  |
| Dow Jones Credit                                   | 12,000  | 12/20/09            | 3.75%  | 118,900                                      |
| JP Morgan Chase Bank                               |   |                     |  |  |
| NRG Energy Credit                                  | 5,000   | 12/20/09            | 2.20%  | 308  |
| Lehman Brothers                                    |   |                     |  |  |
| Boyd Credit  | 5,000   | 12/20/09            | 1.65%  | 66,164                                       |
| Lehman Brothers                                    |   |                     |  |  |
| Hayes Lemmerz Credit                               | 5,000   | 12/20/09            | 2.50%  | 20,558                                       |
| Lehman Brothers                                    |   |                     |  |  |
| HCA Credit   | 5,000   | 12/20/09            | 1.55%  | (2,847)                                      |
| Lehman Brothers, Inc.                              |   |                     |  |  |
| Panamsat Credit                                    | 3,000   | 12/20/09            | 3.00%  | 109,383                                      |
| Lehman Brothers                                    |   |                     |  |  |
| Starwood Credit                                    | 5,000   | 12/20/09            | 1.15%  | 10,265                                       |
| Lehman Brothers                                    |   |                     |  |  |
| Stations Casinos Credit                            | 5,000   | 12/20/09            | 1.45%  | 9,962  |
| Lehman Brothers                                    |   |                     |  |  |
| TRW Credit   | 5,000   | 12/20/09            | 2.05%  | 122,196                                      |
| Merrill Lynch                                      |   |                     |  |  |
| AES Credit   | 3,000   | 12/20/09            | 2.60%  | 24,470                                       |



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| Swap                           | Notional                     |             |  |  |
|--------------------------------|------------------------------|-------------|--|--|
| Counterparty/Referenced        | Amount Payable<br>on Default | Termination | Fixed<br>Payments<br>received by<br>the Fund | Unrealized<br>Appreciation<br>(Depreciation) |
| Debt Obligation                | (000)                        | Date        |  | (Depreciation)                               |
| Merrill Lynch                  |                              |             |  |  |
| Arvinmeritor Credit            | \$ 4,500                     | 12/20/09    | 2.25%  | \$ 99,199                                    |
| Merrill Lynch                  |                              |             |  |  |
| Chesapeake Energy Credit       | 5,000                        | 12/20/09    | 1.30%  | 44,347                                       |
| Merrill Lynch                  |                              |             |  |  |
| Delhaize America Credit        | 5,000                        | 12/20/09    | 1.07%  | 61,212                                       |
| Merrill Lynch                  |                              |             |  |  |
| Electronic Data Systems Credit | 5,000                        | 12/20/09    | 1.45%  | 28,590                                       |
| Merrill Lynch                  |                              |             |  |  |
| Toys R US Credit               | 5,000                        | 12/20/09    | 3.20%  | 98,167                                       |
| Merill Lynch                   |                              |             |  |  |
| Vintage Petroleum Credit       | 3,000                        | 12/20/09    | 1.50%  | 26,342                                       |
| Morgan Stanley                 |                              |             |  |  |
| Dow Jones Credit               | 25,000                       | 12/20/09    | 2.60%  | 320,417                                      |
| Wachovia                       |                              |             |  |  |
| Ford Motor Credit              | 5,000                        | 12/20/09    | 2.14%  | 14,107                                       |
| Wachovia                       |                              |             |  |  |
| General Motors Credit          | 5,000                        | 12/20/09    | 2.26%  | (7,374)                                      |
|                                |                              |             |  | <u>\$ 1,704,615</u>                          |



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b) Options written for the period ended November 30, 2004:

|  | <u>Contracts</u> | <u>Premiums</u> |
|--|------------------|-----------------|
| Options outstanding, October 29, 2004  |                  |                 |
| Options written                        | 682              | 301,146         |
| Options outstanding, November 30, 2004 | 682              | 301,146         |

c) Future contracts outstanding at November 30, 2004:

| <u>Type</u>                     | <u>National</u> |                        | <u>Unrealized<br/>Depreciation</u> |
|---------------------------------|-----------------|------------------------|------------------------------------|
|                                 | <u>Amount</u>   | <u>Expiration Date</u> |                                    |
| Long: Financial Future Euro-CME | 243,806         | 12/13/04               | \$ 125,060                         |

d) Forward foreign currency contracts outstanding at November 30, 2004:

| <u>Sold:</u>                            | <u>U.S. \$ Value<br/>Origination Date</u> | <u>U.S. \$ Value<br/>November 30, 2004</u> | <u>Unrealized<br/>Depreciation</u> |
|---|---|--|------------------------------------|
| 2,808,000 Euro Dollars Settling 12/9/04 | \$ 3,628,441                              | \$ 3,732,086                               | \$ 103,645                         |

At November 30, 2004, the Fund had an unfunded loan commitment pursuant to the following loan agreement:

| <u>Borrower</u>      | <u>Unfunded Commitment</u> |
|----------------------|----------------------------|
| Innophos Term Loan B | \$ 371,318                 |
| Innophos Term Loan B | \$ 386,650                 |

**6. Subsequent Events**

On December 10, 2004, the underwriters exercised an additional 2,300,000 shares pursuant to the Fund's over-allotment option, at a price of \$20.00 per common share, less an underwriting discount of \$0.90 per share.

On December 14, 2004, the Board of Trustees declared the Fund's initial common share income dividend of \$0.09125 per common share. The dividend will be payable on January 7, 2005 to shareholders of record on December 24, 2004.



**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited)

Principal

Amount

| (000)                                     |   | Value             |
|---|---|-------------------|
| <b>SENIOR LOANS (a) (b) (c) (g)-36.5%</b> |   |                   |
| <b>Advertising-0.8%</b>                   |   |                   |
| \$ 7,000                                  | Advert Direct Sol, 4.09%, 11/9/11, Term B       | \$ 7,064,897      |
| <b>Automotive Products-1.4%</b>           |   |                   |
| 5,000                                     | Plastec, 4.73%, 2/15/10                         | 5,082,290         |
| 5,000                                     | TRW Automotive Inc., 3.88%, 10/29/10, Term E 20 | 5,029,165         |
| 2,746                                     | Volkswagon AG, 4.58%, 4/7/11                    | 2,799,547         |
|   |   | <u>12,911,002</u> |
| <b>Building/Construction-0.6%</b>         |   |                   |
| 5,094                                     | Nortek, 4.62%, 8/24/11                          | 5,187,770         |
| 392                                       | Nortek, 5.50%, 8/24/11                          | 395,059           |
|   |   | <u>5,582,829</u>  |
| <b>Chemicals-1.8%</b>                     |   |                   |
| 2,000                                     | Brenntag AG, 4.73%, 2/28/12, Term B2            | 2,036,250         |
| 80  | Hercules Inc., 3.73%, 10/8/10, Term B           | 81,097            |
| 1,311                                     | Hercules Inc., 3.97%, 10/8/10                   | 1,322,234         |
| 2,000                                     | Huntsman International LLC., 5.38%, 12/30/10    | 2,040,500         |
| 10,500                                    | Rockwood Sprical, 4.63%, 7/30/12                | 10,581,564        |
|   |   | <u>16,061,645</u> |
| <b>Diversified Manufacturing-1.6%</b>     |   |                   |
| 5,000                                     | Invensys plc, 6.76%, 12/30/09, Term B           | 5,150,000         |
| 3,555                                     | Kraton Polymers Group, 4.38%, 12/2/09           | 3,602,058         |
| 5,985                                     | Lyondell Citgo, 3.59%, 5/30/07, Term B          | 6,029,850         |
| 15  | Lyondell Citgo, 3.87%, 5/30/07                  | 15,150            |
|   |   | <u>14,797,058</u> |
| <b>Computer Software-0.1%</b>             |   |                   |
| 1,000                                     | UGS Corp., 4.46%, 5/26/11, Term B               | 1,016,875         |
| <b>Consumer Products-1.3%</b>             |   |                   |
| 587                                       | Graham Packaging Co., 4.56%, 9/15/11, Term B    | 596,282           |
| 6,913                                     | Graham Packaging Co., 4.63%, 9/15/11, Term B    | 7,027,603         |

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|                        |   |            |
|------------------------|---|------------|
| 4,000                  | Revlon Inc., 7.86%, 7/31/10, Term B           | 4,100,000  |
|                        |   | 11,723,885 |
| <b>Containers-2.2%</b> |   |            |
| 3,000                  | Affinia Group, 4.71%, 11/30/11 (j)            | 3,000,000  |
| 3,000                  | Horizon Lines Holding LLC., 4.35%, 7/4/11     | 3,054,999  |
| 2,500                  | Intertape Polymer Corp., 4.14%, 7/30/11       | 2,543,750  |
| 4,363                  | Smurfit Stone Container Corp., 1.92%, 11/1/09 | 4,437,636  |
| 5,637                  | Smurfit Stone Container Corp., 4.06%, 11/1/10 | 5,734,755  |
| 630                    | Solo Cup Co., 4.40%, 2/27/11, Term B          | 642,675    |
| 151                    | Solo Cup Co., 4.46%, 2/27/11, Term B          | 154,088    |
| 487                    | Solo Cup Co., 4.48%, 2/27/11, Term B          | 496,868    |
| 232                    | Solo Cup Co., 4.62%, 2/27/11, Term B          | 236,604    |
|                        |   | 20,301,375 |

See accompanying notes to financial statements.

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited) (continued)

Principal

Amount

| (000)   | Value             |
|---|-------------------|
| <b>SENIOR LOANS (continued)</b>                                 |                   |
| <b>Energy-4.5%</b>  |                   |
| \$12,000 El Paso Corp., 11/22/09 (j)                            | \$ 12,102,192     |
| 8,000 El Paso Corp., 11/22/09 (j)                               | 8,048,568         |
| 4,000 Foundation Coal Holdings Inc., 4.04%, 7/30/11, Term B     | 4,064,500         |
| 7,183 Headwaters Inc., 5.33%, 4/30/11                           | 7,285,209         |
| 317 Headwaters Inc., 7.00%, 4/30/11, Term B                     | 321,043           |
| 7,074 Polypore International Inc., 4.53%, 11/12/11, Term B      | 7,179,603         |
| 1,000 Premcor Refining Group Inc., 3.74%, 4/26/09               | 1,015,625         |
|   | <u>40,016,740</u> |
| <b>Entertainment-0.2%</b>                                       |                   |
| 1,000 Warner Music Group Inc., 4.32%, 2/27/11                   | 1,017,188         |
| 5 Warner Music Group Inc., 4.66%, 2/27/11                       | 5,111             |
| 497 Warner Music Group Inc., 4.66%, 2/27/11                     | 506,038           |
| 497 Warner Music Group Inc., 4.97%, 2/27/11                     | 506,038           |
|   | <u>2,034,375</u>  |
| <b>Financial Services-1.3%</b>                                  |                   |
| 1,450 BCP Caylux Holdings Inc., 6.23%, 6/8/11, Term C           | 1,484,437         |
| 3,800 Nalco Co., 4.42%, 11/1/10, Term B                         | 3,843,343         |
| 6,000 Refco Group Ltd., 4.89%, 7/30/11                          | 6,072,750         |
|   | <u>11,400,530</u> |
| <b>Health &amp; Hospitals-1.4%</b>                              |                   |
| 6,000 Ardent Health Inc., 6.00%, 8/15/11                        | 6,022,500         |
| 3,000 Community Health Systems Inc., 3.96%, 8/16/11, Term B (d) | 3,026,250         |
| 877 Davita, Inc. 3.87%, 6/23/09, Term B                         | 889,240           |
| 309 Davita, Inc. 3.98%, 6/23/09, Term B                         | 313,721           |
| 877 Davita, Inc. 3.98%, 6/23/09, Term B                         | 889,240           |
| 522 Davita, Inc. 4.07%, 6/23/09, Term B                         | 529,404           |
| 866 Davita, Inc. 4.17%, 6/23/09, Term B                         | 878,238           |
| 522 Davita, Inc. 4.34%, 6/23/09, Term B                         | 529,404           |
|   | <u>13,077,997</u> |

*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited) (continued)

Principal

Amount

| (000)                             |   | Value             |
|-----------------------------------|---|-------------------|
| <b>SENIOR LOANS (continued)</b>   |   |                   |
| <b>Hotels/Gaming-1.4%</b>         |   |                   |
| \$2,500                           | Ameristar Casinos Inc., 12/20/06 (j)                    | \$ 2,539,582      |
| 5,500                             | Choctaw Resort Development Enterprise Inc., 11/4/11 (j) | 5,606,562         |
| 3,333                             | Host Marriott LP., 9/10/08 (d) (j)                      | 3,108,072         |
| 1,667                             | Host Marriott LP., 9/10/08 (d) (j)                      | 1,554,036         |
|                                   |   | <u>12,808,252</u> |
| <b>Machinery-0.4%</b>             |   |                   |
| 3,153                             | Agco Corp., 3.95%, 1/31/06                              | 3,211,044         |
| 683                               | Agco Corp., 3.98%, 1/31/06                              | 695,962           |
|                                   |   | <u>3,907,006</u>  |
| <b>Measuring Instruments-0.9%</b> |   |                   |
| 8,000                             | Dresser, Inc. 1.00%, 10/29/09 (j)                       | 8,136,000         |
| <b>Miscellaneous-0.4%</b>         |   |                   |
| 3,238                             | Innophos Inc., 4.39%, 8/15/11, Term B                   | 3,312,032         |
| <b>Multi-Media-1.2%</b>           |   |                   |
| DirectTV Holdings LLC,            |   |                   |
| 988                               | 3.95%, 3/6/10   | 1,004,077         |
| 1,012                             | 4.09%, 3/6/10   | 1,027,673         |
| 4,000                             | Insight Midwest Holdings LLC., 4.75%, 12/31/09, Term B  | 4,072,776         |
| 2,500                             | Primedia Inc., 6.69%, 11/10/09, Term C                  | 2,507,292         |
| 2,000                             | Thompson Media, 1.00%, 11/8/11 (j)                      | 2,000,000         |
|                                   |   | <u>10,611,818</u> |
| <b>Office Equipment-0.4%</b>      |   |                   |
| 4,000                             | Xerox Corp., 3.73%, 4/30/05, Term B                     | 4,032,500         |
| <b>Oil &amp; Gas-0.3%</b>         |   |                   |
| 2,488                             | Midwest Generation LLC, 5.26%, 4/27/11                  | 2,528,181         |
| <b>Paper Products-0.3%</b>        |   |                   |

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|                       |  |           |
|-----------------------|--|-----------|
| 2,549                 | Roseburg Forest Products Co., 3.96%, 1/26/10   | 2,564,859 |
| <b>Pipelines-0.4%</b> |  |           |
| 2,000                 | Kinetics Concepts Inc., 3.98%, 7/14/10, Term B | 2,029,584 |
| 2,000                 | Kinetics Concepts Inc., 3.98%, 8/10/11, Term B | 2,029,584 |
|                       |  | <hr/>     |
|                       |  | 4,059,168 |
|                       |  | <hr/>     |

*See accompanying notes to financial statements.*



**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited) (continued)

Principal

Amount

| (000)   | Value            |
|---|------------------|
| <b>SENIOR LOANS (continued)</b>   |                  |
| <b>Printing/Publishing-0.8%</b>   |                  |
| \$6,851 RH Donnelley Corp., 4.05%, 6/30/11, Term B                          | \$ 6,927,610     |
| <b>Real Estate-0.7%</b>   |                  |
| 6,000 General Growth Properties Inc.,-REIT, 4.35%, 11/12/08                 | 6,029,064        |
| <b>Retail-0.8%</b>  |                  |
| 3 Jean Coutu Group Inc., 4.25%, 7/30/11                                     | 2,543            |
| 2,998 Jean Coutu Group Inc., 4.44%, 7/30/11                                 | 3,049,276        |
| 3,000 Simmons Co., 4.19%, 12/19/11, Term C                                  | 3,039,999        |
| 1,000 Simmons Co., 5.13%, 6/19/12   | 1,020,000        |
|   | <u>7,111,818</u> |
| <b>Telecommunications-7.4%</b>  |                  |
| 2,500 Alliance Atlantis Communications Inc., 10/19/11, Term B (j)           | 2,534,375        |
| 5,972 Centennial Cellular Communications Inc., 4.34%-5.15%, 1/20/11, Term B | 6,061,537        |
| 12,000 Charter Communication Inc. 5.29%-5.38%, 4/26/11                      | 11,986,068       |
| 2,000 Dex Media East LLC, 4.18%, 5/8/09, Term B                             | 2,025,000        |
| 5,387 Dex Media West LLC, 4.38%, 9/9/10, Term B                             | 5,443,153        |
| 1,000 Inmarsat Ventures PLC., 4.89%-5.39%, 10/10/11, Term C                 | 1,010,625        |
| Mediacomm Communications Corp.,   |                  |
| 1,970 2.99%, 3/31/10, Term A  | 1,950,300        |
| 2,000 4.17%, 9/30/10, Term B.   | 2,032,876        |
| 2,500 New Skies Satellite, 4.88%, 5/2/10                                    | 2,541,668        |
| 881 Panamsat Corp., 4.63%, 8/20/09  | 887,157          |
| 1,840 Panamsat Corp., 4.63%, 8/20/09  | 1,852,841        |
| 10,500 Qwest Corp., 6.50%, 6/5/07, Term A                                   | 10,961,559       |
| 5,000 Qwest Corp., 6.95%, 6/5/10  | 5,113,750        |
| 6,000 Valor Telecommnications., 9/23/09, Term B (j)                         | 6,075,000        |
| 1,265 Western Wireless Corp., 4.12%, 5/28/10                                | 1,273,451        |
| 616 Western Wireless Corp., 4.21%, 5/28/10                                  | 619,817          |
| 887 Western Wireless Corp., 4.60%, 5/28/10                                  | 903,105          |

See accompanying notes to financial statements.



**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS****November 30, 2004****(unaudited) (continued)****Principal****Amount  
(000)****Value**

| <b>SENIOR LOANS (continued)</b> |   |    |                   |
|---------------------------------|---|----|-------------------|
| \$298                           | Western Wireless Corp., 4.96%, 5/30/11, Term B          | \$ | 303,198           |
| 411                             | Western Wireless Corp., 5.05%, 6/30/11                  |    | 417,844           |
| 1,642                           | Western Wireless Corp., 5.07%, 5/30/11, Term A          |    | 1,671,376         |
| 411                             | Western Wireless Corp., 5.08%, 5/30/11                  |    | 417,844           |
| 411                             | Western Wireless Corp., 5.12%, 5/30/11                  |    | 417,844           |
|                                 |   |    | <b>66,500,388</b> |
| <b>Recreation-0.5%</b>          |   |    |                   |
| 5                               | Loews Cineplex Inc., 4.42%, 7/8/11                      |    | 5,072             |
| 1,043                           | Loews Cineplex Inc., 4.42%, 7/8/11                      |    | 1,057,688         |
| 952                             | Loews Cineplex Inc., 4.44%, 7/8/11                      |    | 966,146           |
| 2,000                           | Six Flags Theme Parks, Inc., 4.57%, 6/30/09             |    | 2,022,500         |
|                                 |   |    | <b>4,051,406</b>  |
| <b>Retail - 1.1%</b>            |   |    |                   |
| 9,429                           | Boise Cascade LLC, 4.47%, 10/29/11                      |    | 9,598,440         |
| <b>Utilities-0.2%</b>           |   |    |                   |
|                                 | AES Corp,   |    |                   |
| 714                             | 4.25%, 4/30/08, Term B                                  |    | 726,384           |
| 714                             | 4.44%, 4/30/04, Term B                                  |    | 727,827           |
|                                 |   |    | <b>1,454,211</b>  |
| <b>Waste Disposal-2.1%</b>      |   |    |                   |
| 2,000                           | Allegheny Energy Inc., 3/8/11 Term B (j)                |    | 2,037,500         |
| 9,000                           | Allegheny Energy Inc., 3/8/11 (j)                       |    | 9,168,750         |
| 6,515                           | Allied Waste North America Inc., 4.62%, 4/30/10         |    | 6,611,811         |
| 97                              | Allied Waste North America Inc., 4.62%, 4/30/10         |    | 97,649            |
| 322                             | Allied Waste North America Inc., 4.62%, 4/30/10         |    | 325,498           |
| 322                             | Allied Waste North America Inc., 4.63%, 4/30/10, Term B |    | 325,498           |
| 4                               | Allied Waste North America Inc., 4.82%, 4/30/12         |    | 3,733             |
| 49                              | Allied Waste North America Inc., 4.95%, 4/30/10         |    | 49,381            |
| 193                             | Allied Waste North America Inc., 4.97%, 4/30/10, Term B |    | 195,299           |
|                                 |   |    | <b>18,815,119</b> |

Total Senior Loans (cost-\$328,180,468)

328,437,080

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*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited) (continued)

| Principal   |  | Credit Rating<br>(Moody s/S&P) | Value             |
|---|--|--------------------------------|-------------------|
| Amount<br>(000)                                     |  |                                |                   |
| <b>ASSET-BACKED SECURITIES-10.4%</b>                |  |                                |                   |
| \$3,000   | Accredited Mortgage Loan Trust, 2.29%, 1/25/35 (f) (d)                         | Aaa/AAA                        | \$ 3,000,000      |
| 7,130   | Amortizing Residential Collateral Trust, 2.66%, 12/25/32 (f)                   | Aaa/AAA                        | 7,156,480         |
| 11,069  | Bear Stearns Asset Backed Securities, Inc. 2.63%, 12/25/33 (f)                 | Aaa/AAA                        | 11,112,294        |
| 7,000   | Asset Backed Securities Corp., 2.53%, 12/25/34 (f) (d)                         | Aaa/AAA                        | 7,000,000         |
| 1,087   | Credit Based Asset Trust, 2.52%, 2/5/33 (f)                                    | Aaa/AAA                        | 1,088,968         |
| 6,046   | Chase Funding Mortgage Loan Trust 2.51%, 1/25/33 (f)                           | Aaa/AAA                        | 6,059,196         |
| 8,524   | Cit Group Home Equity Loan Trust, 2.45%, 6/25/33 (f)                           | Aaa/AAA                        | 8,521,957         |
| 7,000   | CWMBS Inc., 12/30/34 (d) (j)   | Aaa/AAA                        | 6,998,906         |
| 7,000   | CWMBS Inc., 12/30/34 (d) (j)   | Aaa/AAA                        | 6,996,719         |
| 7,000   | Fremont Home Loan Trust 2.34%, 12/25/34 (f) (d)                                | Aaa/AAA                        | 7,000,000         |
| 7,662   | Indymac Home Equity, 2.34%, 7/25/34 (f)  | Aaa/AAA                        | 7,665,754         |
| 7,808   | Long Beach Mortgage Loan Trust, 2.50%, 7/25/33 (f)                             | Aaa/AAA                        | 7,821,804         |
| 3,362   | Morgan Stanley Capital I, 2.34%, 1/25/34 (f)                                   | NR/AAA                         | 3,364,121         |
| 5,041   | Salomon Brothers Mortgage SecuritiesVII, 2.48%, 3/25/32 (f)                    | NR/AAA                         | 5,040,241         |
| 4,563   | Wells Fargo Bank NA., 2.34%, 6/25/19 (f)                                       | Aaa/AAA                        | 4,565,313         |
|   | Total Asset-Backed Securities (cost-\$93,344,749)                              |                                | <u>93,391,753</u> |
| <b>COLLATERALIZED MORTGAGE OBLIGATIONS (f)-0.8%</b> |  |                                |                   |
| 7,000   | Master Adjustable Rate Mortgage Trust, 3.787%, 12/21/34 (d) (cost-\$7,009,843) | Aaa/AAA                        | <u>7,006,541</u>  |
| <b>CORPORATE BONDS &amp; NOTES-11.1%</b>            |  |                                |                   |
| <b>Airlines - 0.7%</b>                              |  |                                |                   |
|   | Jetblue Airways Corp., pass thru certificates,                                 |                                |                   |
| 4,000   | 5.39%, 11/15/08 Ser. 04-2 (f) (d)  | Ba1/NR                         | 4,009,097         |
| 2,300   | 6.13%, 3/15/08 Ser. 04-1(f)  | Ba1/BB+                        | 2,380,857         |
|   |  |                                | <u>6,389,954</u>  |

See accompanying notes to financial statements.

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited) (continued)

| Principal<br>Amount<br>(000)                   |  | Credit Rating<br>(Moody s/S&P) | Value             |
|--|--|--------------------------------|-------------------|
| <b>CORPORATE BONDS &amp; NOTES (continued)</b> |  |                                |                   |
| <b>Financial Services-1.5%</b>                 |  |                                |                   |
| \$ 5,750                                       | Borden US Financial Corp., 6.82%, 7/15/10 (a) (e) (f)          | B3/B-                          | \$ 6,037,500      |
| 5,000  | General Motors Acceptance Corp., 4.56%, 12/1/14 (f)            | Baa1/BBB-                      | 4,955,505         |
| 2,343  | Indosuez Capital Funding III, 2.27%, 12/31/08 (a) (e) (f)      | Aa3/NA                         | 2,347,832         |
|  |  |                                | <u>13,340,837</u> |
| <b>Health &amp; Hospitals-0.6%</b>             |  |                                |                   |
| 5,000  | HCA Inc., 5.25%, 11/6/08                                       | Ba2/BB+                        | 5,013,085         |
| <b>Hotels/Gaming-0.0%</b>                      |  |                                |                   |
| 320  | Park Place Entertainment Corp., 7.88%, 12/15/05                | Ba2/BB-                        | 333,600           |
| <b>Multi-Media- 0.8%</b>                       |  |                                |                   |
| 7,000  | Cablevision Systems Corp., 6.67%, 4/1/09 (a) (e) (f)           | B3/B+                          | 7,437,500         |
| <b>Oil &amp; Gas-0.3%</b>                      |  |                                |                   |
| 2,500  | Gaz Capital SA, 9.125%, 4/25/07                                | NR/BB-                         | 2,737,750         |
| <b>Paper Products-1.7%</b>                     |  |                                |                   |
| 7,000  | Abitibi-Consolidated Inc., 5.38%, 6/15/11 (f)                  | Ba3/BB                         | 7,197,500         |
| 4,000  | Boise Cascade LLC, 5.005%, 10/15/12 (a) (e) (f)                | B1/B+                          | 4,120,000         |
| 4,000  | Bowater Inc., 4.88%, 3/15/10 (f)                               | Ba3/BB                         | 4,040,000         |
|  |  |                                | <u>15,357,500</u> |
| <b>Semi-conductors-0.3%</b>                    |  |                                |                   |
| 2,750  | Freescall Semiconductor, 4.82%, 7/15/09 (f)                    | Ba2/BB+                        | 2,860,000         |
| <b>Telecommunications-5.2%</b>                 |  |                                |                   |
| 5,000  | Dobson Cellular Systems Inc., 6.96%, 11/1/11(a) (e) (f)        | B2/B-                          | 5,137,500         |
| 5,499  | Echostar DBS Corp., 5.26%, 10/1/08 (f)                         | Ba3/BB-                        | 5,732,708         |
| 11,500   | MCI Inc., 5.91%-6.69%, 5/1/07-5/1/09                           | NR/NR                          | 11,662,500        |
| 2,000  | New Skies Satellites NV., 7.44%, 11/1/11 (a) (e) (f)           | B3/B-                          | 2,060,000         |
| 4,650  | Quest Communications International, 5.79%, 2/15/09 (a) (e) (f) | B3/B                           | 4,661,625         |
| 7,750  | Rogers Wireless Inc., 5.53%, 12/15/10 (a) (e) (f)              | Ba3/BB                         | 8,060,000         |
| 3,500  | Rural Cellular Corp., 6.38%, 3/15/10 (f)                       | B2/B-                          | 3,622,500         |

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|       |   |      |             |
|-------|---|------|-------------|
| 5,820 | Time Warner Telecom Holdings, 6.29%, 2/15/11 (f)  | B1/B | 5,834,550   |
|       |   |      | <hr/>       |
|       |   |      | 46,771,383  |
|       |   |      | <hr/>       |
|       | Total Corporate Bonds & Notes (cost-\$99,942,951) |      | 100,241,609 |
|       |   |      | <hr/>       |

*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS**

November 30, 2004

(unaudited) (continued)

| Principal<br>Amount<br>(000)                           |  | Credit Rating<br>(Moody s/S&P) | Value              |
|--|--|--------------------------------|--------------------|
| <b>SOVEREIGN DEBT OBLIGATIONS (f)-1.5%</b>             |  |                                |                    |
| <b>Brazil-1.5%</b>                                     |  |                                |                    |
| \$14,118   | Federal Republic of Brazil, 2.1875%, 4/15/09 (cost-\$12,919,578) | B2/B+                          | \$ 13,268,887      |
| <b>SHORT-TERM INVESTMENTS-39.7%</b>                    |  |                                |                    |
| <b>COMMERCIAL PAPER-11.8%</b>                          |  |                                |                    |
| <b>Banking-7.0%</b>                                    |  |                                |                    |
| 17,700   | Bank of America NA, 2.26%, 3/9/05                                | Aaa/AAA                        | 17,700,000         |
| 17,700   | Citigroup, 2.275%, 2/18/05                                       | Aaa/AAA                        | 17,700,000         |
| 14,900   | HSBC Bank USA, 2.335%, 3/23/05                                   | Aaa/AAA                        | 14,900,000         |
| 12,800   | Rabobank USA Financial Corp., 2.03%, 12/1/04                     | Aaa/AAA                        | 12,800,000         |
|  |  |                                | <u>63,100,000</u>  |
| <b>Conglomerates-2.5%</b>                              |  |                                |                    |
| 22,600   | General Electronic Capital Corp., 2.32%-2.34%, 2/24/05-3/22/05   | P-1/AAA                        | 22,437,528         |
| <b>Oil &amp; Gas-2.3%</b>                              |  |                                |                    |
| 20,600   | TotalFinaElf SA, 2.05%, 12/1/04                                  | B1/B+                          | 20,600,000         |
|  | Total Commercial Paper (cost-\$106,140,589)                      |                                | <u>106,137,528</u> |
| <b>CORPORATE NOTES-1.7%</b>                            |  |                                |                    |
| <b>Energy - 0.6%</b>                                   |  |                                |                    |
| 5,000  | CMS Energy Corp., 7.00%, 1/15/05                                 | B3/B+                          | 5,035,135          |
| <b>Financial Services-0.7%</b>                         |  |                                |                    |
| 6,000  | Ford Motor Credit Co., 7.60%, 8/1/05                             | A3/BBB-                        | 6,162,672          |
| <b>Multi-Media-0.4%</b>                                |  |                                |                    |
| 4,000  | Rogers Cable Systems., 10.00%, 3/15/05 Series B                  | Ba3/BB+                        | 4,080,000          |
|  | Total Corporate Notes-(cost-\$15,281,373)                        |                                | <u>15,277,807</u>  |
| <b>U.S. GOVERNMENT &amp; AGENCY SECURITIES - 18.2%</b> |  |                                |                    |
| <b>Fannie Mae-8.3%</b>                                 |  |                                |                    |
| 75,300   | 1.98%-2.21%, 1/26/05-3/3/05                                      | Aaa/AAA                        | 74,988,753         |



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|  |                               |         |             |
|--|-------------------------------|---------|-------------|
| <b>Federal Home Loan Bank-9.7%</b>                             |                               |         |             |
| 87,800   | 1.759%-2.26%, 12/8/04-3/14/05 | Aaa/AAA | 87,409,995  |
| <b>U.S. Treasury Bills (i) -0.2%</b>                           |                               |         |             |
| 1,450  | 1.83%-1.915%, 12/16/04        | Aaa/AAA | 1,448,873   |
| Total U.S. Government & Agency Securities (cost-\$163,897,134) |                               |         | 163,847,621 |

*See accompanying notes to financial statements.*

**Table of Contents****PIMCO FLOATING RATE STRATEGY FUND****SCHEDULE OF INVESTMENTS****November 30, 2004****(unaudited) (continued)**

|                                      |   |                    |
|--------------------------------------|---|--------------------|
| <b>REPURCHASE AGREEMENTS-8.0%</b>    |   |                    |
| \$20,240                             | State Street Bank & Trust Co. dated 11/30/04, 1.65%, due 12/1/04, proceeds:\$20,240,928; collateralized by Federal Home Loan Bank, 12/15/05, valued at \$20,649,317 (cost-\$20,240,000) | \$ 20,240,000      |
| 50,000                               | U.S. Treasury Repo. dated 11/30/04, 1.90%, due 12/1/04, proceeds:\$50,002,639; collateralized by Federal Home Loan Bank, 12/15/05, valued at \$51,308,377 (cost-\$50,000,000)           | 50,000,000         |
| 1,600                                | U.S. Treasury Repo. dated 11/30/04, 1.90%, due 12/1/04, proceeds:\$1,600,084; collateralized by Federal Home Loan Bank, 12/15/05, valued at \$1,642,400 (cost-\$1,600,000)              | 1,600,000          |
|                                      | Total U.S. Government & Agency Securities (cost-\$71,840,000)   | 71,840,000         |
|                                      | Total Short-Term Investments (cost-\$357,159,096)   | 357,102,956        |
| <b>PUT OPTION PURCHASED (h)-0.0%</b> |   |                    |
| <b>Contracts</b>                     | CME Euro Futures, Chicago Board of Trade:   |                    |
| 275                                  | Strike Price \$93.75, expires 9/19/05   | 1,719              |
| 205                                  | Strike Price \$97.375, expires 12/13/05   | 1,281              |
|                                      | Total options written (cost-\$4,800)  | 3,000              |
|                                      | <b>Total Investments, before call options written (cost-\$898,561,485)-100.0%</b>   | <b>899,451,826</b> |
| <b>CALL OPTION WRITTEN (h)-0.0%</b>  |   |                    |
|                                      | U.S. Treasury Notes Futures, Chicago Board of Trade:  |                    |
| (341)                                | Strike Price \$114, expires 2/18/05   | (79,922)           |
| (341)                                | Strike Price \$109, expires 2/18/05   | (218,453)          |
|                                      | Total call options written (premiums received-\$301,146)  | (298,375)          |
|                                      | <b>Total Investments, net of call options written (cost-\$898,260,339)-100.0%</b>   | <b>899,153,451</b> |

See accompanying notes to financial statements.

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Notes to Schedule of Investments:

- (a) Private Placement. Restricted as to resale and does not have a readily available market.
- (b) Remaining maturities of floating rate loans may be less than the stated maturities shown as a result of contractual or optional payments by the borrower. Such prepayments cannot be predicted with certainty.
- (c) These securities generally pay interest at rates which are periodically pre-determined by reference to a base lending rate plus a premium. These base lending rates are generally either the lending rate offered by one or more major European banks, such as the London Inter-Bank Offered Rate ( LIBOR ) or the prime rate offered by one or more major United States banks, or the certificate of deposit rate. These securities are generally considered to be restricted as the Fund is ordinarily contractually obligated to receive approval from the Agent Bank and/or borrower prior to disposition.
- (d) Fair-valued security.
- (e) 144A Security- Security exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration, typically only to qualified institutional investors.
- (f) Floating Rate Security. Interest rate shown is the rate in effect at November 30, 2004.
- (g) Illiquid security
- (h) Non-income producing security.
- (i) All or partial principal amount segregated as initial margin on futures contracts.
- (j) Unsettled security, coupon rate to be determined on settlement date.

GLOSSARY:

NR - Not Rated

REIT - Real Estate Investment Trust

See accompanying notes to financial statements.

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**APPENDIX A**

**ARTICLE 11 OF THE AMENDED AND RESTATED BYLAWS**

The following provisions will be set forth in the Bylaws of the Fund (or Trust ) relating to the AMPS, and will be incorporated by reference in the Auction Agency Agreement and each Broker-Dealer Agreement. The capitalized terms not defined below are defined in the remaining articles of the Bylaws, which are filed as an exhibit to this Registration Statement. Nothing contained in this Appendix A constitutes a representation by the Fund that in each Auction each party referred to herein actually will perform the procedures described herein to be performed by such party.

**Statement Creating Five Series of Auction Market Preferred Shares**

A series of Auction Market Preferred Shares, Series M: 3,840 preferred shares of beneficial interest, par value \$.00001 per share, liquidation preference \$25,000 per share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) thereon, is hereby designated Auction Market Preferred Shares, Series M. Each share of Auction Market Preferred Shares, Series M (sometimes referred to herein as Series M AMPS ) may be issued on a date to be determined by the Board of Trustees of the Trust or pursuant to their delegated authority; has an Initial Dividend Rate and an Initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board of Trustees of the Trust or pursuant to their delegated authority; and has such other preferences, voting powers, limitations as to dividends, qualifications and terms and conditions of redemption as are set forth in these Bylaws. The Series M AMPS shall constitute a separate series of preferred shares of beneficial interest of the Trust, and each share of Series M AMPS shall be identical.

A series of Auction Market Preferred Shares, Series T: 3,840 preferred shares of beneficial interest, par value \$.00001 per share, liquidation preference \$25,000 per share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) thereon, is hereby designated Auction Market Preferred Shares, Series T. Each share of Auction Market Preferred Shares, Series T (sometimes referred to herein as Series T AMPS ) may be issued on a date to be determined by the Board of Trustees of the Trust or pursuant to their delegated authority; has an Initial Dividend Rate and an Initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board of Trustees of the Trust or pursuant to their delegated authority; and has such other preferences, voting powers, limitations as to dividends, qualifications and terms and conditions of redemption as are set forth in these Bylaws. The Series T AMPS shall constitute a separate series of preferred shares of beneficial interest of the Trust, and each share of Series T AMPS shall be identical.

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A series of Auction Market Preferred Shares, Series W: 3,840 preferred shares of beneficial interest, par value \$.00001 per share, liquidation preference \$25,000 per share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) thereon, is hereby designated Auction Market Preferred Shares, Series W. Each share of Auction Market Preferred Shares, Series W (sometimes referred to herein as Series W AMPS ) may be issued on a date to be determined by the Board of Trustees of the Trust or pursuant to their delegated authority; has an Initial Dividend Rate and an Initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board of Trustees of the Trust or pursuant to their delegated authority; and has such other preferences, voting powers, limitations as to dividends, qualifications and terms and conditions of redemption as are set forth in these Bylaws. The Series W AMPS shall constitute a separate series of preferred shares of beneficial interest of the Trust, and each share of Series W AMPS shall be identical.

A series of Auction Market Preferred Shares, Series TH: 3,840 preferred shares of beneficial interest, par value \$.00001 per share, liquidation preference \$25,000 per share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) thereon, is hereby designated Auction Market Preferred Shares, Series TH. Each share of Auction Market Preferred Shares, Series TH (sometimes referred to herein as Series TH AMPS ) may be issued on a date to be determined by the Board of Trustees of the Trust or pursuant to their delegated authority; has an Initial Dividend Rate and an Initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board of Trustees of the Trust or pursuant to their delegated authority; and has such other preferences, voting powers, limitations as to dividends, qualifications and terms and conditions of redemption as are set forth in these Bylaws. The Series TH AMPS shall constitute a separate series of preferred shares of beneficial interest of the Trust, and each share of Series TH AMPS shall be identical.

A series of Auction Market Preferred Shares, Series F: 3,840 preferred shares of beneficial interest, par value \$.00001 per share, liquidation preference \$25,000 per share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) thereon, is hereby designated Auction Market Preferred Shares, Series F. Each share of Auction Market Preferred Shares, Series F (sometimes referred to herein as Series F AMPS ) may be issued on a date to be determined by the Board of Trustees of the Trust or pursuant to their delegated authority; has an Initial Dividend Rate and an Initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board of Trustees of the Trust or pursuant to their delegated authority; and has such other preferences, voting powers, limitations as to dividends, qualifications and terms and conditions of redemption as are set forth in these Bylaws. The Series F AMPS shall constitute a separate series of preferred shares of beneficial interest of the Trust, and each share of Series F AMPS shall be identical.

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11.1 Definitions. (a) Unless the context or use clearly indicates another or different meaning or intent, in Article 11 of these Bylaws the following terms have the following meanings, whether used in the singular or plural:

Accountant's Confirmation has the meaning set forth in Section 11.7(c) of these Bylaws.

Additional Trustees has the meaning set forth in Section 11.5(b) of these Bylaws.

ADR has the meaning set forth in paragraph (iii) of the definition of Fitch Eligible Assets.

Affiliate means any Person known to the Auction Agent to be controlled by, in control of, or under common control with, the Trust.

Agent Member means a member of or a participant in the Securities Depository that will act on behalf of a Beneficial Owner of one or more AMPS or on behalf of a Potential Beneficial Owner.

AMPS means the Series M AMPS, Series T AMPS, the Series W AMPS, the Series TH AMPS and the Series F AMPS.

Applicable Percentage has the meaning set forth in Section 11.10(a)(vii) of these Bylaws.

Applicable Rate means the rate per annum at which cash dividends are payable on the AMPS for any Dividend Period.

Applicable Spread has the meaning set forth in Section 11.10(a)(vii) of these Bylaws.

Approved Foreign Nations has the meaning set forth in paragraph (iii) of the definition of Fitch Eligible Assets.

Approved Price means the fair value as determined by the Trust in accordance with the valuation procedures adopted from time to time by the Board of Trustees of the Trust and for which the Trust receives a mark-to-market price (which, for the purpose of clarity, shall not mean Market Value) from an independent source at least semi-annually.

Auction means a periodic operation of the Auction Procedures.



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**Auction Agent** means Deutsche Bank Trust Company Americas unless and until another commercial bank, trust company or other financial institution appointed by a resolution of the Board of Trustees of the Trust or a duly authorized committee thereof enters into an agreement with the Trust to follow the Auction Procedures for the purpose of determining the Applicable Rate and to act as transfer agent, registrar, dividend paying agent and redemption agent for the AMPS.

**Auction Date** has the meaning set forth in Section 11.10(a)(ii) of these Bylaws.

**Auction Procedures** means the procedures for conducting Auctions, as set forth in Section 11.10 of these Bylaws.

**Bank Loans** means direct purchases of, assignments of, participations in and other interests in (a) any bank loan or (b) any loan made by an investment bank, investment fund or other financial institution, provided that such loan under this clause (b) is similar to those typically made, syndicated, purchased or participated by a commercial bank or institutional loan investor in the ordinary course of business.

**Beneficial Owner** means a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer (or, if applicable, the Auction Agent) as a holder of AMPS or a Broker-Dealer that holds AMPS for its own account.

**Broker-Dealer** means any broker-dealer, or other entity permitted by law to perform the functions required of a Broker-Dealer pursuant to Section 11.10 of these Bylaws, that has been selected by the Trust and has entered into a Broker-Dealer Agreement with the Auction Agent that remains effective.

**Broker-Dealer Agreement** means an agreement between the Auction Agent and a Broker-Dealer pursuant to which such Broker-Dealer agrees to follow the procedures specified in Section 11.10 of these Bylaws.

**Business Day** means a day on which the New York Stock Exchange is open for trading and which is not a Saturday, Sunday or other day on which banks in New York City are authorized or obligated by law to close.

**Canadian Bonds** has the meaning set forth in the definition of Fitch Eligible Assets.

**Catastrophe Bonds** means securities that entitle the holders thereof to receive a fixed principal or similar amount and a specified return on such amount, generally having the following characteristics: (1) the issuer of such asset-backed security has entered into a swap, insurance contract or similar arrangement with a counterparty pursuant to which such issuer agrees to pay amounts to the counterparty upon the occurrence of certain specified events, including: hurricanes, earthquakes and other events, and (2) payments on such security depend primarily upon the occurrence and/or severity of such events.



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Closing Transactions has the meaning set forth in Section 11.8(a)(i) of these Bylaws.

Common Shares means the shares of beneficial interest designated as common shares, par value \$.00001 per share, of the Trust.

Cure Date has the meaning set forth in Section 11.4(a)(ii) of these Bylaws.

Date of Original Issue means, with respect to any Auction Market Preferred Share, the date on which the Trust first issues such share.

Debt Securities has the meaning set forth in paragraph (vi) of the definition of Fitch Eligible Assets.

Declaration of Trust means the Amended and Restated Agreement and Declaration of Trust of the Trust dated October 5, 2004, as from time to time amended and supplemented.

Deposit Securities means cash and portfolio securities rated at least A2 (having a remaining maturity of 12 months or less), P-1, VMIG-1 or MIG-1 by Moody's or A (having a remaining maturity of 12 months or less), A-1+ or SP-1+ by S&P.

Discount Factor means a Fitch Discount Factor or a Moody's Discount Factor, as applicable.

Discounted Value of any asset of the Trust means the quotient of the Market Value of an Eligible Asset divided by the applicable Discount Factor, provided that with respect to an Eligible Asset that is currently callable, the Discounted Value will be equal to the quotient as calculated above or the call price, whichever is lower, and that with respect to an Eligible Asset that is prepayable, the Discounted Value will be equal to the quotient as calculated above or the par value, whichever is lower.

Dividend Payment Date, with respect to AMPS, has the meaning set forth in Section 11.2(b)(i) of these Bylaws.

Dividend Period means the Initial Dividend Period, any Seven-Day Dividend Period and any Special Dividend Period.

Eligible Asset means a Fitch Eligible Asset (if Fitch Ratings is then rating the AMPS), a Moody's Eligible Asset (if Moody's is then rating the AMPS) and/or any asset included in the calculations used by any Rating Agency then rating the AMPS for purposes of determining such Rating Agency's rating on the AMPS, as applicable.



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Existing Holder means a Broker-Dealer, or any such other Person that may be permitted by the Trust, that is listed as the holder of record of AMPS in the Share Books.

Extension Period has the meaning set forth in Section 11.2(c)(iii) of these Bylaws.

FHLB, FNMA and FFCB Debentures has the meaning set forth in paragraph (ix) of the definition of Moody's Eligible Assets.

Fitch Discount Factor means, for purposes of determining the Discounted Value of any Fitch Eligible Asset, the percentage determined as follows. The Fitch Discount Factor for any Fitch Eligible Asset other than the securities set forth below will be the percentage provided in writing by Fitch Ratings.

(i) Debt Securities: The percentage determined by reference to the rating of the Debt Security with reference to the remaining term to maturity of the Debt Security (other than short-term Debt Securities covered by clause (iii) below), in accordance with the table set forth below.

| Term to Maturity of Debt Security           | Fitch Rating Category |         |         |         |         |                                    |
|---|-----------------------|---------|---------|---------|---------|------------------------------------|
|   | AAA                   | AA      | A       | BBB     | BB      | Not rated or below BB <sup>1</sup> |
| 3 years or less (but longer than 1 year)    | 106.38%               | 108.11% | 109.89% | 111.73% | 129.87% | 151.52%                            |
| 5 years or less (but longer than 3 years)   | 111.11                | 112.99  | 114.94  | 116.96  | 134.24  | 151.52                             |
| 7 years or less (but longer than 5 years)   | 113.64                | 115.61  | 117.65  | 119.76  | 135.66  | 151.52                             |
| 10 years or less (but longer than 7 years)  | 115.61                | 117.65  | 119.76  | 121.95  | 136.74  | 151.52                             |
| 15 years or less (but longer than 10 years) | 119.76                | 121.95  | 124.22  | 126.58  | 139.05  | 151.52                             |
| More than 15 years                          | 124.22                | 126.58  | 129.03  | 131.58  | 144.55  | 151.52                             |

<sup>1</sup> If a security is not rated by Fitch Ratings but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A- and the Moody's rating is Baa1, a rating by Fitch Ratings of BBB+ will be used). If a security is not rated by Fitch Ratings but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA-, a rating by Fitch Ratings of AAA- will be used, and where the only rating on a security is a Moody's rating of Ba3, a rating by Fitch Ratings of BB- will be used). If a security is not rated by any Rating Agency, the Trust will use the percentage set forth under Not rated or below BB in this table.

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The Fitch Discount Factors presented in the immediately preceding table apply to Debt Securities that are Performing and have a Market Value determined by a Pricing Service or an Approved Price. The Fitch Discount Factor noted in the table above for a Debt Security not rated or rated below BB by Fitch Ratings shall apply to any non-Performing Debt Security with a price equal to or greater than \$.20 per security. If a Debt Security does not have a Market Value determined by a Pricing Service or an Approved Price, a rating one rating category below the actual rating on the Debt Security will be used (*e.g.*, where the actual rating is A-, the rating for Debt Securities rated BBB- will be used). The Fitch Discount Factor for a Debt Security issued by a limited partnership that is not a Rule 144A Security shall be the Discount Factor determined in accordance with the table set forth above multiplied by 105%.

The Fitch Discount Factors presented in the immediately preceding table will also apply to (i) interest rate swaps and caps, whereby the rating of the counterparty to the swap or cap will be the rating used to determine the Fitch Discount Factor in the table; and (ii) TRACERs and TRAINs, whereby the ratings in the table will be applied to the underlying securities and the Market Value of each underlying security will be its proportionate amount of the Market Value of the TRACER or TRAIN. The Fitch Discount Factors presented in the immediately preceding table will also apply to corporate obligations backed by a guaranty, a letter of credit or insurance issued by a third party. If the third-party credit rating is the basis for the rating on the obligation, then the rating on the third party will be used to determine the Fitch Discount Factor in the table. The Fitch Discount Factors presented in the immediately preceding table will also apply to preferred trust certificates, the rating on which will be determined by the underlying debt instruments in the trust, unless such preferred trust certificates are determined by Fitch Ratings to qualify for a traditional equity discount factor, in which case the Fitch Discount Factor shall be 370%.

(ii) Preferred shares: The percentage determined by reference to the rating of the preferred shares in accordance with the table set forth below.

| <u>Preferred Shares</u>                           | <u>Discount Factor</u> |
|---|------------------------|
| AAA Taxable Preferred                             | 130%                   |
| AA Taxable Preferred                              | 133%                   |
| A Taxable Preferred                               | 135%                   |
| BBB Taxable Preferred                             | 139%                   |
| BB Taxable Preferred                              | 154%                   |
| Not rated or below BB Taxable Preferred           | 161%                   |
| Investment Grade DRD Preferred                    | 164%                   |
| Not rated or below Investment Grade DRD Preferred | 200% <sup>1</sup>      |

<sup>1</sup> If a security is not rated by Fitch Ratings but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (*e.g.*, where the S&P rating is A- and the Moody's rating is Baa1, a rating by Fitch Ratings of BBB+ will be used). If a security is not rated by Fitch Ratings but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (*e.g.*, where the only rating on a security is an S&P rating of AAA-, a rating by Fitch Rating of AAA- will be used, and where the only rating on a security is a Moody's rating of Ba3, a rating by Fitch Ratings of BB-

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will be used). If a security is not rated by any Rating Agency, the Trust will use the percentage set forth opposite Not rated or below Investment Grade DRD Preferred in this table.

(iii) Short-term instruments: The Fitch Discount Factor applied to short-term portfolio securities, including without limitation Debt Securities with terms to maturity of one year or less, Short Term Money Market Instruments and municipal debt obligations with terms to maturity within the Fitch Exposure Period, will be (A) 100%, so long as such portfolio securities mature or have a demand feature at par exercisable within the Fitch Exposure Period; (B) 115%, so long as such portfolio securities neither mature nor have a demand feature exercisable at par within the Fitch Exposure Period; and (C) 125%, so long as such portfolio securities neither mature within the Fitch Exposure Period nor have a demand feature at par. A Fitch Discount Factor of 100% will be applied to cash.

(iv) U.S. Government Securities and U.S. Treasury Strips: The percentage determined by reference to the remaining term to maturity of the security in accordance with the table below.

| <b>Time Remaining to Maturity</b>          | <b>Discount Factor</b> |
|--|------------------------|
| 1 year or less                             | 101.5 %                |
| 2 years or less (but longer than 1 year)   | 103                    |
| 3 years or less (but longer than 2 years)  | 105                    |
| 4 years or less (but longer than 3 years)  | 107                    |
| 5 years or less (but longer than 4 years)  | 109                    |
| 7 years or less (but longer than 5 years)  | 112                    |
| 10 years or less (but longer than 7 years) | 114                    |
| Greater than 10 years                      | 122                    |

(v) Convertible securities: The Fitch Discount Factor applied to convertible securities will be (a) 200% for investment grade convertible securities and (b) 222% for below investment grade convertible securities so long as such convertible securities have neither (x) a conversion premium greater than 100% nor (y) a yield to maturity or yield to worst of greater than 15.00% above the corresponding Treasury curve.

The Fitch Discount Factor applied to convertible securities which have conversion premiums of greater than 100% will be (a) 152% for investment grade convertible securities and (b) 179% for below investment grade convertible securities so long as such convertible securities do not have a yield to maturity or yield to worst of greater than 15.00% above the corresponding Treasury curve.

The Fitch Discount Factor applied to convertible securities which have a yield to maturity or yield to worst of greater than 15.00% above the corresponding Treasury curve will be 370%.

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If a security is not rated by Fitch Ratings but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (*e.g.*, where the S&P rating is A- and the Moody's rating is Baa1, a rating by Fitch Ratings of BBB+ will be used). If a security is not rated by Fitch Ratings but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (*e.g.*, where the only rating on a security is an S&P rating of AAA, a rating by Fitch Ratings of AAA will be used, and where the only rating on a security is a Moody's rating of Ba3, a rating by Fitch Ratings of BB- will be used). If a security is not rated by any Rating Agency, the Trust will treat the security as if it were below investment grade.

(vi) Rule 144A Securities: The Fitch Discount Factor applied to Rule 144A Securities will be 110% of the Fitch Discount Factor which would apply were the securities registered under the Securities Act.

(vii) Asset-backed and mortgage-backed securities: The percentage determined by reference to the asset type in accordance with the table set forth below.

| Asset Type (with time remaining to maturity, if applicable)                          | Discount Factor |
|--|-----------------|
| U.S. Treasury/agency securities (10 years or less)                                   | 118%            |
| U.S. Treasury/agency securities (greater than 10 years)                              | 127%            |
| U.S. agency sequentials (10 years or less)   | 128%            |
| U.S. agency sequentials (greater than 10 years)                                      | 142%            |
| U.S. agency principal only securities  | 236%            |
| U.S. agency interest only securities (with Market Value greater than \$.40)          | 696%            |
| U.S. agency interest only securities (with Market Value less than or equal to \$.40) | 214%            |
| AAA LockOut securities, interest only  | 236%            |
| U.S. agency planned amortization class bonds (10 years or less)                      | 115%            |
| U.S. agency planned amortization class bonds (greater than 10 years)                 | 136%            |
| AAA sequentials (10 years or less)   | 118%            |
| AAA sequentials (greater than 10 years)  | 135%            |
| AAA planned amortization class bonds (10 years or less)                              | 115%            |
| AAA planned amortization class bonds (greater than 10 years)                         | 140%            |
| Jumbo mortgages rated AAA <sup>1</sup>   | 123%            |
| Jumbo mortgages rated AA <sup>1</sup>  | 130%            |
| Jumbo mortgages rated A <sup>1</sup>   | 136%            |
| Jumbo mortgages rated BBB <sup>1</sup>   | 159%            |
| Commercial mortgage-backed securities rated AAA                                      | 131%            |
| Commercial mortgage-backed securities rated AA                                       | 139%            |
| Commercial mortgage-backed securities rated A  | 148%            |
| Commercial mortgage-backed securities rated BBB                                      | 177%            |
| Commercial mortgage-backed securities rated BB                                       | 283%            |
| Commercial mortgage-backed securities rated B  | 379%            |
| Commercial mortgage-backed securities rated CCC or not rated                         | 950%            |

<sup>1</sup> Applies to jumbo mortgages, credit cards, auto loans, home equity loans, manufactured housing and prime mortgage-backed securities not issued by a U.S. agency or instrumentality.

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(viii) Bank Loans: The percentage determined by reference to the Fitch Loan Category in accordance with the table set forth below.

| <u>Fitch Loan Category</u> | <u>Discount Factor</u> |
|----------------------------|------------------------|
| A                          | 126 %                  |
| B                          | 157                    |
| C                          | 184                    |
| D                          | 433                    |

(ix) REITs:

(a) Common stock and preferred stock of REITs and other real estate companies:

|   | <u>Discount Factor</u> |
|---|------------------------|
| REIT or other real estate company preferred stock | 154%                   |
| REIT or other real estate company common stock    | 196%                   |

(b) Corporate debt securities of REITs:

| <u>Term to Maturity</u> | <u>AAA</u> | <u>AA</u> | <u>A</u> | <u>BBB</u> | <u>BB</u> | <u>B</u> | <u>CCC</u> |
|-------------------------|------------|-----------|----------|------------|-----------|----------|------------|
| 1 year or less          | 111%       | 114%      | 117%     | 120%       | 121%      | 127%     | 227%       |
| 2 years or less         | 116%       | 125%      | 125%     | 127%       | 132%      | 137%     | 137%       |
| 3 years or less         | 121%       | 123%      | 127%     | 131%       | 133%      | 140%     | 225%       |
| 4 years or less         | 126%       | 126%      | 129%     | 132%       | 136%      | 140%     | 164%       |
| 5 years or less         | 131%       | 132%      | 135%     | 139%       | 144%      | 149%     | 185%       |
| 7 years or less         | 140%       | 143%      | 146%     | 152%       | 159%      | 167%     | 228%       |
| 10 years or less        | 141%       | 143%      | 147%     | 153%       | 160%      | 168%     | 232%       |
| 12 years or less        | 144%       | 144%      | 150%     | 157%       | 165%      | 174%     | 249%       |
| 15 years or less        | 148%       | 151%      | 155%     | 163%       | 172%      | 182%     | 274%       |
| 20-30 years or less     | 152%       | 156%      | 160%     | 169%       | 180%      | 191%     | 306%       |

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If a security is not rated by Fitch Ratings but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A- and the Moody's rating is Baa1, a rating by Fitch Ratings of BBB+ will be used). If a security is not rated by Fitch Ratings but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA, a rating by Fitch Ratings of AAA will be used, and where the only rating on a security is a Moody's rating of Ba3, a rating by Fitch Ratings of BB- will be used). If a security is not rated by any Rating Agency, the Trust will treat the security as if it were below investment grade.

(x) Municipal debt obligations: The Fitch Discount Factor applied to municipal debt obligations will be the percentage determined by reference to the table set forth below.

| Fitch Exposure Period                    | Fitch Rating Category |      |      |      |                 |                      |
|--|-----------------------|------|------|------|-----------------|----------------------|
|  | AAA                   | AA   | A    | BBB  | F1 <sup>1</sup> | Unrated <sup>2</sup> |
| 7 weeks                                  | 151%                  | 159% | 166% | 173% | 136%            | 225%                 |
| 8 weeks or less but greater than 7 weeks | 154                   | 161  | 168  | 176  | 137             | 231                  |
| 9 weeks or less but greater than 8 weeks | 158                   | 163  | 170  | 177  | 138             | 240                  |

<sup>1</sup> Municipal debt obligations rated by Fitch Ratings which do not mature or have a demand feature at par exercisable in 30 days and which do not have a long-term rating.

<sup>2</sup> If a security is not rated by Fitch Ratings but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A- and the Moody's rating is Baa1, a rating by Fitch Ratings of BBB+ will be used). If a security is not rated by Fitch Ratings but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA-, a rating by Fitch Ratings of AAA- will be used, and where the only rating on a security is a Moody's rating of Ba3, a rating by Fitch Ratings of BB- will be used). If a security is not rated by any Rating Agency, the Trust will use the percentage set forth under Unrated in this table.

(xi) Foreign Bonds: The Fitch Discount Factor (A) for a Foreign Bond the principal of which (if not denominated in U.S. dollars) is subject to a currency hedging transaction will be the Fitch Discount Factor that would otherwise apply to such Foreign Bonds in accordance with this definition and (B) for (1) a Foreign Bond the principal of which (if not denominated in U.S. dollars) is not subject to a currency hedging transaction and (2) a bond issued in a currency other than U.S. dollars by a corporation, limited liability company or limited partnership domiciled in, or the government or any agency, instrumentality or political subdivision of, a nation other than an Approved Foreign Nation, will be 370%.



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(xii) Structured Notes: The Fitch Discount Factor applied to Structured Notes will be (A) in the case of a corporate issuer, the Fitch Discount Factor determined in accordance with paragraph (i) under this definition, whereby the rating on the issuer of the Structured Note will be the rating on the Structured Note for purposes of determining the Fitch Discount Factor in the table in paragraph (i); and (B) in the case of an issuer that is the U.S. government or an agency or instrumentality thereof, the Fitch Discount Factor determined in accordance with paragraph (iii) under this definition.

(xiii) Unhedged foreign investments: A discount factor of 105% shall be applied to the Market Value of unhedged foreign investments otherwise determined in accordance with the preceding paragraphs; provided, however, if the foreign issuer of such unhedged foreign investment is from a country whose sovereign debt rating in a non-local currency is not assigned a rating of AA or better by Fitch, a discount factor of 117% shall be applied to the Market Value thereof otherwise determined in accordance with the preceding paragraphs.

(xiv) Catastrophe Bonds: The Fitch Discount Factor applied to Catastrophe Bonds will be 333.33%.

(xv) Common stock and warrants: The Fitch Discount Factor applied to common stock will be 200% for large-cap stocks (i.e., stocks of companies having a market capitalization greater than \$10 billion), 233% for mid-cap stocks (i.e., stocks of companies with a market capitalization between \$2 billion to \$10 billion), 286% for small cap stocks (i.e., stocks of companies with market capitalizations between \$300 million to \$2 billion), and 370% for others.

Fitch Eligible Assets means

(i) cash (including interest and dividends due on assets rated (A) BBB or higher by Fitch Ratings or the equivalent by another Rating Agency if the payment date is within five Business Days of the Valuation Date, (B) A or higher by Fitch Ratings or the equivalent by another Rating Agency if the payment date is within thirty days of the Valuation Date, and (C) A+ or higher by Fitch Ratings or the equivalent by another Rating Agency if the payment date is within the Fitch Exposure Period) and receivables for Fitch Eligible Assets sold if the receivable is due within five Business Days of the Valuation Date, and if the trades which generated such receivables are (A) settled through clearing house firms with respect to which the Trust has received prior written authorization from Fitch Ratings or (B) (1) with counterparties having a long-term debt rating of at least BBB- from Fitch Ratings or the equivalent from another Rating Agency or (2) with counterparties having a Short Term Money Market Instrument rating of at least F1+ by Fitch Ratings or the equivalent by another Rating Agency;

(ii) preferred shares if (A) dividends on such preferred shares are cumulative, (B) such securities provide for the periodic payment of dividends thereon in cash in U.S. dollars or euros and do not provide for conversion or exchange into, or have warrants attached entitling the holder to receive common stock or its equivalent at any time over the respective lives of such securities, (C) the issuer of such a preferred shares has common

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stock listed on either the New York Stock Exchange or the American Stock Exchange, (D) the issuer of such preferred shares has a senior debt rating or preferred stock rating from Fitch Ratings of BBB- or higher or the equivalent rating by another Rating Agency and (E) the preferred shares are part of an issue that is at least \$50 million;

(iii) (A) common stocks (1) which are traded on the New York Stock Exchange or the American Stock Exchange or in the over-the-counter market, (2) which, if cash dividend paying, pay cash dividends in U.S. dollars, and (3) which may be sold without restriction by the Trust; provided, however, that (a) common stock which, while a Fitch Eligible Asset owned by the Trust, ceases paying any regular cash dividend will no longer be considered a Fitch Eligible Asset until 60 calendar days after the date of the announcement of such cessation, unless the issuer of the common stock has senior debt securities rated at least A- by Fitch and (b) the aggregate Market Value of the Trust's holdings of the common stock of any issuer in excess of 5% per U.S. issuer of the number of outstanding shares of such issuer times the Market Value of such common stock shall not be a Fitch's Eligible Asset; and (B) common stocks or their equivalent denominated in any currency other than the U.S. dollar and common stocks or their equivalent of issuers formed under the laws of jurisdictions other than the United States, its states and the District of Columbia for which there are dollar-denominated American Depository Receipts ( ADRs ) which are traded in the United States on exchanges or over-the-counter and are issued by banks formed under the laws of the United States, its states or the District of Columbia; provided, however, that the aggregate Market Value of the Trust's holdings of securities denominated in currencies other than the U.S. dollar and ADRs in excess of 3% of the aggregate Market Value of the outstanding shares of common stock or its equivalent of such issuer or in excess of 10% of the Market Value of the Trust's Fitch Eligible Assets with respect to issuers formed under the laws of any single such non-U.S. jurisdiction other than Argentina, Australia, Brazil, Chile, France, Germany, Italy, Japan, Korea, Mexico, Spain or the United Kingdom (each an Approved Foreign Nation, and collectively the Approved Foreign Nations ) or Canada shall not be a Fitch Eligible Asset;

(iv) Short Term Money Market Instruments so long as (A) such securities are rated at least F1+ by Fitch Ratings or the equivalent by another Rating Agency, (B) in the case of demand deposits, time deposits and overnight funds, the supporting entity is rated at least A by Fitch Ratings or the equivalent by another Rating Agency, or (C) in all other cases, the supporting entity (1) is rated at least A by Fitch Ratings or the equivalent by another Rating Agency and the security matures within one month, (2) is rated at least A by Fitch Ratings or the equivalent by another Rating Agency and the security matures within three months or (3) is rated at least AA by Fitch Ratings or the equivalent by another Rating Agency and the security matures within six months;

(v) U.S. Government Securities and U.S. Treasury Strips;

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(vi) debt securities if (A) such securities have been registered under the Securities Act or are restricted as to resale under federal securities laws but are eligible for resale pursuant to Rule 144A under the Securities Act as determined by the Trust's investment manager or portfolio manager acting pursuant to procedures approved by the Board of Trustees of the Trust; and (B) such securities are issued by (1) a U.S. corporation, limited liability company or limited partnership, (2) a corporation, limited liability company or limited partnership domiciled in an Approved Foreign Nation, (3) the government of any Approved Foreign Nation or any of its agencies, instrumentalities or political subdivisions (the debt securities of Approved Foreign Nation issuers being referred to collectively as "Foreign Bonds"), (4) a corporation, limited liability company or limited partnership domiciled in Canada or (5) the Canadian government or any of its agencies, instrumentalities or political subdivisions (the debt securities of Canadian issuers being referred to collectively as "Canadian Bonds"). Foreign Bonds held by the Trust will qualify as Fitch Eligible Assets only up to a maximum of 20% of the aggregate Market Value of all assets constituting Fitch Eligible Assets. Similarly, Canadian Bonds held by the Trust will qualify as Fitch Eligible Assets only up to a maximum of 20% of the aggregate Market Value of all assets constituting Fitch Eligible Assets. Notwithstanding the limitations in the two preceding sentences, Foreign Bonds and Canadian Bonds held by the Trust will qualify as Fitch Eligible Assets only up to a maximum of 30% of the aggregate Market Value of all assets constituting Fitch Eligible Assets. In addition, bonds which are issued in connection with a reorganization under U.S. federal bankruptcy law ("Reorganization Bonds") will be considered debt securities constituting Fitch Eligible Assets if (a) they provide for periodic payment of interest in cash in U.S. dollars or euros; (b) they do not provide for conversion or exchange into equity capital at any time over their lives; (c) they have been registered under the Securities Act or are restricted as to resale under federal securities laws but are eligible for trading under Rule 144A promulgated pursuant to the Securities Act as determined by the Trust's investment manager or portfolio manager acting pursuant to procedures approved by the Board of Trustees of the Trust; (d) they were issued by a U.S. corporation, limited liability company or limited partnership; and (e) at the time of purchase at least one year had elapsed since the issuer's reorganization. Reorganization Bonds may also be considered debt securities constituting Fitch Eligible Assets if they have been approved by Fitch Ratings, which approval shall not be unreasonably withheld. All debt securities satisfying the foregoing requirements and restrictions of this paragraph (vi) are herein referred to as "Debt Securities."

(vii) asset-backed and mortgage-backed securities;

(viii) Rule 144A Securities;

(ix) Bank Loans;

(x) municipal debt obligations;

(xi) TRACERs, TRAINs and Structured Notes;

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(xii) interest rate swaps entered into according to International Swap Dealers Association standards if (A) the counterparty to the swap transaction has a short-term rating of not less than F1 from Fitch Ratings or the equivalent by another Rating Agency, or, if the swap counterparty does not have a short-term rating, the counterparty has a senior unsecured long-term debt rating of AA or higher from Fitch Ratings or the equivalent from another Rating Agency and (B) the original aggregate notional amount of the interest rate swap transaction or transactions is not greater than the liquidation preference of the AMPS originally issued;

(xiii) any common stock, preferred stock or any debt security of REITs or real estate companies;

(xiv) Catastrophe Bonds; and

(xv) unrated debt securities issued by an issuer which (A) has not filed for bankruptcy in the past three years; (B) is current on all interest and principal on its fixed income obligations; and (C) is current on all preferred stock dividends.

Financial contracts, as such term is defined in Section 3(c)(2)(B)(ii) of the 1940 Act, not otherwise provided for in this definition may be included in Fitch Eligible Assets, but, with respect to any financial contract, only upon receipt by the Trust of a writing from Fitch Ratings specifying any conditions on including such financial contract in Fitch Eligible Assets and assuring the Trust that including such financial contract in the manner so specified would not affect the credit rating assigned by Fitch Ratings to the AMPS.

In addition, portfolio holdings as described below must be within the following diversification and issue size requirements in order to be included in Fitch's Eligible Assets:

| <u>Security Rated At Least</u> | <u>Maximum Single</u>     | <u>Maximum Single</u>         | <u>Minimum Issue Size</u>          |
|--------------------------------|---------------------------|-------------------------------|------------------------------------|
|                                | <u>Issuer<sup>1</sup></u> | <u>Industry<sup>1,2</sup></u> | <u>(\$ in million)<sup>3</sup></u> |
| AAA                            | 100%                      | 100%                          | \$ 100                             |
| AA                             | 20                        | 75                            | 100                                |
| A                              | 10                        | 50                            | 100                                |
| BBB                            | 6                         | 25                            | 100                                |
| BB                             | 4                         | 16                            | 50                                 |
| B                              | 3                         | 12                            | 50                                 |
| CCC                            | 2                         | 8                             | 50                                 |

<sup>1</sup> Percentages represent a portion of the aggregate market value of corporate debt securities.

<sup>2</sup> Industries are determined according to Fitch's Industry Classifications, as defined herein.

<sup>3</sup> Preferred stock has a minimum issue size of \$50 million for all rating categories in the table.

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Where the Trust sells an asset and agrees to repurchase such asset in the future, the Discounted Value of such asset will constitute a Fitch Eligible Asset and the amount the Trust is required to pay upon repurchase of such asset will count as a liability for the purposes of the Preferred Shares Basic Maintenance Amount. Where the Trust purchases an asset and agrees to sell it to a third party in the future, cash receivable by the Trust thereby will constitute a Fitch Eligible Asset if the long-term debt of such other party is rated at least A- by Fitch Ratings or the equivalent by another Rating Agency and such agreement has a term of 30 days or less; otherwise the Discounted Value of such purchased asset will constitute a Fitch Eligible Asset.

Notwithstanding the foregoing, an asset will not be considered a Fitch Eligible Asset to the extent that it has been irrevocably deposited for the payment of (i)(A) through (i)(E) under the definition of Preferred Shares Basic Maintenance Amount or to the extent it is subject to any Liens, except for (A) Liens which are being contested in good faith by appropriate proceedings and which Fitch Ratings has indicated to the Trust will not affect the status of such asset as a Fitch Eligible Asset, (B) Liens for taxes that are not then due and payable or that can be paid thereafter without penalty, (C) Liens to secure payment for services rendered or cash advanced to the Trust by its investment manager or portfolio manager, the Trust's custodian, transfer agent or registrar or the Auction Agent and (D) Liens arising by virtue of any repurchase agreement.

Fitch Exposure Period means the period commencing on (and including) a given Valuation Date and ending 49 days thereafter.

Fitch Hedging Transactions has the meaning set forth in Section 11.8(f) of these Bylaws.

Fitch Industry Classifications means, for the purposes of determining Fitch Eligible Assets, each of the following industry classifications (or such other classifications as Fitch Ratings may from time to time approve for application to the AMPS):

1. Aerospace & Defense
  
2. Automobiles
  
3. Banking, Finance & Real Estate
  
4. Broadcasting & Media
  
5. Building & Materials
  
6. Business Services

7. Cable

8. Chemicals

9. Computers & Electronics

10. Consumer Products

11. Energy

12. Environmental Services

13. Farming & Agriculture

14. Food, Beverage & Tobacco

15. Gaming, Lodging & Restaurants

16. Healthcare & Pharmaceuticals

17. Industrial/Manufacturing

18. Insurance

19. Leisure & Entertainment

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- 20. Metals & Mining
- 21. Miscellaneous
- 22. Packaging and Containers
- 23. Paper & Forest Products
- 24. Retail
- 25. Sovereign
- 26. Structured Finance Obligations
- 27. Supermarkets & Drugstores
- 28. Telecommunications
- 29. Textiles & Furniture
- 30. Transportation
- 31. Utilities

The Trust shall use its discretion in determining which industry classification is applicable to a particular investment.

Fitch Loan Category means the following four categories (and, for purposes of this categorization, the Market Value of a Fitch Eligible Asset trading at par is equal to \$1.00):

- (i) Fitch Loan Category A means Performing Bank Loans which have a Market Value or an Approved Price greater than or equal to \$.90.
- (ii) Fitch Loan Category B means: (A) Performing Bank Loans which have a Market Value or an Approved Price of greater than or equal to \$.80 but less than \$.90; and (B) non-Performing Bank Loans which have a Market Value or an Approved Price greater than or equal to \$.85.
- (iii) Fitch Loan Category C means: (A) Performing Bank Loans which have a Market Value or an Approved Price of greater than or equal to \$.70 but less than \$.80; (B) non-Performing Bank Loans which have a Market Value or an Approved Price of greater than or equal to \$.75 but less than \$.85; and (C) Performing Bank Loans without an Approved Price rated BB- or higher by Fitch Ratings. If a security is not rated by Fitch Ratings but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A- and the Moody's rating is Baa1, a rating by Fitch Ratings of BBB+ will be used). If a security is not rated by Fitch Ratings but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA-, a rating by Fitch Ratings of AAA- will be used, and where the only rating on a security is a Moody's rating of Ba3, a rating by Fitch Ratings of BB- will be used).

(iv) Fitch Loan Category D means Bank Loans not described in any of the foregoing categories.

Notwithstanding any other provision contained above, for purposes of determining whether a Fitch Eligible Asset falls within a specific Fitch Loan Category, to the extent that any Fitch



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Eligible Asset would fall within more than one of the Fitch Loan Categories, such Fitch Eligible Asset shall be deemed to fall into the Fitch Loan Category with the lowest applicable Fitch Discount Factor.

Fitch Ratings means Fitch, Inc., doing business as Fitch Ratings, or its successors.

Foreign Bonds has the meaning set forth in clause (vi) of the definition of Fitch Eligible Assets.

Forward Commitment has the meaning set forth in Section 11.8(d) of these Bylaws.

Holder means a Person identified as a holder of record of AMPS in the Share Register.

Independent Accountant means a nationally recognized accountant, or firm of accountants, that is, with respect to the Trust, an independent registered public accountant or firm of independent registered public accountants under the Securities Act and serving as such for the Trust.

Initial Dividend Payment Date means, with respect to a series of AMPS, the initial dividend payment date with respect to the Initial Dividend Period as determined by the Board of Trustees of the Trust or pursuant to their delegated authority with respect to such series.

Initial Dividend Period has the meaning set forth in Section 11.2(c)(i) of these Bylaws.

Initial Dividend Rate means, with respect to a series of AMPS, the rate per annum applicable to the Initial Dividend Period for such series of AMPS.

LIBOR Dealers means Merrill Lynch, Pierce, Fenner and Smith Incorporated and such other dealer or dealers as the Trust may from time to time appoint, or, in lieu of any thereof, their respective affiliates or successors.

LIBOR Rate, on any Auction Date, means (i) the rate for deposits in U.S. dollars for the designated Dividend Period, which appears on display page 3750 of Moneyline's Telerate Service ( Telerate Page 3750 ) (or such other page as may replace that page on that service, or such other service as may be selected by the LIBOR Dealer or its successors that are LIBOR Dealers) as of 11:00 a.m., London time, on the day that is the London Business Day preceding the Auction Date (the LIBOR Determination Date ), or (ii) if such rate does not appear on Telerate Page 3750 or such other page as may replace such Telerate Page 3750, (A) the LIBOR Dealer will determine the arithmetic mean of the offered quotations of the Reference Banks to leading banks in the London interbank market for deposits in U.S. dollars for the designated Dividend Period in an amount determined by such LIBOR Dealer by reference to requests for quotations as of approximately 11:00 a.m. (London time) on such date made by such LIBOR Dealer to the Reference Banks, (B) if at least two of the Reference Banks provide such quotations, LIBOR Rate will equal such arithmetic mean of such quotations, (C) if only one or none of the Reference Banks provide such quotations, LIBOR Rate will be deemed to be the arithmetic mean of the offered quotations that leading banks in The City of New York selected by the LIBOR Dealer (after obtaining

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the Trusts approval) are quoting on the relevant LIBOR Determination Date for deposits in U.S. dollars for the designated Dividend Period in an amount determined by the LIBOR Dealer (after obtaining the

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Trust's approval) that is representative of a single transaction in such market at such time by reference to the principal London offices of leading banks in the London interbank market; provided, however, that if one of the LIBOR Dealers does not quote a rate required to determine the LIBOR Rate, the LIBOR Rate will be determined on the basis of the quotation or quotations furnished by any Substitute LIBOR Dealer or Substitute LIBOR Dealers selected by the Trust to provide such rate or rates not being supplied by the LIBOR Dealer; provided further, that if the LIBOR Dealer and Substitute LIBOR Dealers are required but unable to determine a rate in accordance with at least one of the procedures provided above, LIBOR Rate will be LIBOR Rate as determined on the previous Auction Date. If the number of Dividend Period days will be (i) 7 or more but fewer than 21 days, such rate will be the seven-day LIBOR rate; (ii) 21 or more but fewer than 49 days, such rate will be the one-month LIBOR rate; (iii) 49 or more but fewer than 77 days, such rate will be the two-month LIBOR rate; (iv) 77 or more but fewer than 112 days, such rate will be the three-month LIBOR rate; (v) 112 or more but fewer than 140 days, such rate will be the four-month LIBOR rate; (vi) 140 or more but fewer than 168 days, such rate will be the five-month LIBOR rate; (vii) 168 or more but fewer than 189 days, such rate will be the six-month LIBOR rate; (viii) 189 or more but fewer than 217 days, such rate will be the seven-month LIBOR rate; (ix) 217 or more but fewer than 252 days, such rate will be the eight-month LIBOR rate; (x) 252 or more but fewer than 287 days, such rate will be the nine-month LIBOR rate; (xi) 287 or more but fewer than 315 days, such rate will be the ten-month LIBOR rate; (xii) 315 or more but fewer than 343 days, such rate will be the eleven-month LIBOR rate; and (xiii) 343 or more but fewer than 365 days, such rate will be the twelve-month LIBOR rate.

Lien means any material lien, mortgage, pledge, security interest or security agreement of any kind.

London Business Day means any day on which commercial banks are generally open for business in London.

Long Term Dividend Period means a Special Dividend Period consisting of a specified period of one whole year or more but not greater than five years (sometimes referred to as a Long Term Special Rate Period).

Mandatory Redemption Price means \$25,000 per Auction Market Preferred Share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption.

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Market Value of any asset of the Trust shall be the market value thereof determined by a Pricing Service. The Market Value of any asset shall include any interest accrued thereon. A Pricing Service shall value portfolio securities at the quoted bid prices or the mean between the quoted bid and asked prices or the yield equivalent when quotations are not readily available. Securities for which quotations are not readily available shall be valued at fair value as determined by a Pricing Service using methods which include consideration of: yields or prices of securities of comparable quality, type of issue, coupon, maturity and rating; indications as to value from dealers; and general market conditions. A Pricing Service may employ electronic data processing techniques and/or a matrix system to determine valuations. In the event a Pricing Service is unable to value a security, the security shall be valued at the lower of two bid quotations obtained by the Trust from dealers who are members of the National Association of Securities Dealers, Inc. and who make a market in the security, at least one of which shall be in writing. If two bid quotations are not readily available for any securities, such securities shall be valued in good faith at fair value pursuant to procedures approved by the Board of Trustees of the Trust. Futures contracts and options are valued at the closing prices for such instruments established by the exchange or board of trade on which they are traded, or if market quotations are not readily available, are valued at fair value in good faith pursuant to procedures approved by the Board of Trustees of the Trust. All other assets will be valued at fair value on a consistent basis using methods determined in good faith by the Board of Trustees of the Trust.

Maximum Applicable Rate, with respect to AMPS, has the meaning set forth in Section 11.10(a)(vii) of these Bylaws.

Moody's means Moody's Investors Service, Inc. or its successors.

Moody's Discount Factor means, for purposes of determining the Discounted Value of any Moody's Eligible Asset, the percentage determined as follows. The Moody's Discount Factor for any Moody's Eligible Asset other than the securities set forth below will be the percentage provided in writing by Moody's.

(i) Convertible securities (including convertible preferred stock): (1) For convertible securities having a Delta between 0.4 and 0.0, the Moody's Discount Factor shall be 100% of the Moody's Discount Factor applied to non-convertible corporate debt securities (i.e. using the Moody's Discount Factors found in the subsection (ii) of this definition), (2) for convertible securities having a Delta between 0.8 and 0.4, the Moody's Discount Factor shall be 192% for securities rated Baa or above and 226% for securities rated Ba and below, and (3) for convertible securities having a Delta between 1.0 and 0.8, the Moody's Discount Factor shall be 195% for securities rated Baa or above and 229% for securities rated Ba and below; provided, however, that for any unrated convertible security, the Moody's Discount Factor shall be 250%.<sup>2</sup>

<sup>1</sup> Unless conclusions regarding liquidity risk as well as estimates of both the probability and severity of default for applicable Trust assets can be derived from other sources as well as combined with a number of sources as presented by the Trust to Moody's, unrated fixed-income and convertible securities, which are securities that are not rated by any of Moody's, S&P or Fitch Ratings, are limited to 10% of Moody's Eligible Assets for purposes of calculations related to the APS Basic Maintenance Amount. If a convertible security is not rated by any of Moody's, S&P or Fitch Ratings, the Trust will consider the security unrated for the purposes of the discounts discussed above. Ratings assigned by S&P and/or Fitch Ratings are generally accepted at face value. However, adjustments to face value may be made to particular categories of credits for which the ratings by S&P and/or Fitch Ratings do not seem to

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approximate a Moody's rating equivalent. Split-rated securities assigned by S&P and Fitch Ratings (i.e., these Rating Agencies assign different rating categories to the security) will be accepted at the lower of the two ratings.

<sup>2</sup> Discount factors are for 7-week exposure period.

For the purposes of determining such discount factors,  $\Delta$ , which is intended to express the change in the price of the convertible security per unit of change in the price of the common stock into which the convertible security is convertible, shall be the number provided by Merrill Lynch, Pierce, Fenner and Smith, Incorporated or such other provider as the Trust shall determine from time to time. The Trust shall use commercially reasonable efforts to update such Delta figures monthly.

Upon conversion to common stock, the Discount Factors applicable to common stock will apply:

| <u>Common Stocks<sup>(1)</sup></u> | <u>Large-Cap</u> | <u>Mid-Cap</u> | <u>Small Cap</u> |
|------------------------------------|------------------|----------------|------------------|
| 7 week exposure period             | 200%             | 205%           | 220%             |

<sup>(1)</sup> Market cap for Large-cap stocks are \$10 billion and up, Mid-cap stocks range between \$2 billion and \$10 billion, and Small-cap stocks are \$2 billion and below.

(ii) Corporate debt securities (non-convertible): The percentage determined by reference to the rating on such asset with reference to the remaining term to maturity of such asset, in accordance with the table set forth below.

| <u>Term to Maturity of</u><br><u>Corporate Debt Security</u> | <u>Moody's Rating Category</u> |           |          |            |           |          |  |
|--|--------------------------------|-----------|----------|------------|-----------|----------|--|
|  | <u>Aaa</u>                     | <u>Aa</u> | <u>A</u> | <u>Baa</u> | <u>Ba</u> | <u>B</u> | <u>Below B and Unrated<sup>1</sup></u> |
| 1 year or less   | 109%                           | 112%      | 115%     | 118%       | 137%      | 150%     | 250%                                   |
| 2 years or less (but longer than 1 year)                     | 115                            | 118       | 122      | 125        | 146       | 160      | 250                                    |
| 3 years or less (but longer than 2 years)                    | 120                            | 123       | 127      | 131        | 153       | 168      | 250                                    |
| 4 years or less (but longer than 3 years)                    | 126                            | 129       | 133      | 138        | 161       | 176      | 250                                    |
| 5 years or less (but longer than 4 years)                    | 132                            | 135       | 139      | 144        | 168       | 185      | 250                                    |
| 7 years or less (but longer than 5 years)                    | 139                            | 143       | 147      | 152        | 179       | 197      | 250                                    |
| 10 years or less (but longer than 7 years)                   | 145                            | 150       | 155      | 160        | 189       | 208      | 250                                    |
| 15 years or less (but longer than 10 years)                  | 150                            | 155       | 160      | 165        | 196       | 216      | 250                                    |
| 20 years or less (but longer than 15 years)                  | 150                            | 155       | 160      | 165        | 196       | 228      | 250                                    |
| 30 years or less (but longer than 20 years)                  | 150                            | 155       | 160      | 165        | 196       | 229      | 250                                    |
| Greater than 30 years  | 165                            | 173       | 181      | 189        | 205       | 240      | 250                                    |

<sup>1</sup> Unless conclusions regarding liquidity risk as well as estimates of both the probability and severity of default for applicable Trust assets can be derived from other sources as well as combined with a number of sources as presented by the Trust to Moody's, securities rated below B by Moody's and, unrated fixed-income and convertible securities (which are securities that are not rated by any of Moody's, S&P or Fitch Ratings) are limited to 10% of Moody's Eligible Assets for purposes of calculations related to the Preferred Shares Basic Maintenance Amount. If a corporate debt security is not rated by any of Moody's, S&P or Fitch Ratings, the Trust will use the applicable

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percentage set forth under the column entitled "Below B and Unrated" in the table above. Ratings assigned by S&P and/or Fitch Ratings are generally accepted by Moody's at face value. However, adjustments to face value may be made to particular categories of credits for which the ratings by S&P and/or Fitch Ratings do not seem to approximate a Moody's rating equivalent. Split-rated securities assigned by S&P and Fitch Ratings (i.e., these Rating Agencies assign different rating categories to the security) will be accepted at the lower of the two ratings.

The Moody's Discount Factors presented in the immediately preceding table will also apply to Moody's Eligible Assets that are FHLB, FNMA and FFCB Debentures and to

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rated TRACERs and TRAINs, whereby the ratings in the table will be applied to the underlying securities and the Market Value of each underlying security will be its proportionate amount of the Market Value of the TRACER or TRAIN, provided that (i) the Moody's Discount Factor for any TRAIN or TRACER rated by Moody's will be the percentage determined, based on the Moody's rating of the TRAIN or TRACER, in accordance with the table set forth above and (ii) the Moody's Discount Factors determined from the table shall be multiplied by a factor of 120% for purposes of calculating the Discounted Value of TRAINs. The Moody's Discount Factors presented in the immediately preceding table will also apply to corporate debt securities that do not pay interest in U.S. dollars or euros. The Trust will consult with Moody's to determine incremental discount factors for non-U.S. dollar and non-euro denominated bonds.

(iii) Preferred stock (other than convertible preferred stock, which is subject to paragraph (i) above): The Moody's Discount Factor for preferred stock shall be (A) for preferred stocks issued by a utility, 155%; (B) for preferred stocks of industrial and financial issuers, 209%; and (C) for auction rate preferred stocks, 350%.

(iv) Short-term instruments: The Moody's Discount Factor applied to short-term portfolio securities, including without limitation short-term corporate debt securities, Short Term Money Market Instruments and short-term municipal debt obligations, will be (A) 100%, so long as such portfolio securities mature or have a demand feature at par exercisable within the Moody's Exposure Period; (B) 115%, so long as such portfolio securities do not mature within the Moody's Exposure Period, or have a demand feature at par not exercisable within the Moody's Exposure Period; and (C) 125%, if such securities are not rated by Moody's, so long as such portfolio securities are rated at least A-1+/AA or SP-1+/AA by S&P or Fitch Ratings and mature or have a demand feature at par exercisable within the Moody's Exposure Period. A Moody's Discount Factor of 100% will be applied to cash.

(v) U.S. Government Securities and U.S. Treasury Strips: The percentage determined by reference to the remaining term to maturity of such asset, in accordance with the table set forth below.

| <u>Remaining Term to Maturity</u>           | <u>U.S. Government Securities<br/>Discount Factor</u> | <u>U.S. Treasury Strips<br/>Discount Factor</u> |
|---|---|---|
| 1 year or less                              | 107%  | 107%  |
| 2 years or less (but longer than 1 year)    | 113   | 115   |
| 3 years or less (but longer than 2 years)   | 118   | 121   |
| 4 years or less (but longer than 3 years)   | 123   | 128   |
| 5 years or less (but longer than 4 years)   | 128   | 135   |
| 7 years or less (but longer than 5 years)   | 135   | 147   |
| 10 years or less (but longer than 7 years)  | 141   | 163   |
| 15 years or less (but longer than 10 years) | 146   | 191   |
| 20 years or less (but longer than 15 years) | 154   | 218   |
| 30 years or less (but longer than 20 years) | 154   | 244   |

(vi) Rule 144A Securities: The Moody's Discount Factor applied to Rule 144A Securities whose terms include rights to registration under the Securities Act exercisable within 1 year of the applicable date shall be 100% of the Moody's Discount Factor that

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would apply were the securities registered under the Securities Act. The Moody's Discount Factor applied to Rule 144A Securities whose terms include rights to registration under the Securities Act that are not exercisable within 1 year of the applicable date shall be 120% of the Moody's Discount Factor that would apply were the securities registered under the Securities Act. The Moody's Discount Factor applied to Rule 144A Securities whose terms do not include rights to registration under the Securities Act shall be 130% of the Moody's Discount Factor that would apply were the securities registered under the Securities Act.

(vii) Bank Loans: The Moody's Discount Factor applied to senior Bank Loans ( Senior Loans ) shall be the percentage specified in accordance with the table set forth below (or such lower percentages as Moody's may approve in writing from time to time):

| <u>Type of Loan</u>         | <u>Moody's Rating Category</u> |                                |                       |  |
|-----------------------------|--------------------------------|--------------------------------|-----------------------|--|
|                             | <u>Aaa-A</u>                   | <u>Baa and Ba</u> <sup>1</sup> | <u>B</u> <sup>1</sup> | <u>Caa and below<br/>(including distressed<br/>and unrated)</u> <sup>1</sup> |
| Senior Loans > \$250 MM     | 118%                           | 136%                           | 149%                  | 250%   |
| Non-Senior Loans > \$250 MM | 128%                           | 146%                           | 159%                  | 260%   |
| Loans < \$250 MM            | 138%                           | 156%                           | 169%                  | 270%   |
| Second Lien Bank Loans      | 168%                           | 188%                           | 200%                  | 270%   |

<sup>1</sup> If a Bank Loan is not rated by any of Moody's, S&P or Fitch Ratings, the Trust will use the applicable percentage set forth under the column entitled "Caa and below (including distressed and unrated)" in the table above. Ratings assigned by S&P and/or Fitch Ratings are generally accepted by Moody's at face value. However, adjustments to face value may be made to particular categories of securities for which the ratings by S&P and/or Fitch Ratings do not seem to approximate a Moody's rating equivalent. Split-rated securities assigned by S&P and Fitch Ratings (i.e., these Rating Agencies assign different rating categories to the security) will be accepted at the lower of the two ratings; provided however, that, in a situation where a security is rated "B" (or equivalent) by a given Rating Agency and rated "Caa" (or equivalent) by another Rating Agency, the Trust will use the applicable percentage set forth under the column entitled "B" in the table above.



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(viii) Asset-backed and mortgage-backed securities: The Moody's Discount Factor applied to asset-backed securities shall be 131%. The Moody's Discount Factor applied to collateralized mortgage obligations, planned amortization class bonds and targeted amortization class bonds shall be determined by reference to the weighted average life of the security and whether cash flow is retained (*i.e.*, controlled by a trustee) or excluded (*i.e.*, not controlled by a trustee), in accordance with the table set forth below.

| <u>Remaining Term to Maturity</u>           | <u>Cash Flow Retained</u> | <u>Cash Flow Excluded</u> |
|---|---------------------------|---------------------------|
| 3 years or less                             | 133%                      | 141%                      |
| 7 years or less (but longer than 3 years)   | 142                       | 151                       |
| 10 years or less (but longer than 7 years)  | 158                       | 168                       |
| 20 years or less (but longer than 10 years) | 174                       | 185                       |

The Moody's Discount Factor applied to residential mortgage pass-throughs (including private-placement mortgage pass-throughs) shall be determined by reference to the coupon paid by such security and whether cash flow is retained (*i.e.*, controlled by a trustee) or excluded (*i.e.*, not controlled by a trustee), in accordance with the table set forth below.

| <u>Coupon</u> | <u>Cash Flow Retained</u> | <u>Cash Flow Excluded</u> |
|---------------|---------------------------|---------------------------|
| 5%            | 166%                      | 173%                      |
| 6             | 162                       | 169                       |
| 7             | 158                       | 165                       |
| 8             | 154                       | 161                       |
| 9             | 151                       | 157                       |
| 10            | 148                       | 154                       |
| 11            | 144                       | 154                       |
| 12            | 142                       | 151                       |
| 13            | 139                       | 148                       |
| adjustable    | 165                       | 172                       |

The Moody's Discount Factor applied to fixed-rate pass-throughs that are not rated by Moody's and are serviced by a servicer approved by Moody's shall be determined by reference to the table in the following paragraph (relating to whole loans).

The Moody's Discount Factor applied to whole loans shall be determined by reference to the coupon paid by such security and whether cash flow is retained (*i.e.*, controlled by a trustee) or excluded (*i.e.*, not controlled by a trustee), in accordance with the table set forth below.

| <u>Coupon</u> | <u>Cash Flow Retained</u> | <u>Cash Flow Excluded</u> |
|---------------|---------------------------|---------------------------|
| 5%            | 172%                      | 179%                      |
| 6             | 167                       | 174                       |
| 7             | 163                       | 170                       |
| 8             | 159                       | 165                       |
| 9             | 155                       | 161                       |

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|            |     |     |
|------------|-----|-----|
| 10         | 151 | 158 |
| 11         | 148 | 157 |
| 12         | 145 | 154 |
| 13         | 142 | 151 |
| adjustable | 170 | 177 |

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(ix) Municipal debt obligations: The Moody's Discount Factor applied to municipal debt obligations shall be the percentage determined by reference to the rating on such asset and the shortest Exposure Period set forth opposite such rating that is the same length as or is longer than the Moody's Exposure Period, in accordance with the table set forth below (provided that, except as provided in the following table, any municipal obligation:

| <u>Exposure Period</u>                       | <u>Aaa</u> | <u>Aa</u> | <u>A</u> | <u>Baa</u> | <u>Other</u> | <u>(V)MIG-1<sup>1</sup></u> | <u>SP-1+<sup>2</sup></u> | <u>Unrated<sup>3</sup></u> |
|--|------------|-----------|----------|------------|--------------|-----------------------------|--------------------------|----------------------------|
| 7 weeks                                      | 151%       | 159%      | 166%     | 173%       | 187%         | 136%                        | 148%                     | 225%                       |
| 8 weeks or less but greater than seven weeks | 154        | 161       | 168      | 176        | 190          | 137                         | 149                      | 231                        |
| 9 weeks or less but greater than eight weeks | 158        | 163       | 170      | 177        | 192          | 138                         | 150                      | 240                        |

<sup>1</sup> Municipal debt obligations not rated by Moody's but rated equivalent to MIG-1, (V)MIG-1, or P-1, by S&P and Fitch Ratings that have a maturity less than or equal to 49 days.

<sup>2</sup> Municipal debt obligations not rated by Moody's but rated equivalent to MIG-1, (V)MIG-1, or P-1 by S&P and Fitch Ratings that have a maturity greater than 49 days.

<sup>3</sup> Unless conclusions regarding liquidity risk as well as estimates of both the probability and severity of default for the corporation's or municipal issuer's assets can be derived from other sources as well as combined with a number of sources as presented by the Trust to Moody's securities rated below B by Moody's and unrated securities, which are securities rated by neither Moody's, S&P nor Fitch Ratings, are limited to 10% of Moody's Eligible Assets. If a municipal debt security is unrated by Moody's, S&P or Fitch, the Trust will use the percentage set forth under Other in the Municipal Debt Table. Ratings assigned by S&P or Fitch are generally accepted by Moody's at face value (e.g., treating a rating of AAA by S&P or Fitch Ratings as Aaa for purposes of the table above and a rating of AA by S&P or Fitch Ratings as Aa for purposes of the table above. However, adjustments to face value may be made to particular categories of credits for which the ratings by S&P and/or Fitch Rating do not seem to approximate a Moody's rating equivalent. Split-rated securities assigned by S&P and Fitch Ratings (i.e., these Rating Agencies assign different rating categories to the security) will be accepted at the lower of the two ratings.

(x) Structured Notes: The Moody's Discount Factor applied to Structured Notes will be (A) in the case of a corporate issuer, the Moody's Discount Factor determined in accordance with paragraph (ii) under this definition, whereby the rating on the issuer of the Structured Note will be the rating on the Structured Note for purposes of determining the Moody's Discount Factor in the table in paragraph (ii); and (B) in the case of an issuer that is the U.S. government or an agency or instrumentality thereof, the Moody's Discount Factor determined in accordance with paragraph (v) under this definition.

The Moody's Discount Factor for any Moody's Eligible Asset other than the securities set forth above will be the percentage provided in writing by Moody's. Additionally, in order to merit consideration as a Moody's Eligible Asset, securities should be issued by entities which: (a) have not filed for bankruptcy within the past three years, (b) are current on all principal and interest in their fixed income obligations, (c) are current on all preferred stock dividends, and (d) possess a current, unqualified auditor's report without qualified, explanatory language.

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Moody's Eligible Assets means

(i) cash (including interest and dividends due on assets rated (A) Baa3 or higher by Moody's if the payment date is within five Business Days of the Valuation Date, (B) A2 or higher if the payment date is within thirty days of the Valuation Date, and (C) A1 or higher if the payment date is within the Moody's Exposure Period) and receivables for Moody's Eligible Assets sold if the receivable is due within five Business Days of the Valuation Date, and if the trades which generated such receivables are (A) settled through clearing house firms or (B) (1) with counterparties having a Moody's long-term debt rating of at least Baa3 or (2) with counterparties having a Moody's Short Term Money Market Instrument rating of at least P-1;

(ii) Short Term Money Market Instruments so long as (A) such securities are rated at least P-1, (B) in the case of demand deposits, time deposits and overnight funds, the supporting entity is rated at least A2, or (C) in all other cases, the supporting entity (1) is rated A2 and the security matures within one month, (2) is rated A1 and the security matures within three months or (3) is rated at least Aa3 and the security matures within six months; provided, however, that for purposes of this definition, such instruments (other than commercial paper rated by S&P or Fitch Ratings and not rated by Moody's) need not meet any otherwise applicable rating criteria of S&P or Fitch Ratings;

(iii) U.S. Government Securities and U.S. Treasury Strips;

(iv) Rule 144A Securities;

(v) Senior Loans and other Bank Loans\*

\* Bank Loans that are not Senior Loans will be designated in any Preferred Shares Basic Maintenance Report delivered to Moody's.

(vi) Corporate debt securities if (A) such securities are rated Caa or higher by Moody's; (B) such securities provide for the periodic payment of interest in cash in U.S. dollars or euros, except that such securities that do not pay interest in U.S. dollars or euros shall be considered Moody's Eligible Assets if they are rated by Moody's, S&P or Fitch Ratings; (C) for securities which provide for conversion or exchange into equity capital at some time over their lives, the issuer must be rated at least B3 by Moody's and the discount factor will be 250%; (D) for debt securities rated Ba1 and below, no more than 10% of the original amount of such issue may constitute Moody's Eligible Assets; (E) such securities have been registered under the Securities Act or are restricted as to resale under federal securities laws but are eligible for resale pursuant to Rule 144A under the Securities Act as determined by the Trust's investment manager or portfolio manager acting pursuant to procedures approved by the Board of Trustees, except that such securities that are not subject to U.S. federal securities laws shall be considered Moody's Eligible Assets if they are publicly traded; and (F) such securities are not subject to extended settlement.

Notwithstanding the foregoing limitations, (x) corporate debt securities not rated at least Caa by Moody's or not rated by Moody's shall be considered to be Moody's Eligible

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Assets only to the extent the Market Value of such corporate debt securities does not exceed 10% of the aggregate Market Value of all Moody's Eligible Assets; provided, however, that if the Market Value of such corporate debt securities exceeds 10% of the aggregate Market Value of all Moody's Eligible Assets, a portion of such corporate debt securities (selected by the Trust) shall not be considered Moody's Eligible Assets, so that the Market Value of such corporate debt securities (excluding such portion) does not exceed 10% of the aggregate Market Value of all Moody's Eligible Assets; and (y) corporate debt securities rated by none of Moody's, S&P, or Fitch Ratings shall be considered to be Moody's Eligible Assets only to the extent such securities are issued by entities which (i) have not filed for bankruptcy within the past three years, (ii) are current on all principal and interest in their fixed income obligations, (iii) are current on all preferred stock dividends and (iv) possess a current, unqualified auditor's report without qualified, explanatory language.

(vii) Convertible securities (including convertible preferred stock), provided that (A) the issuer of common stock must have a Moody's senior unsecured debt of Caa or better, or a rating of CCC or better by S&P or Fitch Ratings, (B) the common stocks must be traded on the New York Stock Exchange, the American Stock Exchange, or the NASDAQ, (C) dividends must be paid in U.S. dollars, (D) the portfolio of convertible bonds must be diversified as set forth in the table set forth below, (E) the company shall not hold shares exceeding the average weekly trading volume during the preceding month and (F) synthetic convertibles are excluded from asset eligibility.

**Convertible Bonds Diversification Guidelines**

| <u>Type</u> | <u>Maximum Single Issuer (%)<sup>1</sup></u> | <u>Maximum Single Industry (%)</u> | <u>Maximum Single State (%)<sup>1</sup></u> |
|-------------|--|------------------------------------|---|
| Utility     | 4  | 50                                 | 7 <sup>2</sup>                              |
| Other       | 6  | 20                                 | n/a   |

<sup>1</sup> Percentage represent a portion of the aggregate market value and number of outstanding shares of the convertible stock portfolio.

<sup>2</sup> Utility companies operating in more than one state should be diversified according to the state in which they generate the largest part of their revenues. Publicly available information on utility company revenues by state is available from the Uniform Statistical Report (USR) or the Federal Energy Regulation Commission (FERC).

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(viii) Preferred stocks if (A) dividends on such preferred stock are cumulative, (B) such securities provide for the periodic payment of dividends thereon in cash in U.S. dollars or euros and do not provide for conversion or exchange into, or have warrants attached entitling the holder to receive, equity capital at any time over the respective lives of such securities, (C) the issuer of such a preferred stock has common stock listed on either the New York Stock Exchange, the American Stock Exchange or the NASDAQ, (D) the issuer of such a preferred stock has a senior debt rating from Moody's of Baa1 or higher or a preferred stock rating from Moody's of Baa3 or higher and (E) such preferred stock has paid consistent cash dividends in U.S. dollars or euros over the last three years or has a minimum rating of A1 (if the issuer of such preferred stock has other preferred issues outstanding that have been paying dividends consistently for the last three years, then a preferred stock without such a dividend history would also be eligible); provided, however, that convertible preferred stock shall be treated as convertible securities in accordance with paragraph (vii) above. In addition, the preferred stocks must have the following diversification requirements: (X) the preferred stock issue must be greater than \$50 million and (Y) the minimum holding by the Trust of each issue of preferred stock is \$500,000 and the maximum holding of preferred stock of each issue is \$5 million. In addition, preferred stocks issued by transportation companies will not be considered Moody's Eligible Assets;

(ix) Asset-backed and mortgage-backed securities:

(A) Asset-backed securities if (1) such securities are rated at least Aa3 by Moody's or at least AA by S&P or Fitch Ratings, (2) the securities are part of an issue that is \$250 million or greater, or the issuer of such securities has a total of \$500 million or greater of asset-backed securities outstanding at the time of purchase of the securities by the Trust and (3) the expected average life of the securities is not greater than 4 years;

(B) Collateralized mortgage obligations ( CMOs ), including CMOs with interest rates that float at a multiple of the change in the underlying index according to a pre-set formula, provided that any CMO held by the Trust (1) has been rated Aaa by Moody's or AAA by S&P or Fitch Ratings, (2) does not have a coupon which floats inversely, (3) is not portioned as an interest-only or principal-only strip and (4) is part of an issuance that had an original issue size of at least \$100 million;

(C) Planned amortization class bonds ( PACs ) and targeted amortization class bonds ( TACs ) provided that such PACs or TACs are (1) backed by certificates of either the Federal National Mortgage Association ( FNMA ), the Government National Mortgage Association ( GNMA ) or the Federal Home Loan Mortgage Corporation ( FHLMC ) representing ownership in single-family first lien mortgage loans with original terms of 30 years, (2) part of an issuance that had an original issue size of at least \$10 million, (3) part of PAC or TAC classes that have payment priority over other PAC or TAC classes, (4) if TACs, TACs that do not support PAC classes, and (5) if TACs, not considered reverse TACs (*i.e.*, do not protect against extension risk);

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(D) Consolidated senior debt obligations of Federal Home Loan Banks ( FHLBs ), senior long-term debt of the FNMA, and consolidated systemwide bonds and FCS Financial Assistance Corporation Bonds of Federal Farm Credit Banks ( FFCBs ) (collectively, FHLB, FNMA and FFCB Debentures ), provided that such FHLB, FNMA and FFCB Debentures are (1) direct issuance corporate debt rated Aaa by Moody's, (2) senior debt obligations backed by the FHLBs, FFCBs or FNMA, (3) part of an issue entirely denominated in U.S. dollars and (4) not callable or exchangeable debt issues;

(E) Mortgage pass-throughs rated at least Aa by Moody's and pass-throughs issued prior to 1987 (if rated AA by S&P or Fitch Ratings and based on fixed-rate mortgage loans) by Travelers Mortgage Services, Citicorp Homeowners, Citibank, N.A., Sears Mortgage Security or RFC Salomon Brothers Mortgage Securities, Inc., provided that (1) certificates must evidence a proportional, undivided interest in specified pools of fixed or adjustable rate mortgage loans, secured by a valid first lien, on one- to four-family residential properties and (2) the securities are publicly registered (not issued by FNMA, GNMA or FHLMC);

(F) Private-placement mortgage pass-throughs provided that (1) certificates represent a proportional undivided interest in specified pools of fixed-rate mortgage loans, secured by a valid first lien, on one- to four-family residential properties, (2) documentation is held by a trustee or independent custodian, (3) pools of mortgage loans are serviced by servicers that have been approved by FNMA or FHLMC and funds shall be advanced to meet deficiencies to the extent provided in the pooling and servicing agreements creating such certificates, and (4) pools have been rated Aa or better by Moody's; and

(G) Whole loans (*e.g.*, direct investments in mortgages) provided that (1) at least 65% of such loans (a) have seasoning of no less than 6 months, (b) are secured by single-family detached residences, (c) are owner-occupied primary residences, (d) are secured by a first-lien, fully-documented mortgage, (e) are neither currently delinquent (30 days or more) nor delinquent during the preceding year, (f) have loan-to-value ratios of 80% or below, (g) carry normal hazard insurance and title insurance, as well as special hazard insurance, if applicable, (h) have original terms to maturity not greater than 30 years, with at least one year remaining to maturity, (i) have a minimum of \$10,000 remaining principal balance, (j) for loans underwritten after January 1, 1978, FNMA and/or FHLMC forms are used for fixed-rate loans, and (k) are whole loans and not participations; (2) for loans that do not satisfy the requirements set forth in the foregoing clause (1), (a) non-owner occupied properties represent no greater than 15% of the aggregate of either the adjustable-rate pool or the fixed-rate pool, (b) multi-family properties (those with five or more units) represent no greater than 15% of the aggregate of either the adjustable-rate pool or the fixed-rate pool, (c) condominiums represent no greater than 10% of the aggregate of either the adjustable-rate pool or the fixed-rate pool, and any condominium project must be 80% occupied at the time the loan is originated, (d) properties with loan-to-value ratios exceeding 80% represent no greater than 25% of the aggregate of either the adjustable-rate pool or the fixed-rate pool and that the portion of the mortgage on any such property that exceeds a loan-to-

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value ratio of 80% is insured with Primary Mortgage Insurance from an insurer rated at least Baa3 by Moody's and (e) loan balances in excess of the current FHLMC limit plus \$75,000 represent no greater than 25% of the aggregate of either the adjustable-rate pool or the fixed-rate pool, loan balances in excess of \$350,000 represent no greater than 10% of the aggregate of either the adjustable-rate pool or the fixed-rate pool, and loan balances in excess of \$1,000,000 represent no greater than 5% of the aggregate of either the adjustable-rate pool or the fixed-rate pool; (3) no greater than 5% of the pool of loans is concentrated in any one zip code; (4) the pool of loans contains at least 100 loans or \$2 million in loans per servicer; (5) for adjustable-rate mortgages (ARMs), (a) any ARM is indexed to the National Cost of Funds index, the 11th District Cost of Funds index, the 1-year Treasury or the 6-month Treasury, (b) the margin over the given index is between .15% and .25% for either cost-of-funds index and between .175% and .325% for Treasuries, (c) the maximum yearly interest rate increase is 2%, (d) the maximum life-time interest rate increase is 6.25% and (e) ARMs may include Federal Housing Administration and Department of Veterans Affairs loans; and (6) for teaser loans, (a) the initial discount from the current ARM market rate is no greater than 2%, (b) the loan is underwritten at the market rate for ARMs, not the teaser rate, and (c) the loan is seasoned six months beyond the teaser period.

(x) Any municipal debt obligation that (A) pays interest in cash, (B) does not have a Moody's rating, as applicable, suspended by Moody's, and (C) is part of an issue of municipal debt obligations of at least \$5,000,000, except for municipal debt obligations rated below A by Moody's, in which case the minimum issue size is \$10,000,000;

(xi) Structured Notes, rated TRACERs and TRAINs;

(xii) Financial contracts, as such term is defined in Section 3(c)(2)(B)(ii) of the 1940 Act, not otherwise provided for in this definition but only upon receipt by the Trust of a letter from Moody's specifying any conditions on including such financial contract in Moody's Eligible Assets and assuring the Trust that including such financial contract in the manner so specified would not affect the credit rating assigned by Moody's to the AMPS; and

(xiii) Common stock, preferred stock or any debt security of REITs or real estate companies.



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In addition, portfolio holdings as described below must be within the following diversification and issue size requirements in order to be included in Moody's Eligible Assets:

| <b>Ratings</b> <sup>1</sup> | <b>Maximum Single Issuer</b> <sup>2,3</sup> | <b>Maximum Single Industry</b> <sup>3,4</sup> | <b>Minimum Issue Size</b><br><b>(\$ in million)</b> <sup>5</sup> |
|-----------------------------|---|---|--|
| Aaa                         | 100%  | 100%  | \$ 100   |
| Aa                          | 20  | 60  | 100  |
| A                           | 10  | 40  | 100  |
| Baa                         | 6   | 20  | 100  |
| Ba                          | 4   | 12  | 50 <sup>6</sup>  |
| B1-B2                       | 3   | 8   | 50 <sup>6</sup>  |
| B3 or below                 | 2   | 5   | 50 <sup>6</sup>  |

<sup>1</sup> Refers to the preferred stock and senior debt rating of the portfolio holding.

<sup>2</sup> Companies subject to common ownership of 25% or more are considered as one issuer.

<sup>3</sup> Percentages represent a portion of the aggregate Market Value of corporate debt securities.

<sup>4</sup> Industries are determined according to Moody's Industry Classifications, as defined herein.

<sup>5</sup> Except for preferred stock, which has a minimum issue size of \$50 million.

<sup>6</sup> Portfolio holdings from issues ranging from \$50 million to \$100 million are limited to 20% of the Trust's total assets.

Where the Trust sells an asset and agrees to repurchase such asset in the future, the Discounted Value of such asset will constitute a Moody's Eligible Asset and the amount the Trust is required to pay upon repurchase of such asset will count as a liability for the purposes of the Preferred Shares Basic Maintenance Amount. Where the Trust purchases an asset and agrees to sell it to a third party in the future, cash receivable by the Trust thereby will constitute a Moody's Eligible Asset if the long-term debt of such other party is rated at least A2 by Moody's and such agreement has a term of 30 days or less; otherwise the Discounted Value of such purchased asset will constitute a Moody's Eligible Asset. For the purposes of calculation of Moody's Eligible Assets, portfolio securities which have been called for redemption by the issuer thereof shall be valued at the lower of Market Value or the call price of such portfolio securities.

Notwithstanding the foregoing, an asset will not be considered a Moody's Eligible Asset to the extent that it (i) has been irrevocably deposited for the payment of (i)(A) through (i)(E) under the definition of Preferred Shares Basic Maintenance Amount or to the extent it is subject to any Liens, except for (A) Liens which are being contested in good faith by appropriate proceedings and which Moody's has indicated to the Trust will not affect the status of such asset as a Moody's Eligible Asset, (B) Liens for taxes that are not then due and payable or that can be paid thereafter without penalty, (C) Liens to secure payment for services rendered or cash advanced to the Trust by its investment manager or portfolio manager, the Trust's custodian, transfer agent or registrar or the Auction Agent and (D) Liens arising by virtue of any repurchase agreement, or (ii) has been segregated against obligations of the Trust in connection with an outstanding derivative transaction.

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Moody's Exposure Period means the period commencing on a given Valuation Date and ending 49 days thereafter.

Moody's Hedging Transactions has the meaning set forth in Section 11.8(a) of these Bylaws.

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Moody's Industry Classification means, for the purposes of determining Moody's Eligible Assets, each of the following industry classifications (or such other classifications as Moody's may from time to time approve for application to the AMPS):

1. Aerospace and Defense: Major Contractor, Subsystems, Research, Aircraft Manufacturing, Arms, Ammunition
2. Automobile: Automobile Equipment, Auto-Manufacturing, Auto Parts Manufacturing, Personal Use Trailers, Motor Homes, Dealers
3. Banking: Bank Holding, Savings and Loans, Consumer Credit, Small Loan, Agency, Factoring, Receivables
4. Beverage, Food and Tobacco: Beer and Ale, Distillers, Wines and Liquors, Distributors, Soft Drink Syrup, Bottlers, Bakery, Mill Sugar, Canned Foods, Corn Refiners, Dairy Products, Meat Products, Poultry Products, Snacks, Packaged Foods, Candy, Gum, Seafood, Frozen Food, Cigarettes, Cigars, Leaf/Snuff, Vegetable Oil
5. Buildings and Real Estate: Brick, Cement, Climate Controls, Contracting, Engineering, Construction, Hardware, Forest Products (building-related only), Plumbing, Roofing, Wallboard, Real Estate, Real Estate Development, REITs, Land Development
6. Chemicals, Plastics and Rubber: Chemicals (non-agricultural), Industrial Gases, Sulfur, Plastics, Plastic Products, Abrasives, Coatings, Paints, Varnish, Fabricating
7. Containers, Packaging and Glass: Glass, Fiberglass, Containers made of: Glass, Metal, Paper, Plastic, Wood or Fiberglass
8. Personal and Non-Durable Consumer Products (manufacturing only): Soaps, Perfumes, Cosmetics, Toiletries, Cleaning Supplies, School Supplies
9. Diversified/Conglomerate Manufacturing
10. Diversified/Conglomerate Service
11. Diversified Natural Resources, Precious Metals and Minerals: Fabricating, Distribution
12. Ecological: Pollution Control, Waste Removal, Waste Treatment and Waste Disposal
13. Electronics: Computer Hardware, Electric Equipment, Components, Controllers, Motors, Household Appliances, Information Service Communicating Systems, Radios, TVs, Tape Machines, Speakers, Printers, Drivers, Technology
14. Finance: Investment Brokerage, Leasing, Syndication, Securities
15. Farming and Agriculture: Livestock, Grains, Produce, Agriculture Chemicals, Agricultural Equipment, Fertilizers



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16. Grocery: Grocery Stores, Convenience Food Stores
17. Healthcare, Education and Childcare: Ethical Drugs, Proprietary Drugs, Research, Health Care Centers, Nursing Homes, HMOs, Hospitals, Hospital Supplies, Medical Equipment
18. Home and Office Furnishings, Housewares, and Durable Consumer Products: Carpets, Floor Coverings, Furniture, Cooking, Ranges
19. Hotels, Motels, Inns and Gaming
20. Insurance: Life, Property and Casualty, Broker, Agent, Surety
21. Leisure, Amusement, Motion Pictures, Entertainment: Boating, Bowling, Billiards, Musical Instruments, Fishing, Photo Equipment, Records, Tapes, Sports, Outdoor Equipment (camping), Tourism, Resorts, Games, Toy Manufacturing, Motion Picture Production Theaters, Motion Picture Distribution
22. Machinery (non-agricultural, non-construction, non-electronic): Industrial, Machine Tools, Steam Generators
23. Mining, Steel, Iron and Non-Precious Metals: Coal, Copper, Lead, Uranium, Zinc, Aluminum, Stainless Steel, Integrated Steel, Ore Production, Refractories, Steel Mill Machinery, Mini-Mills, Fabricating, Distribution and Sales of the foregoing
24. Oil and Gas: Crude Producer, Retailer, Well Supply, Service and Drilling
25. Printing, Publishing, and Broadcasting: Graphic Arts, Paper, Paper Products, Business Forms, Magazines, Books, Periodicals, Newspapers, Textbooks, Radio, TV, Cable Broadcasting Equipment
26. Cargo Transport: Rail, Shipping, Railroads, Railcar Builders, Ship Builders, Containers, Container Builders, Parts, Overnight Mail, Trucking, Truck Manufacturing, Trailer Manufacturing, Air Cargo, Transport
27. Retail Stores: Apparel, Toy, Variety, Drug, Department, Mail Order Catalog, Showroom
28. Telecommunications: Local, Long Distance, Independent, Telephone, Telegraph, Satellite, Equipment, Research, Cellular
29. Textiles and Leather: Producer, Synthetic Fiber, Apparel Manufacturer, Leather Shoes
30. Personal Transportation: Air, Bus, Rail, Car Rental

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- 31. Utilities: Electric, Water, Hydro Power, Gas
  
- 32. Diversified Sovereigns: Semi-sovereigns, Canadian Provinces, Supra-national Agencies

The Trust will use its discretion in determining which industry classification is applicable to a particular investment in consultation with the Independent Accountant and Moody's, to the extent the Trust considers necessary.

1940 Act means the Investment Company Act of 1940, as amended from time to time.

1940 Act Cure Date, with respect to the failure by the Trust to maintain the 1940 Act Preferred Shares Asset Coverage (as required by these Bylaws) as of the last Business Day of each month, means the last Business Day of the following month.

1940 Act Preferred Shares Asset Coverage means asset coverage, as defined in Section 18(h) of the 1940 Act, of at least 200% with respect to all outstanding senior securities of the Trust which are shares of beneficial interest, including AMPS (or such other asset coverage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities which are shares of beneficial interest of a closed-end investment company as a condition of paying dividends on its common shares).

Non-Call Period has the meaning set forth under the definition of Specific Redemption Provisions.

Non-Payment Period means a period commencing on and including a Dividend Payment Date or redemption date for which the Trust shall fail to (i) declare, prior to the close of business on the second Business Day preceding such Dividend Payment Date, for payment (to the extent permitted by Section 11.2(c)(i) of these Bylaws) within three Business Days after such Dividend Payment Date to the Holders as of 12:00 noon, New York City time, on the Business Day preceding such Dividend Payment Date, the full amount of any dividend on AMPS payable on such Dividend Payment Date, provided, however, that if the Trust is not able to make such declaration in compliance with the foregoing because an unforeseen event or unforeseen events causes or cause a day that otherwise would have been a Business Day not to be a Business Day, then the Trust may make such declaration on the Business Day immediately preceding the Dividend Payment Date, if possible, or, if not possible, on the Dividend Payment Date, and in such case the Trust shall not be deemed to have failed to declare a dividend otherwise required to be declared, or (ii) deposit, irrevocably in trust, in same-day funds, with the Auction Agent by 12:00 noon, New York City time, (A) on such Dividend Payment Date the full amount of any cash dividend on such shares payable (if declared) on such Dividend Payment Date or (B) on any such redemption date for any AMPS called for redemption, the Mandatory Redemption Price per share of such AMPS or, in the case of an optional redemption, the Optional Redemption Price per share, and ending on and including the Business Day on which, by 12:00 noon, New York City time, all unpaid cash dividends and unpaid redemption prices shall have been so deposited or shall have otherwise been made available to Holders in same-day funds; provided that a Non-Payment Period shall not end unless the Trust shall have given at least five days but no more than 30 days written notice of such deposit or availability to the Auction Agent, all Existing Holders (at their addresses

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appearing in the Share Books) and the Securities Depository. Notwithstanding the foregoing, the failure by the Trust to deposit funds as provided for by clauses (ii)(A) or (ii)(B) above within three Business Days after any Dividend Payment Date or redemption date, as the case may be, in each case to the extent contemplated by Section 11.2(c)(i) of these Bylaws, shall not constitute a Non-Payment Period.

**Non-Payment Period Rate** means, initially, 300% of the applicable Reference Rate, provided that the Board of Trustees of the Trust shall have the authority to adjust, modify, alter or change from time to time the initial Non-Payment Period Rate if the Board of Trustees of the Trust determines and each of Fitch Ratings and Moody's (and any Substitute Rating Agency in lieu of Fitch Ratings or Moody's in the event Fitch Ratings or Moody's shall not rate the AMPS) advises the Trust in writing that such adjustment, modification, alteration or change will not adversely affect its then current ratings on the AMPS.

**Normal Dividend Payment Date** has the meaning set forth in Section 11.2(b)(i) of these Bylaws.

**Notice of Redemption** means any notice with respect to the redemption of AMPS pursuant to Section 11.4 of these Bylaws.

**Notice of Revocation** has the meaning set forth in Section 11.2(c)(iii) of these Bylaws.

**Notice of Special Dividend Period** has the meaning set forth in Section 11.2(c)(iii) of these Bylaws.

**Optional Redemption Price** means \$25,000 per Auction Market Preferred Share plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption plus any applicable redemption premium attributable to the designation of a Premium Call Period.

**Outstanding** means, as of any date, (i) with respect to AMPS, AMPS theretofore issued by the Trust except, without duplication, (A) any AMPS theretofore canceled or delivered to the Auction Agent for cancellation, or redeemed by the Trust, or as to which a Notice of Redemption shall have been given and Deposit Securities shall have been deposited in trust or segregated by the Trust pursuant to Section 11.4(c) hereto and (B) any AMPS as to which the Trust or any Affiliate (other than an Affiliate that is a Broker-Dealer) thereof shall be a Beneficial Owner, provided that AMPS held by an Affiliate shall be deemed outstanding for purposes of calculating the Preferred Shares Basic Maintenance Amount and (ii) with respect to other preferred shares of beneficial interest of the Trust, the meaning equivalent to that for AMPS as set forth in clause (i).

**Parity Shares** means the AMPS and each other outstanding series of preferred shares of beneficial interest of the Trust the holders of which, together with the holders of the AMPS, shall be entitled to the receipt of dividends or of amounts distributable upon liquidation, dissolution or winding up, as the case may be, in proportion to the full respective preferential amounts to which they are entitled, without preference or priority one over the other.

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**Performing** means with respect to the issuer of any asset that is a Bank Loan, Corporate Debt Security or other debt, the issuer of such investment is not in default of any payment obligations in respect thereof.

**Person** means and includes an individual, a corporation, a partnership, a trust, an unincorporated association, a joint venture or other entity or a government or any agency or political subdivision thereof.

**Potential Beneficial Owner** means a customer of a Broker-Dealer or a Broker-Dealer that is not a Beneficial Owner of AMPS but that wishes to purchase such shares, or that is a Beneficial Owner that wishes to purchase additional AMPS.

**Potential Holder** means any Broker-Dealer or any such other Person as may be permitted by the Trust, including any Existing Holder, who may be interested in acquiring AMPS (or, in the case of an Existing Holder, additional AMPS).

**Preferred Shares Basic Maintenance Amount**, as of any Valuation Date, means the dollar amount equal to the sum of (i)(A) the product of the number of AMPS Outstanding on such date multiplied by \$25,000, plus any redemption premium applicable to AMPS then subject to redemption; (B) the aggregate amount of dividends that will have accumulated at the respective Applicable Rates (whether or not earned or declared) to (but not including) the first respective Dividend Payment Dates for each series of AMPS Outstanding that follow such Valuation Date (plus the aggregate amount of dividends, whether or not earned or declared, that will have accumulated in respect of other outstanding preferred shares to, but not including, the first respective dividend payment dates for such other shares that follow such Valuation Date); (C) the aggregate amount of dividends that would accumulate on shares of each series of AMPS Outstanding from such first respective Dividend Payment Date therefor through the 49th day after such Valuation Date, at the Maximum Applicable Rate (calculated as if such Valuation Date were the Auction Date for the Dividend Period commencing on such Dividend Payment Date) for a 7-Day Dividend Period of shares of such series to commence on such Dividend Payment Date, multiplied by the Volatility Factor (except that (1) if such Valuation Date occurs during a Non-Payment Period, the dividend for purposes of calculation would accumulate at the then current Non-Payment Period Rate and (2) for those days during the period described in this clause (C) in respect of which the Applicable Rate in effect immediately prior to such Dividend Payment Date will remain in effect, the dividend for purposes of calculation would accumulate at such Applicable Rate in respect of those days); (D) the amount of anticipated expenses of the Trust for the 90 days subsequent to such Valuation Date; and (E) any current liabilities as of such Valuation Date to the extent not reflected in any of (i)(A) through (i)(D) (including, without limitation, any payables for portfolio securities of the Trust purchased as of such Valuation Date and any liabilities incurred for the purpose of clearing securities transactions) less (ii) the value (*i.e.*, the face value of cash, short-term securities rated MIG-1, VMIG-1 or P-1, and short-term securities that are the direct obligation of the U.S. government, provided in each case that such securities mature on or prior to the date upon which any of (i)(A) through (i)(E) become payable, otherwise the Discounted Value) of any of the Trust's assets irrevocably deposited by the Trust for the payment of any of (i)(A) through (i)(E).



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Preferred Shares Basic Maintenance Cure Date, with respect to the failure by the Trust to satisfy the Preferred Shares Basic Maintenance Amount (as required by Section 11.7(a) of these Bylaws) as of a given Valuation Date, means the sixth Business Day following such Valuation Date.

Preferred Shares Basic Maintenance Report means a report signed by any of the President, Treasurer, any Senior Vice President or any Vice President of the Trust which sets forth, as of the related Valuation Date, the assets of the Trust, the Market Value and the Discounted Value thereof (seriatim and in aggregate), and the Preferred Shares Basic Maintenance Amount.

Premium Call Period has the meaning set forth under the definition of Specific Redemption Provisions.

Pricing Service means any pricing service designated by the Board of Trustees of the Trust and approved by Fitch Ratings, Moody's or any Substitute Rating Agency, as applicable, for purposes of determining whether the Trust has Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount.

Quarterly Valuation Date means the last Business Day of the last month of each fiscal quarter of the Trust in each fiscal year of the Trust, commencing February 28, 2005.

Rating Agency means a nationally recognized statistical rating organization.

Reference Banks means four major banks in the London interbank market selected by Merrill Lynch, Pierce, Fenner and Smith Incorporated or its affiliates or successors or such other party as the Trust may from time to time appoint.

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Reference Rate means the LIBOR Rate (for a Dividend Period of fewer than 365 days) or the applicable Treasury Index Rate (for a Dividend Period of 365 days or more).

REITs means real estate investment trusts.

Reorganization Bonds has the meaning set forth under the definition of Fitch Eligible Assets.

Request for Special Dividend Period has the meaning set forth in Section 11.2(c)(iii) of these Bylaws.

Response has the meaning set forth in Section 11.2(c)(iii) of these Bylaws.

Rule 144A Securities means securities which are restricted as to resale under federal securities laws but are eligible for resale pursuant to Rule 144A under the Securities Act as determined by the Trust's investment manager or portfolio manager acting pursuant to procedures approved by the Board of Trustees of the Trust.

S&P means Standard & Poor's, a division of The McGraw-Hill Companies, Inc., or its successors.

Securities Act means the Securities Act of 1933, as amended from time to time.

Securities Depository means The Depository Trust Company and its successors and assigns or any successor securities depository selected by the Trust as securities depository for the AMPS that agrees to follow the procedures required to be followed by such securities depository in connection with the AMPS.

Senior Loans has the meaning set forth in paragraph (vii) of the definition of Moody's Discount Factor.

Series M AMPS means the Auction Market Preferred Shares, Series M.

Series T AMPS means the Auction Market Preferred Shares, Series T.

Series W AMPS means the Auction Market Preferred Shares, Series W.

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Series TH AMPS means the Auction Market Preferred Shares, Series TH.

Series F AMPS means the Auction Market Preferred Shares, Series F.

Seven-Day Dividend Period means a Subsequent Dividend Period that (a) consists of seven days or (b) would consist of seven days but for the fact that the Dividend Payment Date which immediately follows, or the Dividend Payment Date which falls within, such Subsequent Dividend Period is not a Business Day.

Share Books means the books maintained by the Auction Agent setting forth at all times a current list, as determined by the Auction Agent, of Existing Holders of the AMPS.

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Share Register means the register of Holders maintained on behalf of the Trust by the Auction Agent in its capacity as transfer agent and registrar for the AMPS.

Short Term Dividend Period means a Special Dividend Period consisting of a specified number of days, evenly divisible by seven and not fewer than fourteen nor more than 364.

Short Term Money Market Instruments means the following types of instruments if, on the date of purchase or other acquisition thereof by the Trust, the remaining term to maturity thereof is not in excess of 180 days (or 270 days for instruments rated at least Aaa for purposes of determining Moody's Eligible Assets):

(i) commercial paper rated either F-1 by Fitch Ratings or A-1 by S&P if such commercial paper matures in 30 days or P-1 by Moody's and either F-1+ by Fitch Ratings or A-1+ by S&P if such commercial paper matures in over 30 days;

(ii) demand or time deposits in, and banker's acceptances and certificates of deposit of, (A) a depository institution or trust company incorporated under the laws of the United States of America or any state thereof or the District of Columbia or (B) a United States branch office or agency of a foreign depository institution (provided that such branch office or agency is subject to banking regulation under the laws of the United States, any state thereof or the District of Columbia);

(iii) overnight funds;

(iv) U.S. Government Securities; and

(v) Eurodollar demand or time deposits in, or certificates of deposit of, the head office or the London branch office of a depository institution or trust company if the certificates of deposit, if any, and the long-term unsecured debt obligations (other than such obligations the ratings of which are based on the credit of a person or entity other than such depository institution or trust company) of such depository institution or trust company that have (1) credit ratings on each Valuation Date of at least P-1 from Moody's and either F-1+ from Fitch Ratings or A-1+ from S&P, in the case of commercial paper or certificates of deposit, and (2) credit ratings on each Valuation Date of at least Aa3 from Moody's and either AA from Fitch Ratings or AA- from S&P, in the case of long-term unsecured debt obligations; provided, however, that in the case of any such investment that matures in no more than one Business Day from the date of purchase or other acquisition by the Trust, all of the foregoing requirements shall be applicable except that the required long-term unsecured debt credit rating of such depository institution or trust company from Moody's, Fitch Ratings and S&P shall be at least A2, A-2 and A, respectively; and provided further, however, that the foregoing credit rating requirements shall be deemed to be met with respect to a depository institution or trust company if (1) such depository institution or trust company is the principal depository institution in a holding company system, (2) the certificates of deposit, if any, of such depository institution or trust company are not rated on any Valuation Date below P-1 by Moody's, F-1+ by Fitch Ratings or A-1+ by S&P and there is no long-term rating, and (3) the holding company shall meet all of the foregoing credit rating requirements (including the preceding proviso

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in the case of investments that mature in no more than one Business Day from the date of purchase or other acquisition by the Trust); and provided further, that the interest receivable by the Trust shall not be subject to any withholding or similar taxes.

Special Dividend Period (sometimes referred to as a Special Rate Period) means a Short Term Dividend Period or a Long Term Dividend Period.

Specific Redemption Provisions means, with respect to a Special Dividend Period either, or both, of (i) a period (a Non-Call Period) determined by the Board of Trustees of the Trust, after consultation with the Auction Agent and the Broker-Dealers, during which the AMPS subject to such Special Dividend Period shall not be subject to redemption at the option of the Trust and (ii) a period (a Premium Call Period), consisting of a number of whole years and determined by the Board of Trustees of the Trust, after consultation with the Auction Agent and the Broker-Dealers, during each year of which the AMPS subject to such Special Dividend Period shall be redeemable at the Trust's option at a price per share equal to \$25,000, plus accumulated but unpaid dividends (whether or not earned or declared) to (but not including) the date fixed for redemption, plus a premium expressed as a percentage or percentages of \$25,000, as determined by the Board of Trustees of the Trust after consultation with the Auction Agent and the Broker-Dealers.

Structured Notes means privately negotiated debt obligations where the principal and/or interest is determined by reference to the performance of a benchmark asset or market (an embedded index), such as selected securities or an index of securities, or the differential performance of two assets or markets, such as indices reflecting bonds.

Subsequent Dividend Period has the meaning set forth in Section 11.2(c)(i) of these Bylaws.

Substitute LIBOR Dealer means any LIBOR Dealer selected by the Trust as to which Moody's, Fitch Ratings or any other Rating Agency then rating the AMPS shall not have objected; provided, however, that none of such entities shall be a LIBOR Dealer.

Substitute Rating Agency means a Rating Agency selected by Merrill Lynch, Pierce, Fenner and Smith Incorporated or its affiliates and successors, after consultation with the Trust, to act as the substitute Rating Agency to determine the credit ratings of the AMPS.

Sufficient Clearing Bids has the meaning set forth in Section 11.10(d)(i) of these Bylaws.

TRACERs means traded custody receipts representing direct ownership in a portfolio of underlying securities.

TRAINS means Targeted Return Index Securities, which are trust certificates comprised of bonds that are chosen to track a particular index.

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Treasury Bill means a direct obligation of the U.S. government having a maturity at the time of issuance of 364 days or less.

Treasury Bonds means United States Treasury Bonds or Notes.

Treasury Index Rate means the average yield to maturity for actively traded marketable U.S. Treasury fixed interest rate securities having the same number of 30-day periods to maturity as the length of the applicable Dividend Period, determined, to the extent necessary, by linear interpolation based upon the yield for such securities having the next shorter and next longer number of 30-day periods to maturity treating all Dividend Periods with a length greater than the longest maturity for such securities as having a length equal to such longest maturity, in all cases based upon data set forth in the most recent weekly statistical release published by the Board of Governors of the Federal Reserve System (currently in H.15 (519)); provided, however, if the most recent such statistical release shall not have been published during the 15 days preceding the date of computation, the foregoing computations shall be based upon the average of comparable data as quoted to the Trust by at least three recognized dealers in U.S. government securities selected by the Trust.

Trust means the PIMCO Floating Rate Strategy Fund.

U.S. Government Securities means direct obligations of the United States or of its agencies or instrumentalities that are entitled to the full faith and credit of the United States and that, other than Treasury Bills, provide for the periodic payment of interest and the full payment of principal at maturity or call for redemption.

U.S. Treasury Securities means direct obligations of the United States Treasury that are entitled to the full faith and credit of the United States.

U.S. Treasury Strips means securities based on U.S. Treasury Securities created through the Separate Trading of Registered Interest and Principal of Securities program.

Valuation Date means, for purposes of determining whether the Trust is maintaining the Preferred Shares Basic Maintenance Amount, the last Business Day of each week commencing with the Date of Original Issue.

Volatility Factor means 1.89.

Voting Period has the meaning set forth in Section 11.5(b) of these Bylaws.

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(b) The foregoing definitions of Accountant's Confirmation, Preferred Shares Basic Maintenance Amount, Preferred Shares Basic Maintenance Cure Date, Preferred Shares Basic Maintenance Report, Bank Loans, Closing Transactions, Cure Date, Debt Securities, Deposit Securities, Discounted Value, Fitch Discount Factor, Fitch Eligible Assets, Fitch Exposure Period, Fitch Hedging Transactions, Fitch Industry Classifications, Forward Commitment, LIBOR Dealer, Independent Accountant, Market Value, Maximum Applicable Rate, Moody's Advance Rate, Moody's Discount Factor, Moody's Eligible Assets, Moody's Exposure Period, Moody's Hedging Transactions, Moody's Industry Classification, 1940 Act Cure Date, 1940 Act Preferred Shares Asset Coverage, Performing, Senior Loans, Short Term Money Market Instruments, Structured Notes, Substitute LIBOR Dealer, TRAINs, TRACERs, Treasury Bill, Treasury Bonds, U.S. Government Securities, U.S. Treasury Securities, U.S. Treasury Strips, Valuation Date and Volatility Factor (and any terms defined within such definitions) have been determined by the Board of Trustees of the Trust in order to obtain a rating of AAA from Fitch Ratings and a rating of Aaa from Moody's on the AMPS on their Date of Original Issue; and the Board of Trustees of the Trust shall have the authority, without shareholder approval, to amend, alter or repeal from time to time the foregoing definitions (and any terms defined within such definitions) and the restrictions and guidelines set forth thereunder if Fitch Ratings, Moody's or any Substitute Rating Agency advises the Trust in writing that such amendment, alteration or repeal will not adversely affect its then current rating on the AMPS.

11.2 Dividends.

(a) The Holders of a particular series of AMPS shall be entitled to receive, when, as and if declared by the Board of Trustees of the Trust, out of funds legally available therefor, cumulative dividends each consisting of cash at the Applicable Rate and no more, payable on the respective dates set forth below. Dividends on the shares of each series of AMPS so declared and payable shall be paid in preference to and in priority over any dividends declared and payable on the Common Shares.

(b) (i) Cash dividends on shares of each series of AMPS shall accumulate at the relevant Applicable Rate(s) from the Date of Original Issue and shall be payable, when, as and if declared by the Board of Trustees of the Trust, out of funds legally available therefor, commencing on the Initial Dividend Payment Date. Following the Initial Dividend Payment Date for a series of AMPS, dividends on that series of AMPS will be payable, at the option of the Trust, either (i) with respect to any Seven-Day Dividend Period and any Short Term Dividend Period of 35 or fewer days, on the day next succeeding the last day thereof, or (ii) with respect to any Short Term Dividend Period of more than 35 days and with respect to any Long Term Dividend Period, monthly on the first Business Day of each calendar month during such Short Term Dividend Period or Long Term Dividend Period and on the day next succeeding the last day thereof (each such date referred to in clause (i) or (ii) being herein referred to as a Normal Dividend Payment Date), except that if such Normal Dividend Payment Date is not a Business Day, then the Dividend Payment Date shall be the first Business Day next succeeding such Normal Dividend Payment Date; provided, however, that if a Normal Dividend Payment Date is not a Business Day because the New York Stock Exchange is closed for business for more than three consecutive Business Days due to an act of God, natural disaster, act of war, civil or military disturbance, act of terrorism, sabotage, riots or a loss or malfunction of utilities or communication services, or the dividend payable on

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such date cannot be paid for any such reason, then the Dividend Payment Date shall be the next succeeding Business Day on which the Trust and its dividend paying agent, if any, are able to cause the dividend to be paid using their reasonable best efforts. Although any particular Dividend Payment Date may not occur on the originally scheduled date because of the exceptions discussed above, the next succeeding Dividend Payment Date, subject to such exceptions, will occur on the next following originally scheduled date. If for any reason a Dividend Period for a series of AMPS is scheduled to begin on the same day and end on the same day as a Dividend Period for another series of AMPS, then the last day of such Dividend Period for such other series of AMPS shall be the second Business Day next succeeding such scheduled day unless the Trust obtains the opinion of tax counsel referred to in this paragraph. Subject to the limitation in the next sentence, if for any reason a Dividend Payment Date cannot be fixed as described above, then the Board of Trustees of the Trust shall fix the Dividend Payment Date. However, no Dividend Period of any series of AMPS shall be co-extensive with any Dividend Period of any other series of AMPS unless the Trust has received an opinion of tax counsel that having such co-extensive periods will not affect the deductibility, for federal income tax purposes, of dividends paid on the different series of AMPS. The Board of Trustees of the Trust before authorizing a dividend may change a Dividend Payment Date if such change does not adversely affect the contract rights of the Holders of AMPS set forth in the Declaration of Trust or the Bylaws. The Initial Dividend Period, Seven-Day Dividend Periods and Special Dividend Periods with respect to a series of AMPS are hereinafter sometimes referred to as Dividend Periods. Each dividend payment date determined as provided above is hereinafter referred to as a Dividend Payment Date.

(ii) Each dividend shall be paid to the Holders as they appear in the Share Register as of 12:00 noon, New York City time, on the Business Day preceding the Dividend Payment Date. Dividends in arrears for any past Dividend Period may be declared and paid at any time, without reference to any regular Dividend Payment Date, to the Holders as they appear on the Share Register on a date, not exceeding 15 days prior to the payment date therefor, as may be fixed by the Board of Trustees of the Trust.

(c) (i) During the period from and including the Date of Original Issue to but excluding the Initial Dividend Payment Date for a series of AMPS (the Initial Dividend Period), the Applicable Rate for such series of AMPS shall be the Initial Dividend Rate. Commencing on the Initial Dividend Payment Date for a series of AMPS, the Applicable Rate on that series for each subsequent dividend period (hereinafter referred to as a Subsequent Dividend Period), which Subsequent Dividend Period shall commence on and include a Dividend Payment Date and shall end on and include the calendar day prior to the next Dividend Payment Date (or last Dividend Payment Date in a Dividend Period if there is more than one Dividend Payment Date), shall be equal to the rate per annum that results from implementation of the Auction Procedures.



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For a series of AMPS, the Applicable Rate for such series for each Dividend Period commencing during a Non-Payment Period shall be equal to the Non-Payment Period Rate; and each Dividend Period, commencing after the first day of and during, but not after the end of, a Non-Payment Period shall be a Seven-Day Dividend Period. Except in the case of the willful failure of the Trust to pay a dividend on a Dividend Payment Date or to redeem any AMPS on the date set for such redemption, any amount of any dividend due on any Dividend Payment Date (if, prior to the close of business on the second Business Day preceding such Dividend Payment Date, the Trust has declared such dividend payable on such Dividend Payment Date to the Holders of such AMPS as of 12:00 noon, New York City time, on the Business Day preceding such Dividend Payment Date) or redemption price with respect to any AMPS not paid to such Holders when due may be paid to such Holders in the same form of funds by 12:00 noon, New York City time, on any of the first three Business Days after such Dividend Payment Date or due date, as the case may be, provided that such amount is accompanied by a late charge calculated for such period of non-payment at the Non-Payment Period Rate applied to the amount of such non-payment based on the actual number of days comprising such period (excluding any days that would have been Business Days but for the occurrence of any unforeseen event or unforeseen events that caused such days not to be Business Days) divided by 365, and in such case such period shall not constitute a Non-Payment Period; provided, however, that the Trust shall not be required to pay any late charge if it declares a dividend on the Dividend Payment Date or the Business Day immediately preceding such Dividend Payment Date in accordance with clause (i) of the definition of "Non-Payment Period" and deposits payment for such dividend as contemplated by clause (ii)(A) of the definition of "Non-Payment Period" on or before the second Business Day succeeding the day on which the dividend was declared. In the case of a willful failure of the Trust to pay a dividend on a Dividend Payment Date or to redeem any AMPS on the date set for such redemption, the preceding sentence shall not apply and the Applicable Rate for the Dividend Period commencing during the Non-Payment Period resulting from such failure shall be the Non-Payment Period Rate. For the purposes of the foregoing, payment to a person in same-day funds on any Business Day at any time shall be considered equivalent to payment to such person in New York Clearing House (next-day) funds at the same time on the preceding Business Day, and any payment made after 12:00 noon, New York City time, on any Business Day shall be considered to have been made instead in the same form of funds and to the same person before 12:00 noon, New York City time, on the next Business Day.

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(ii) The amount of dividends per share of any series of AMPS payable (if declared) on the Initial Dividend Payment Date, each Dividend Payment Date of each Seven-Day Dividend Period, each Dividend Payment Date of each Short Term Dividend Period and each Dividend Payment Date of each Long Term Dividend Period shall be computed by multiplying the Applicable Rate for such Dividend Period by a fraction, the numerator of which will be the number of days in such Dividend Period or part thereof that such share was outstanding and the denominator of which will be 365, multiplying the amount so obtained by \$25,000, and rounding the amount so obtained to the nearest cent.

(iii) The Trust may, at its sole option and to the extent permitted by law, by telephonic and written notice (a Request for Special Dividend Period ) to the Auction Agent and to each Broker-Dealer, request that the next succeeding Dividend Period for a series of AMPS be a number of days (other than seven), evenly divisible by seven and not fewer than fourteen nor more than 364 in the case of a Short Term Dividend Period or one whole year or more but not greater than five years in the case of a Long Term Dividend Period, specified in such notice, provided that the Trust may not give a Request for Special Dividend Period for a Dividend Period of greater than 28 days (and any such request shall be null and void) unless, for any Auction occurring after the initial Auction, Sufficient Clearing Bids were made in the last occurring Auction and unless full cumulative dividends and any amounts due with respect to redemptions have been paid in full. Such Request for Special Dividend Period, in the case of a Short Term Dividend Period, shall be given on or prior to the second Business Day but not more than seven Business Days prior to an Auction Date for a series of AMPS and, in the case of a Long Term Dividend Period, shall be given on or prior to the second Business Day but not more than 28 days prior to an Auction Date for a series of AMPS. Upon receiving such Request for Special Dividend Period, the Broker-Dealer(s) shall jointly determine the Optional Redemption Price of the AMPS of the applicable series of AMPS during such Special Dividend Period and the Specific Redemption Provisions and shall give the Trust and the Auction Agent written notice (a Response ) of such determination by no later than the second Business Day prior to such Auction Date. In making such determination the Broker-Dealer(s) will consider (1) existing short-term and long-term market rates and indices of such short-term and long-term rates, (2) existing market supply and demand for short-term and long-term securities, (3) existing yield curves for short-term and long-term securities comparable to the AMPS, (4) industry and financial conditions which may affect the AMPS of the applicable series, (5) the investment objective of the Trust, and (6) the Dividend Periods and dividend rates at which current and potential beneficial holders of the AMPS would remain or become beneficial holders. After providing the Request for Special Dividend Period to the Auction Agent and each Broker-Dealer as set forth above, the Trust may by no later than the second Business Day prior to such Auction Date give a notice (a Notice of Special Dividend Period ) to the Auction Agent, the Securities Depository and each Broker-Dealer which notice will specify (i) the duration of the Special Dividend Period,

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(ii) the Optional Redemption Price, if any, as specified in the related Response and (iii) the Specific Redemption Provisions, if any, as specified in the related Response. The Trust also shall provide a copy of such Notice of Special Dividend Period to Fitch Ratings, Moody's and any Substitute Rating Agency. The Trust shall not give a Notice of Special Dividend Period and, if the Trust has given a Notice of Special Dividend Period, the Trust is required to give telephonic and written notice of its revocation (a Notice of Revocation) to the Auction Agent, each Broker-Dealer, and the Securities Depository on or prior to the Business Day prior to the relevant Auction Date if (x) either the 1940 Act Preferred Shares Asset Coverage is not satisfied or the Trust shall fail to maintain Fitch Eligible Assets and Moody's Eligible Assets each with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount, on each of the two Valuation Dates immediately preceding the Business Day prior to the relevant Auction Date on an actual basis and on a pro forma basis giving effect to the proposed Special Dividend Period (using as a pro forma dividend rate with respect to such Special Dividend Period the dividend rate which the Broker-Dealers shall advise the Trust is an approximately equal rate for securities similar to the AMPS with an equal dividend period) or (y) sufficient funds for the payment of dividends payable on the immediately succeeding Dividend Payment Date have not been irrevocably deposited with the Auction Agent by the close of business on the third Business Day preceding the Auction Date immediately preceding such Dividend Payment Date. The Trust also shall provide a copy of such Notice of Revocation to Fitch Ratings, Moody's and any Substitute Rating Agency. If the Trust is prohibited from giving a Notice of Special Dividend Period as a result of any of the factors enumerated in clause (x) or (y) above or if the Trust gives a Notice of Revocation with respect to a Notice of Special Dividend Period for any series of AMPS, the next succeeding Dividend Period for that series will be a Seven-Day Dividend Period. In addition, in the event Sufficient Clearing Bids are not made in an Auction, or if an Auction is not held for any reason, such next succeeding Dividend Period will be a Seven-Day Dividend Period and the Trust may not again give a Notice of Special Dividend Period for the AMPS (and any such attempted notice shall be null and void) until Sufficient Clearing Bids have been made in an Auction with respect to a Seven-Day Dividend Period. If an Auction is not held because an unforeseen event or unforeseen events cause a day that otherwise would have been a Dividend Payment Date or an Auction Date not to be a Business Day, then the length of the Dividend Period relating to such Dividend Payment Date shall be extended by seven days (or a multiple thereof if necessary because of such unforeseen event or events) (an Extension Period), the Applicable Rate for such Extension Period shall be the Applicable Rate for the Dividend Period so extended and the Dividend Payment Date for such Dividend Period shall be the first Business Day next succeeding the end of such Extension Period. The Trust will not declare a Special Dividend Period unless it has received confirmation from Moody's and Fitch Ratings, and any Substitute Rating Agency, that the proposed Special Dividend Period will not adversely affect such Rating Agency's then current rating on the AMPS.

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(d) (i) Holders shall not be entitled to any dividends, whether payable in cash, property or AMPS, in excess of full cumulative dividends as herein provided. Except for the late charge payable pursuant to Section 11.2(c)(i) hereof, no interest, or sum of money in lieu of interest, shall be payable in respect of any dividend payment on the AMPS that may be in arrears.

(ii) For so long as any AMPS are Outstanding, the Trust shall not declare, pay or set apart for payment any dividend or other distribution (other than a dividend or distribution paid in shares of, or options, warrants or rights to subscribe for or purchase, Common Shares or other shares of beneficial interest, if any, ranking junior to the AMPS as to dividends or upon liquidation) in respect of the Common Shares or any other shares of beneficial interest of the Trust ranking junior to or on a parity with the AMPS as to dividends or upon liquidation, or call for redemption, redeem, purchase or otherwise acquire for consideration any Common Shares or any other such junior shares (except by conversion into or exchange for shares of the Trust ranking junior to the AMPS as to dividends and upon liquidation) or any other such Parity Shares (except by conversion into or exchange for stock of the Trust ranking junior to or on a parity with the AMPS as to dividends and upon liquidation), unless (A) immediately after such transaction, the Trust shall have Fitch Eligible Assets and Moody's Eligible Assets each with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount and the Trust shall maintain the 1940 Act Preferred Shares Asset Coverage, (B) full cumulative dividends on AMPS due on or prior to the date of the transaction have been declared and paid or shall have been declared and sufficient funds for the payment thereof deposited with the Auction Agent and (C) the Trust has redeemed the full number of AMPS required to be redeemed by any provision for mandatory redemption contained herein. Further, for so long as any AMPS are Outstanding, the Trust shall not declare, pay or set apart for payment any dividend or other distribution on any Parity Shares other than the AMPS unless contemporaneously herewith it declares, pays or sets apart for payment, as the case may be, the same proportionate share of dividends on the AMPS.

(e) Each dividend shall consist of cash at the Applicable Rate.

(f) No fractional AMPS shall be issued.

(g) Solely for purposes of the proviso in clause (i) under the definition of "Non-Payment Period," the second parenthetical in the second sentence of the second paragraph of Section 11.2(c)(i) of these Bylaws and the last sentence of Section 11.2(c)(iii) of these Bylaws, any day on which banks in New York City generally are closed, for any reason, while the New York Stock Exchange remains open for trading and any day which otherwise would be a Business Day as defined in these Bylaws on which the Auction Agent is closed for business, for any reason, shall be considered a day which is not a Business Day.

11.3 Liquidation Rights. Upon any liquidation, dissolution or winding up of the Trust, whether voluntary or involuntary, the Holders of AMPS then outstanding shall be entitled to receive, out of the assets of the Trust available for distribution to shareholders, before any distribution or payment is made upon any Common Shares or any other shares of beneficial interest ranking junior in right of payment upon liquidation to the AMPS, the sum of \$25,000 per

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share plus accumulated but unpaid dividends (whether or not earned or declared) thereon to (but not including) the date of distribution, and after such payment the Holders will be entitled to no other payments. If upon any liquidation, dissolution or winding up of the Trust, the amounts payable with respect to the AMPS and any other Outstanding class or series of preferred shares of beneficial interest of the Trust ranking on a parity with the AMPS as to payment upon liquidation are not paid in full, the Holders and the holders of such other class or series will share ratably in any such distribution of assets in proportion to the respective preferential amounts to which they are entitled. After payment of the full amount of the liquidating distribution to which they are entitled, the Holders will have no right or claim to any of the remaining assets of the Trust. A consolidation, merger or statutory share exchange of the Trust with or into any other trust or entity or a sale, whether for cash, shares of stock, securities or properties, of all or substantially all or any part of the assets of the Trust shall not be deemed or construed to be a liquidation, dissolution or winding up of the Trust.

11.4 Redemption.

(a) AMPS shall be redeemable by the Trust as provided below:

(i) To the extent permitted under the 1940 Act and Massachusetts law, upon giving a Notice of Redemption, the Trust at its option may redeem shares of any series of AMPS, in whole or in part, out of funds legally available therefor, at the Optional Redemption Price per share, on any Dividend Payment Date; provided that no AMPS may be redeemed at the option of the Trust during (A) the Initial Dividend Period with respect to a series of shares or (B) a Non-Call Period to which such share is subject.

(ii) The Trust shall redeem, out of funds legally available therefor, at the Mandatory Redemption Price per share, AMPS to the extent permitted under the 1940 Act and Massachusetts law, on a date fixed by the Board of Trustees of the Trust, if the Trust fails to maintain Fitch Eligible Assets and Moody's Eligible Assets each with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount as provided in Section 11.7(a) or to satisfy the 1940 Act Preferred Shares Asset Coverage as provided in Section 11.6 and such failure is not cured on or before the Preferred Shares Basic Maintenance Cure Date or the 1940 Act Cure Date (herein collectively referred to as a Cure Date), as the case may be. The number of AMPS to be redeemed shall be equal to the lesser of (i) the minimum number of AMPS the redemption of which, if deemed to have occurred immediately prior to the opening of business on the Cure Date, together with all other preferred shares of beneficial interest of the Trust subject to redemption or retirement, would result in the Trust having Fitch Eligible Assets and Moody's Eligible Assets each with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount or satisfaction of the 1940 Act Preferred Shares Asset Coverage, as the case may be, on such Cure Date (provided that, if there is no such minimum number of AMPS and other preferred shares of beneficial interest of the Trust the redemption of which would have such result, all AMPS and other preferred shares of beneficial interest of the Trust then Outstanding shall be redeemed), and (ii) the maximum number of AMPS, together with all other preferred shares of beneficial

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interest of the Trust subject to redemption or retirement, that can be redeemed out of funds expected to be legally available therefor on such redemption date. In determining the number of AMPS required to be redeemed in accordance with the foregoing, the Trust shall allocate the number required to be redeemed which would result in the Trust having Fitch Eligible Assets and Moody's Eligible Assets each with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount or satisfaction of the 1940 Act Preferred Shares Asset Coverage, as the case may be, pro rata among AMPS of all series and other preferred shares of beneficial interest of the Trust subject to redemption pursuant to provisions similar to those contained in this Section 11.4(a)(ii); provided that AMPS which may not be redeemed at the option of the Trust due to the designation of a Non-Call Period applicable to such shares (A) will be subject to mandatory redemption only to the extent that other shares are not available to satisfy the number of shares required to be redeemed and (B) will be selected for redemption in an ascending order of outstanding number of days remaining in the Non-Call Period (with shares with the lowest number of days to be redeemed first) and by lot in the event of shares having an equal number of days remaining in such Non-Call Period. The Trust shall effect such redemption on a Business Day which is not later than 35 days after such Cure Date, except that if the Trust does not have funds legally available for the redemption of all of the required number of AMPS and other preferred shares of beneficial interest of the Trust which are subject to mandatory redemption or the Trust otherwise is unable to effect such redemption on or prior to 35 days after such Cure Date, the Trust shall redeem those AMPS which it is unable to redeem on the earliest practicable date on which it is able to effect such redemption out of funds legally available therefor.

(b) Notwithstanding any other provision of this Section 11.4, no AMPS may be redeemed pursuant to Section 11.4(a)(i) of these Bylaws unless (i) all dividends in arrears on all remaining outstanding Parity Shares shall have been or are being contemporaneously paid or declared and set apart for payment, and (ii) redemption thereof would not result in the Trust's failure to maintain Fitch Eligible Assets or Moody's Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount. In the event that less than all the outstanding shares of a series of AMPS are to be redeemed and there is more than one Holder, the shares of that series of AMPS to be redeemed shall be selected by lot or such other method as the Trust shall deem fair and equitable.

(c) Whenever AMPS are to be redeemed, the Trust, not less than 17 nor more than 30 days prior to the date fixed for redemption, shall mail a notice ( Notice of Redemption ) by first-class mail, postage prepaid, to each Holder of AMPS to be redeemed and to the Auction Agent. The Notice of Redemption shall set forth (i) the redemption date, (ii) the amount of the redemption price, (iii) the aggregate number of AMPS of such series to be redeemed, (iv) the place or places where AMPS of such series are to be surrendered for payment of the redemption price, (v) a statement that dividends on the shares to be redeemed shall cease to accumulate on such redemption date and (vi) the provision of these Bylaws pursuant to which such shares are being redeemed. No defect in the Notice of Redemption or in the mailing or publication thereof shall affect the validity of the redemption proceedings, except as required by applicable law.

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If the Notice of Redemption shall have been given as aforesaid and, concurrently or thereafter, the Trust shall have deposited in trust with the Auction Agent, or segregated in an account at the Trust's custodian bank for the benefit of the Auction Agent, Deposit Securities (with a right of substitution) having an aggregate Discounted Value equal to the redemption payment (including any applicable premiums) for the AMPS as to which such Notice of Redemption has been given with irrevocable instructions and authority to pay the redemption price to the Holders of such shares, then upon the date of such deposit or, if no such deposit is made, then upon such date fixed for redemption (unless the Trust shall default in making the redemption payment), all rights (including without limitation voting rights) of the Holders of such shares as shareholders of the Trust by reason of the ownership of such shares will cease and terminate (except their right to receive the redemption price in respect thereof, but without interest), and such shares shall no longer be deemed Outstanding. The Trust shall be entitled to receive, from time to time, from the Auction Agent the interest, if any, on such Deposit Securities deposited with it and the Holders of any shares so redeemed shall have no claim to any of such interest. In case the Holder of any shares so called for redemption shall not claim the redemption payment for his shares within one year after the date of redemption, the Auction Agent shall, upon demand, pay over to the Trust such amount remaining on deposit and the Auction Agent shall thereupon be relieved of all responsibility to the Holder of such shares called for redemption and such Holder thereafter shall look only to the Trust for the redemption payment.

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11.5 Voting Rights.

(a) General. Except as otherwise provided in the Declaration of Trust or Bylaws or as otherwise required by applicable law, each Holder of AMPS shall be entitled to one vote for each share held on each matter submitted to a vote of shareholders of the Trust, and the holders of Outstanding preferred shares of beneficial interest of the Trust, including AMPS, and of Common Shares shall vote together as a single class; provided that the holders of Outstanding preferred shares of beneficial interest of the Trust, including AMPS, shall be entitled, as a class, to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Trust, to elect two trustees of the Trust. Subject to Section 11.5(b) hereof, the holders of shares of beneficial interest of the Trust, including the holders of preferred shares of beneficial interest of the Trust, including AMPS, voting as a single class, shall elect the balance of the trustees.

(b) Right to Elect Majority of Board of Trustees. Except as otherwise required by law, during any period in which any one or more of the conditions described below shall exist (such period being referred to herein as a Voting Period ), the number of trustees constituting the Board of Trustees of the Trust shall be automatically increased by the smallest number that, when added to the two trustees elected exclusively by the holders of preferred shares of beneficial interest of the Trust, including the AMPS, would constitute a majority of the Board of Trustees of the Trust as so increased by such smallest number; and the holders of preferred shares of beneficial interest of the Trust shall be entitled, voting separately as one class (to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Trust), to elect such smallest number of additional trustees (as so elected, the Additional Trustees ), in addition to the two trustees that such holders are in any event entitled to elect.

A Voting Period shall commence:

(i) if at any time accumulated dividends (whether or not earned or declared, and whether or not funds are then legally available in an amount sufficient therefor) on any outstanding preferred shares, including the AMPS, equal to at least two full years' dividends shall be due and unpaid and sufficient cash or specified securities shall not have been deposited with the Auction Agent for the payment of such accumulated dividends; or

(ii) if at any time holders of any preferred shares of beneficial interest of the Trust, including the holders of AMPS, are entitled to elect a majority of the trustees of the Trust under the 1940 Act.

Upon the termination of a Voting Period, the voting rights described in this Section 11.5(b) shall cease, subject always, however, to the reversion of such voting rights in the Holders upon the further occurrence of any of the events described in this Section 11.5(b), the terms of the Additional Trustees shall terminate automatically, and the remaining Trustees shall constitute the Trustees of the Trust.

(c) Right to Vote with Respect to Certain Other Matters. So long as any AMPS are Outstanding, the Trust shall not, without the affirmative vote or consent of the holders of a



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majority of the preferred shares of the Trust, including the AMPS, Outstanding at the time, voting separately as one class: (i) authorize, create or issue any class or series of shares of beneficial interest ranking prior to the AMPS or any other series of preferred shares of beneficial interest of the Trust with respect to payment of dividends or the distribution of assets upon dissolution, liquidation or winding up the affairs of the Trust; provided, however, that no vote is required to authorize the issuance of another series of AMPS or another class of preferred shares of beneficial interest of the Trust that is substantially identical in all respects to the AMPS; or (ii) amend, alter or repeal the provisions of the Declaration of Trust or Bylaws, whether by merger, consolidation or otherwise, so as to adversely affect any of the contract rights expressly set forth in the Declaration of Trust or Bylaws of holders of AMPS or any other preferred shares of beneficial interest of the Trust. To the extent permitted under the 1940 Act, in the event shares of more than one series of preferred shares of the Trust, including the AMPS, are outstanding, the Trust shall not approve any of the actions set forth in clause (i) or (ii) which adversely affects the contract rights expressly set forth in the Declaration of Trust or Bylaws of a Holder of a series of AMPS differently than those of a Holder of any other series of preferred shares of the Trust, including the AMPS, without the affirmative vote of the holders of at least a majority of the AMPS of each series adversely affected and Outstanding at such time (each such adversely affected series voting separately as a class). Unless a higher percentage is provided for under the Declaration of Trust or these Bylaws, the affirmative vote of the holders of a majority of the outstanding preferred shares of beneficial interest of the Trust, including AMPS, voting together as a single class, will be required to approve any plan of reorganization (including bankruptcy proceedings) adversely affecting such shares or any action requiring a vote of security holders under Section 13(a) of the 1940 Act. To the extent permitted under the 1940 Act, in the event shares of more than one series of AMPS are outstanding, with respect to any action requiring Shareholder approval pursuant to the operation of Section 2 or Section 3 of Article V of the Declaration of Trust, the affirmative vote of at least seventy-five percent of the AMPS of each series Outstanding at such time (each such series voting separately as a class) shall also be required. The class (and, where applicable, the series) vote of holders of preferred shares of beneficial interest of the Trust, including AMPS, described above will in each case be in addition to a separate vote of the requisite percentage of Common Shares and preferred shares of beneficial interest of the Trust, including AMPS, voting together as a single class, necessary to authorize the action in question.

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(d) Voting Procedures.

(i) As soon as practicable after the accrual of any right of the holders of preferred shares of beneficial interest of the Trust to elect additional trustees as described in Section 11.5(b) above, the Trust shall call a special meeting of such holders and instruct the Auction Agent and any other registrar for preferred shares of beneficial interest of the Trust other than AMPS to mail a notice of such special meeting to such holders, such meeting to be held not less than 10 nor more than 20 days after the date of mailing of such notice. If the Trust fails to send such notice to the Auction Agent and any other applicable registrar, or if the Trust does not call such a special meeting, it may be called by any such holder on like notice. The record date for determining the holders entitled to notice of and to vote at such special meeting shall be the close of business on the fifth Business Day preceding the day on which such notice is mailed. At any such special meeting and at each meeting held during a Voting Period at which trustees are to be elected, such holders, voting together as a class (to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Trust), shall be entitled to elect the number of Trustees prescribed in Section 11.5(b) above. At any such meeting or adjournment thereof in the absence of a quorum, a majority of such holders present in person or by proxy shall have the power to adjourn the meeting without notice, other than by an announcement at the meeting, to a date not more than 120 days after the original record date.

(ii) Except as otherwise required by applicable law, for purposes of determining any rights of the Holders to vote on any matter or the number of shares required to constitute a quorum, whether such right is created by these Bylaws, by the other provisions of the Declaration of Trust, by statute or otherwise, an Auction Market Preferred Share which is not Outstanding shall not be counted.

(iii) The terms of office of all persons who are trustees of the Trust at the time of a special meeting of Holders and holders of other preferred shares of beneficial interest of the Trust to elect trustees shall continue, notwithstanding the election at such meeting by the Holders and such other holders of the number of trustees that they are entitled to elect, and the persons so elected by the Holders and such other holders, together with the two incumbent trustees elected by the Holders and such other holders of preferred shares of beneficial interest of the Trust and the remaining incumbent trustees elected by the holders of the Common Shares and preferred shares of beneficial interest of the Trust, shall constitute the duly elected trustees of the Trust.

(iv) Simultaneously with the termination of a Voting Period, the terms of office of the Additional Trustees shall automatically terminate, the remaining trustees shall constitute the trustees of the Trust and the voting rights of the Holders and such other holders to elect additional trustees pursuant to Section 11.5(b) above shall cease, subject to the provisions of the last sentence of Section 11.5(b).

(e) Exclusive Remedy. Unless otherwise required by law, the Holders shall not have any rights or preferences other than those specifically set forth herein. The Holders shall have no preemptive rights or rights to cumulative voting. In the event that the Trust fails to

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pay any dividends on the AMPS, the exclusive remedy of the Holders shall be the right to vote for trustees pursuant to the provisions of this Section 11.5.

11.6 1940 Act Preferred Shares Asset Coverage . The Trust shall maintain, as of the last Business Day of each month in which any AMPS are Outstanding, the 1940 Act Preferred Shares Asset Coverage.

11.7 Preferred Shares Basic Maintenance Amount.

(a) So long as any AMPS are outstanding and any Rating Agency so requires, the Trust shall maintain, on each Valuation Date, and shall verify to its satisfaction that it is maintaining on such Valuation Date, Fitch Eligible Assets and Moody's Eligible Assets each having an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount. Upon any failure to maintain the required Discounted Value, the Trust will use its best efforts to alter the composition of its portfolio to retain a Discounted Value of both Fitch Eligible Assets and Moody's Eligible Assets at least equal to the Preferred Shares Basic Maintenance Amount on or prior to the Preferred Shares Basic Maintenance Cure Date.

(b) On or before 5:00 p.m., New York City time, on the third Business Day after a Valuation Date on which the Trust fails to satisfy the Preferred Shares Basic Maintenance Amount, the Trust shall complete and deliver to (i) the Auction Agent and (ii) Fitch Ratings, Moody's and any other Rating Agency then rating the AMPS the Discounted Value of whose Eligible Assets fails to satisfy the Preferred Shares Basic Maintenance Amount, as applicable, a complete Preferred Shares Basic Maintenance Report as of the date of such failure, which will be deemed to have been delivered to such recipient if the recipient receives a copy or telecopy, telex or other electronic transcription thereof and on the same day the Trust mails to the recipient for delivery on the next Business Day the complete Preferred Shares Basic Maintenance Report. The Trust will deliver a Preferred Shares Basic Maintenance Report to each applicable Rating Agency on or before 5:00 p.m., New York City time, on the third Business Day after a Valuation Date on which the Trust cures its failure to maintain Eligible Assets of each applicable Rating Agency with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount or on which the Trust fails to maintain Eligible Assets of each applicable Rating Agency with an aggregate Discounted Value which exceeds the Preferred Shares Basic Maintenance Amount by 5% or more. The Trust will also deliver a Preferred Shares Basic Maintenance Report to the Auction Agent, Fitch Ratings and Moody's as of each Quarterly Valuation Date on or before the third Business Day after such date. Additionally, on or before 5:00 p.m., New York City time, on the third Business Day after the first day of a Special Dividend Period, the Trust will deliver a Preferred Shares Basic Maintenance Report to the Auction Agent, Fitch Ratings and Moody's. The Trust shall also provide Fitch Ratings or Moody's with a Preferred Shares Basic Maintenance Report when specifically requested by Fitch Ratings or Moody's, respectively.

(c) Within ten Business Days after the date of delivery of a Preferred Shares Basic Maintenance Report in accordance with Section 11.7(b) above relating to a Quarterly Valuation Date (except as described in the following sentence), the Independent Accountant will confirm in writing to the Auction Agent, Fitch Ratings and Moody's, (i) the mathematical accuracy of the calculations reflected in such Report (and in any other Preferred Shares Basic

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Maintenance Report, randomly selected by the Independent Accountant, that was delivered by the Trust during the quarter ending on such Quarterly Valuation Date), (ii) that, in such Report (and in such randomly selected Report), the Trust correctly determined the assets of the Trust which constitute Fitch Eligible Assets and Moody's Eligible Assets at such Quarterly Valuation Date in accordance with these Bylaws, (iii) that, in such Report (and in such randomly selected Report), the Trust determined whether the Trust had, at such Quarterly Valuation Date (and at the Valuation Date addressed in such randomly selected Report) in accordance with these Bylaws, Fitch Eligible Assets and Moody's Eligible Assets each with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount, (iv) with respect to the ratings by S&P or Fitch Ratings on portfolio securities of the Trust, the issuer name, issue size and coupon rate, if any, listed in such Report, that the Independent Accountant has requested that S&P or Fitch Ratings verify such information and the Independent Accountant shall provide a listing in its letter of any differences, (v) with respect to the Fitch Ratings' ratings on portfolio securities of the Trust, the issuer name, issue size and coupon rate, if any, listed in such Report, that such information has been verified by Fitch Ratings (in the event such information is not verified by Fitch Ratings, the Independent Accountant will inquire of Fitch Ratings what such information is, and provide a listing in its letter of any differences), (vi) with respect to the Moody's ratings on portfolio securities of the Trust, the issuer name, issue size and coupon rate, if any, listed in such Report, that such information has been verified by Moody's (in the event such information is not verified by Moody's, the Independent Accountant will inquire of Moody's what such information is, and provide a listing in its letter of any differences) and (vii) with respect to the bid or mean price (or such alternative permissible factor used in calculating the Market Value) provided by the custodian of the Trust's assets to the Trust for purposes of valuing securities in the Trust's portfolio, the Independent Accountant has traced the price used in such Report to the bid or mean price listed in such Report as provided to the Trust and verified that such information agrees (in the event such information does not agree, the Independent Accountant will provide a listing in its letter of such differences) (such confirmation is herein called the Accountant's Confirmation). Notwithstanding the foregoing sentence, the Independent Accountant will provide the confirmation described in the foregoing sentence with respect to Preferred Shares Basic Maintenance Reports delivered pursuant to the third sentence of Section 11.7(b) above only for such Preferred Shares Basic Maintenance Reports relating to the last fiscal quarter of each fiscal year.

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(d) Within ten Business Days after the date of delivery to the Auction Agent and any applicable Rating Agency of a Preferred Shares Basic Maintenance Report in accordance with Section 11.7(b) above relating to any Valuation Date on which the Trust failed to maintain Eligible Assets of such applicable Rating Agency with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount, and relating to the Preferred Shares Basic Maintenance Cure Date with respect to such failure, the Trust shall cause the Independent Accountant to provide to the Auction Agent and each applicable Rating Agency an Accountant's Confirmation as to such Preferred Shares Basic Maintenance Report.

(e) If any Accountant's Confirmation delivered pursuant to subparagraph (c) or (d) of this Section 11.7 shows that an error was made in the Preferred Shares Basic Maintenance Report for a particular Valuation Date for which such Accountant's Confirmation was required to be delivered, or shows that a lower aggregate Discounted Value for the aggregate of all Fitch Eligible Assets or Moody's Eligible Assets of the Trust was determined by the Independent Accountant, the calculation or determination made by such Independent Accountant shall be final and conclusive and shall be binding on the Trust, and the Trust shall accordingly amend and deliver the Preferred Shares Basic Maintenance Report to the Auction Agent and each applicable Rating Agency promptly following receipt by the Trust of such Accountant's Confirmation.

(f) Within five Business Days after the Date of Original Issue of the AMPS, the Trust will complete and deliver to Moody's a Preferred Shares Basic Maintenance Report as of the close of business on such Date of Original Issue. Also, on or before 5:00 p.m., New York City time, on the first Business Day after any Common Shares are repurchased by the Trust, the Trust will complete and deliver to Fitch Ratings and Moody's a Preferred Shares Basic Maintenance Report as of the close of business on such date that Common Shares are repurchased.

11.8 Certain Other Restrictions.

(a) For so long as any AMPS are rated by Moody's, the Trust will not buy or sell financial futures contracts, write, purchase or sell call options on financial futures contracts or purchase put options on financial futures contracts or write call options (except covered call options) on portfolio securities unless it receives written confirmation from Moody's that engaging in such transactions would not impair the ratings then assigned to the AMPS by Moody's, except that the Trust may purchase or sell exchange-traded financial futures contracts based on any index approved by Moody's or Treasury Bonds, and purchase, write or sell exchange-traded put options on such financial futures contracts, any index approved by Moody's or Treasury Bonds, and purchase, write or sell exchange-traded call options on such financial futures contracts, any index approved by Moody's or Treasury Bonds (collectively Moody's Hedging Transactions), subject to the following limitations:

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(i) the Trust will not engage in any Moody's Hedging Transaction based on any index approved by Moody's (other than transactions that terminate a futures contract or option held by the Trust by the Trust's taking the opposite position thereto (Closing Transactions)) that would cause the Trust at the time of such transaction to own or have sold:

(A) outstanding financial futures contracts based on such index exceeding in number 10% (or such higher percentage as Moody's may approve) of the average number of daily traded financial futures contracts based on such index in the 30 days preceding the time of effecting such transaction as reported by *The Wall Street Journal*; or

(B) outstanding financial futures contracts based on any index approved by Moody's having a Market Value exceeding 50% (or such higher percentage as Moody's may approve) of the Market Value of all portfolio securities of the Trust constituting Moody's Eligible Assets owned by the Trust (other than Moody's Eligible Assets already subject to a Moody's Hedging Transaction);

(ii) the Trust will not engage in any Moody's Hedging Transaction based on Treasury Bonds (other than Closing Transactions) that would cause the Trust at the time of such transaction to own or have sold:

(A) outstanding financial futures contracts based on Treasury Bonds with such contracts having an aggregate Market Value exceeding 20% (or such higher percentage as Moody's may approve) of the aggregate Market Value of Moody's Eligible Assets owned by the Trust and rated Aa or higher by Moody's (or, if not rated by Moody's but rated by S&P or Fitch Ratings, rated AAA by S&P or Fitch Ratings); or

(B) outstanding financial futures contracts based on Treasury Bonds with such contracts having an aggregate Market Value exceeding 80% of the aggregate Market Value of all portfolio securities of the Trust constituting Moody's Eligible Assets owned by the Trust (other than Moody's Eligible Assets already subject to a Moody's Hedging Transaction) and rated Baa or A by Moody's (or, if not rated by Moody's but rated by S&P or Fitch Ratings, rated A or AA by S&P or Fitch Ratings)

(for purposes of the foregoing clauses (i) and (ii), the Trust shall be deemed to own the number of financial futures contracts that underlie any outstanding options written by the Trust);

(iii) the Trust will engage in Closing Transactions to close out any outstanding financial futures contract based on any index approved by Moody's if the amount of open interest in such index as reported by *The Wall Street Journal* is less than an amount to be mutually determined by Moody's and the Trust;

(iv) the Trust will engage in a Closing Transaction to close out any outstanding financial futures contract by no later than the fifth Business Day of the

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month in which such contract expires and will engage in a Closing Transaction to close out any outstanding option on a financial futures contract by no later than the first Business Day of the month in which such option expires;

(v) the Trust will engage in Moody's Hedging Transactions only with respect to financial futures contracts or options thereon having the next settlement date or the settlement date immediately thereafter;

(vi) the Trust (A) will not engage in options and futures transactions for leveraging or speculative purposes, except that an option or futures transaction shall not for these purposes be considered a leveraged position or speculative so long as the combination of the Trust's non-derivative positions, together with the relevant option or futures transaction, produces a synthetic investment position, or the same economic result, that could be achieved by an investment, consistent with the Trust's investment objectives and policies, in a security that is not an option or futures transaction, and (B) will not write any call options or sell any financial futures contracts for the purpose of hedging the anticipated purchase of an asset prior to completion of such purchase; and

(vii) while the Trust may use options and futures transactions for hedging and risk management purposes, it will not enter into an option or futures transaction unless, after giving effect thereto, the Trust would continue to have Moody's Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount.

(b) For purposes of determining whether the Trust has Moody's Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount, the Discounted Value of Moody's Eligible Assets that the Trust is obligated to deliver or receive pursuant to an outstanding futures contract or option shall be as follows:

(i) assets subject to call options written by the Trust that are either exchange-traded and readily reversible or that expire within 49 days after the date as of which such valuation is made shall be valued at the lesser of (A) Discounted Value and (B) the exercise price of the call option written by the Trust;

(ii) assets subject to call options written by the Trust not meeting the requirements of clause (i) of this sentence shall have no value;

(iii) assets subject to put options written by the Trust shall be valued at the lesser of (A) the exercise price and (B) the Discounted Value of the assets subject to the option;

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(iv) futures contracts shall be valued at the lesser of (A) settlement price and (B) the Discounted Value of the assets subject to the futures contract, provided that, if a contract matures within 49 days after the date as of which such valuation is made, where the Trust is the seller the contract may be valued at the settlement price and where the Trust is the buyer the contract may be valued at the Discounted Value of the assets subject to the futures contract; and

(v) where delivery may be made to the Trust with any security of a class of securities, the Trust shall assume that it will take delivery of the security with the lowest Discounted Value.

(c) For purposes of determining whether the Trust has Moody's Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount, the following amounts shall be subtracted from the aggregate Discounted Value of the Moody's Eligible Assets held by the Trust to the extent the relevant asset is a Moody's Eligible Asset:

(i) 10% of the exercise price of a written call option;

(ii) the exercise price of any written put option;

(iii) where the Trust is the seller under a financial futures contract, 10% of the settlement price of the financial futures contract;

(iv) where the Trust is the purchaser under a financial futures contract, any amounts payable by the Trust under such financial futures contract;

(v) the settlement price of the underlying financial futures contract if the Trust writes put options on a financial futures contract; and

(vi) 105% of the Market Value of the underlying financial futures contract if the Trust writes call options on a financial futures contract and does not own the underlying contract.

(d) For so long as any AMPS are rated by Moody's, the Trust will not enter into any Forward Commitment, herein defined as any contract to purchase securities for a fixed price at a future date beyond customary settlement time (other than such contracts that constitute Fitch Hedging Transactions or Moody's Hedging Transactions, as applicable), except that the Trust may enter into Forward Commitments subject to the following limitations:



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(i) for each Forward Commitment, the Trust will maintain with its custodian (A) cash, cash equivalents or short-term, fixed-income securities rated P-1, MIG-1 or VMIG-1 by Moody's or A-1 by S&P or Fitch Ratings and maturing in one year or less with a fair market value that equals or exceeds the amount by which the Trust's obligations under any Forward Commitments to which it is from time to time a party exceed obligations to the Trust arising from securities sales by the Trust that are scheduled to settle at a future date, or (B) long-term, fixed-income securities with a then current market value that equals or exceeds the amount by which the Trust's obligations under any Forward Commitments to which it is from time to time a party exceed obligations to the Trust arising from securities sales by the Trust that are scheduled to settle on a future date, or (C) a combination of assets described in (A) and (B) above that in the aggregate equals or exceeds the amount by which the Trust's obligations under any Forward Commitments to which it is from time to time a party exceed obligations to the Trust arising from securities sales by the Trust that are scheduled to settle on a future date; and

(ii) the Trust will not enter into a Forward Commitment unless, after giving effect thereto, the Trust would continue to have Moody's Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount.

For purposes of determining whether the Trust has Moody's Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount, the Discounted Value of all Forward Commitments to which the Trust is a party and of all securities deliverable to the Trust pursuant to such Forward Commitments shall be zero.

(e) For so long as any AMPS are Outstanding and Fitch Ratings or Moody's or both are rating such shares, the Trust, unless it has received written confirmation from Fitch Ratings or Moody's or both, as applicable, that such action would not impair the rating then assigned to the AMPS by Fitch Ratings or Moody's or both, as applicable, will not:

(i) borrow money except for the purpose of clearing transactions in portfolio securities (which borrowings under any circumstances shall be limited to an amount equal to 5% of the Market Value of the Trust's assets at the time of such borrowings and which borrowings shall be repaid within 60 days and not be extended or renewed and shall not cause the aggregate Discounted Value of Fitch Eligible Assets or Moody's Eligible Assets, as applicable, to be less than the Preferred Shares Basic Maintenance Amount);

(ii) engage in short sales of securities;

(iii) lend any securities;

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(iv) issue any class or series of shares of beneficial interest ranking prior to or on a parity with the AMPS with respect to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the Trust;

(v) merge or consolidate into or with any other corporation or entity; and

(vi) change any Pricing Service of the Trust.

(f) For so long as any AMPS are rated by Fitch Ratings, the Trust will not buy or sell financial futures contracts, write, purchase or sell call options on financial futures contracts or purchase put options on financial futures contracts or write call options (except covered call options) on portfolio securities unless it receives written confirmation from Fitch Ratings that engaging in such transactions would not impair the ratings then assigned to the AMPS by Fitch Ratings, except that the Trust may purchase or sell exchange-traded financial futures contracts based on any index approved by Fitch Ratings or Treasury Bonds, and purchase, write or sell exchange-traded put options on such financial futures contracts, any index approved by Fitch Ratings or Treasury Bonds and purchase, write or sell exchange-traded call options on such financial futures contracts, any index approved by Fitch Ratings or Treasury Bonds (collectively Fitch Hedging Transactions ), subject to the following limitations:

(i) the Trust will not engage in any Fitch Hedging Transaction based on any index approved by Fitch Ratings (other than Closing Transactions) that would cause the Trust at the time of such transaction to own or have sold outstanding financial futures contracts based on such index exceeding in number 10% of the average number of daily traded financial futures contracts based on such index in the 30 days preceding the time of effecting such transaction as reported by *The Wall Street Journal*;

(ii) the Trust will not engage in any Fitch Hedging Transaction based on Treasury Bonds (other than Closing Transactions) that would cause the Trust at the time of such transaction to own or have sold:

(A) outstanding financial futures contracts based on Treasury Bonds with such contracts having an aggregate Market Value exceeding 20% of the aggregate Market Value of Fitch Eligible Assets owned by the Trust and rated at least AA by Fitch Ratings (or, if not rated by Fitch Ratings, rated at least Aa by Moody's; or, if not rated by Moody's, rated AAA by S&P); or

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(B) outstanding financial futures contracts based on Treasury Bonds with such contracts having an aggregate Market Value exceeding 40% of the aggregate Market Value of all Fitch Eligible Assets owned by the Trust (other than Fitch Eligible Assets already subject to a Fitch Hedging Transaction) and rated at least A or BBB by Fitch Ratings (or, if not rated by Fitch Ratings, rated at least Baa by Moody's; or, if not rated by Moody's, rated at least A or AA by S&P)

(for purposes of the foregoing clauses (i) and (ii), the Trust shall be deemed to own futures contracts that underlie any outstanding options written by the Trust);

(iii) the Trust will engage in Closing Transactions to close out any outstanding financial futures contract based on any index approved by Fitch Ratings if the amount of open interest in such index as reported by *The Wall Street Journal* is less than an amount to be mutually determined by Fitch Ratings and the Trust; and

(iv) the Trust will not enter into an option or futures transaction unless, after giving effect thereto, the Trust would continue to have Fitch Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount.

(g) For purposes of determining whether the Trust has Fitch Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount, the Discounted Value of Fitch Eligible Assets that the Trust is obligated to deliver or receive pursuant to an outstanding futures contract or option shall be as follows:

(i) assets subject to call options written by the Trust that are either exchange-traded and readily reversible or that expire within 49 days after the date as of which such valuation is made shall be valued at the lesser of (A) Discounted Value and (B) the exercise price of the call option written by the Trust;

(ii) assets subject to call options written by the Trust not meeting the requirements of clause (i) of this sentence shall have no value;

(iii) assets subject to put options written by the Trust shall be valued at the lesser of (A) the exercise price and (B) the Discounted Value of the assets subject to the option;

(iv) futures contracts shall be valued at the lesser of (A) settlement price and (B) the Discounted Value of the assets subject to the futures contract, provided that, if a contract matures within 49 days after the date as of which such valuation is made, where the Trust is the seller the contract may be valued at the settlement price and where the Trust is the buyer the contract may be valued at the Discounted Value of the assets subject to the futures contract; and

(v) where delivery may be made to the Trust with any security of a class of securities, the Trust shall assume that it will take delivery of the security with the lowest Discounted Value.



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(h) For purposes of determining whether the Trust has Fitch Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount, the following amounts shall be subtracted from the aggregate Discounted Value of the Fitch Eligible Assets held by the Trust to the extent the relevant asset is a Fitch Eligible Asset:

(i) 10% of the exercise price of a written call option;

(ii) the exercise price of any written put option;

(iii) where the Trust is the seller under a financial futures contract, 10% of the settlement price of the financial futures contract;

(iv) where the Trust is the purchaser under a financial futures contract, the settlement price of assets purchased under such financial futures contract;

(v) the settlement price of the underlying financial futures contract if the Trust writes put options on a financial futures contract and does not own the underlying contract; and

(vi) 105% of the Market Value of the underlying financial futures contracts if the Trust writes call options on a financial futures contract and does not own the underlying contract.

(i) For so long as any AMPS are rated by Fitch Ratings, the Trust will not enter into any Forward Commitments, except that the Trust may enter into Forward Commitments subject to the following limitations:

(i) the Trust will maintain in a segregated account with its custodian cash, cash equivalents or short-term, fixed-income securities rated F1 or better by Fitch Ratings (or, if not rated by Fitch Ratings, rated P-1 by Moody's) and maturing prior to the date of the Forward Commitment with a Market Value that equals or exceeds the amount of the Trust's obligations under any Forward Commitments to which it is from time to time a party or long-term fixed income securities with a Discounted Value that equals or exceeds the amount of the Trust's obligations under any Forward Commitment to which it is from time to time a party; and

(ii) the Trust will not enter into a Forward Commitment unless, after giving effect thereto, the Trust would continue to have Fitch Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount.

For purposes of determining whether the Trust has Fitch Eligible Assets with an aggregate Discounted Value that equals or exceeds the Preferred Shares Basic Maintenance Amount, the Discounted Value of all Forward Commitments to which the Trust is a party and of all securities deliverable to the Trust pursuant to such Forward Commitments shall be zero.



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11.9 Notice. All notices or communications, unless otherwise specified in these Bylaws, shall be sufficiently given if in writing and delivered in person or mailed by first-class mail, postage prepaid. Notice shall be deemed given on the earlier of the date received or the date seven days after which such notice is mailed.

11.10 Auction Procedures.

(a) Certain Definitions. As used in this Section 11.10, the following terms shall have the following meanings, unless the context otherwise requires:

(i) AMPS means the AMPS being auctioned pursuant to this Section 11.10

(ii) Auction Date means the first Business Day preceding the first day of a Dividend Period.

(iii) Available AMPS has the meaning specified in Section 11.10(d)(i)(A) below.

(iv) Bid has the meaning specified in Section 11.10(b)(i)(B) below.

(v) Bidder has the meaning specified in Section 11.10(b)(i)(B) below.

(vi) Hold Order has the meaning specified in Section 11.10(b)(i)(B) below.

(vii) Maximum Applicable Rate for any Dividend Period will be the greater of the Applicable Percentage of the Reference Rate or the Applicable Spread plus the Reference Rate. The Auction Agent will round each applicable Maximum Applicable Rate to the nearest one-thousandth (.001) of one percent per annum, with any such number ending in five ten-thousandths of one percent being rounded upwards to the nearest one-thousandth (.001) of one percent. The Auction Agent will not round the applicable Reference Rate as part of its calculation of the Maximum Applicable Rate.

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The **Applicable Percentage** shall be the percentage determined based on the lower of the credit ratings assigned on such date by Moody's and Fitch Ratings as follows:

| <b>Credit Ratings</b> |               | <b>Applicable Percentage</b> |
|-----------------------|---------------|------------------------------|
| <b>Moody's</b>        | <b>Fitch</b>  |                              |
| Aaa                   | AAA           | 125%                         |
| Aa3 to Aa1            | AA- to AA+    | 150%                         |
| A3 to A1              | A- to A+      | 200%                         |
| Baa3 to Baa1          | BBB- to BBB+  | 250%                         |
| Ba1 and lower         | BB+ and lower | 300%                         |

The Applicable Percentage as so determined shall be further subject to upward but not downward adjustment in the discretion of the Board of Trustees of the Trust after consultation with the Broker-Dealers, provided that the Board of Trustees has received assurance from Moody's, Fitch Ratings and from any other Rating Agency then rating the AMPS that such increase will not impair such Rating Agency's rating thereof, and further provided that immediately following any such increase the Trust would be in compliance with the Preferred Shares Basic Maintenance Amount. The Trust shall take all reasonable action necessary to enable Moody's or Fitch Ratings to provide a rating for each series of AMPS. If Moody's or Fitch Ratings shall not make such a rating available, Merrill Lynch, Pierce, Fenner and Smith Incorporated or its affiliates and successors, after consultation with the Trust, shall select another Rating Agency to act as a Substitute Rating Agency.

**Applicable Spread** means the spread determined based on the credit rating assigned to the series of AMPS on such date by Moody's and Fitch Ratings as follows:

| <b>Credit Ratings</b> |               | <b>Applicable Spread over Reference Rate</b> |
|-----------------------|---------------|--|
| <b>Moody's</b>        | <b>Fitch</b>  |  |
| Aaa                   | AAA           | 125 bps                                      |
| Aa3 to Aa1            | AA- to AA+    | 150 bps                                      |
| A3 to A1              | A- to A+      | 200 bps                                      |
| Baa3 to Baa1          | BBB- to BBB+  | 250 bps                                      |
| Ba1 and lower         | BB+ and lower | 300 bps                                      |



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The Applicable Spread as so determined will be further subject to upward but not downward adjustment in the discretion of the Board of Directors after consultation with the Broker-Dealers, provided that that immediately following any such increase the Trust would be in compliance with the Preferred Shares Basic Maintenance Amount. The Trust will take all reasonable action necessary to enable either Moody's or Fitch to provide a rating for each series of AMPS. If neither Moody's nor Fitch will make such a rating available, the Trust will select another Rating Agency to act as a substitute Rating Agency.

For purposes of this definition, the prevailing rating of shares of a series of AMPS will be (i) AAA if such shares have a rating of AAA by Moody's or Fitch or the equivalent of such ratings by such agencies or substitute rating agencies selected as provided below; (ii) if not AAA, then AA- if such shares have a rating of AA- or better by Moody's or Fitch or the equivalent of such ratings by such agencies or substitute rating agencies selected as provided below, (iii) if not AA- or higher, than A- if such shares have a rating of A- or better by Moody's or Fitch or the equivalent of such ratings by such agencies or substitute rating agencies selected as provided below, (iv) if not A- or higher than BBB- if such shares have a rating of BBB- or better by Moody's or Fitch or the equivalent of such ratings by such agencies or substitute rating agencies selected as provided below, (v) if not BBB- or higher, then below BBB-; provided, however, that if such shares are rated by only one rating agency, the prevailing rating will be determined without reference to the rating of any other rating agency.

(viii) Order has the meaning specified in Section 11.10(b)(i)(B) below.

(ix) Sell Order has the meaning specified in Section 11.10(b)(i)(B) below.

(x) Submission Deadline means 1:00 p.m., New York City time, on any Auction Date or such other time on any Auction Date as may be specified by the Auction Agent from time to time as the time by which each Broker-Dealer must submit to the Auction Agent in writing all Orders obtained by it for the Auction to be conducted on such Auction Date.

(xi) Submission Processing Deadline means the earlier of (i) 40 minutes after the Submission Deadline and (ii) the time when the Auction Agent begins to disseminate the results of the Auction to the Broker-Dealers.

(xii) Submitted Bid has the meaning specified in Section 11.10(d)(i) below.

(xiii) Submitted Hold Order has the meaning specified in Section 11.10(d)(i) below.

(xiv) Submitted Order has the meaning specified in Section 11.10(d)(i) below.

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(xv) Submitted Sell Order has the meaning specified in Section 11.10(d)(i) below.

(xvi) Sufficient Clearing Bids has the meaning specified in Section 11.10(d)(i) below.

(xvii) Winning Bid Rate has the meaning specified in Section 11.10(d)(i)(C) below.

(b) Orders by Beneficial Owners, Potential Beneficial Owners, Existing Holders and Potential Holders.

(i) Unless otherwise permitted by the Trust, Beneficial Owners and Potential Beneficial Owners may only participate in Auctions through their Broker-Dealers. Broker-Dealers will submit the Orders of their respective customers who are Beneficial Owners and Potential Beneficial Owners to the Auction Agent, designating themselves as Existing Holders in respect of shares subject to Orders submitted or deemed submitted to them by Beneficial Owners and as Potential Holders in respect of shares subject to Orders submitted to them by Potential Beneficial Owners. A Broker-Dealer may also hold AMPS in its own account as a Beneficial Owner. A Broker-Dealer may thus submit Orders to the Auction Agent as a Beneficial Owner or a Potential Beneficial Owner and therefore participate in an Auction as an Existing Holder or Potential Holder on behalf of both itself and its customers. On or prior to the Submission Deadline on each Auction Date:

(A) each Beneficial Owner may submit to its Broker-Dealer information as to:

(1) the number of Outstanding AMPS, if any, held by such Beneficial Owner which such Beneficial Owner desires to continue to hold without regard to the Applicable Rate for the next succeeding Dividend Period for such shares;

(2) the number of Outstanding AMPS, if any, held by such Beneficial Owner which such Beneficial Owner desires to continue to hold, provided that the Applicable Rate for the next succeeding Dividend Period for such shares shall not be less than the rate per annum specified by such Beneficial Owner; and/or

(3) the number of Outstanding AMPS, if any, held by such Beneficial Owner which such Beneficial Owner offers to sell without regard to the Applicable Rate for the next succeeding Dividend Period; and

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(B) each Broker-Dealer, using a list of Potential Beneficial Owners that shall be maintained in good faith in a commercially reasonable manner for the purpose of conducting a competitive Auction, shall contact Potential Beneficial Owners, including Persons that are not Beneficial Owners, on such list to determine the number of Outstanding AMPS, if any, which each such Potential Beneficial Owner offers to purchase, provided that the Applicable Rate for the next succeeding Dividend Period shall not be less than the rate per annum specified by such Potential Beneficial Owner.

For the purposes hereof, the communication by a Beneficial Owner or Potential Beneficial Owner to a Broker-Dealer, or the communication by a Broker-Dealer acting for its own account to the Auction Agent, of information referred to in clause (A) or (B) of this Section 11.10(b)(i) is hereinafter referred to as an Order and each Beneficial Owner and each Potential Beneficial Owner placing an Order, including a Broker-Dealer acting in such capacity for its own account, is hereinafter referred to as a Bidder ; an Order containing the information referred to in clause (A)(1) of this Section 11.10(b)(i) is hereinafter referred to as a Hold Order ; an Order containing the information referred to in clause (A)(2) or (B) of this Section 11.10(b)(i) is hereinafter referred to as a Bid ; and an Order containing the information referred to in clause (A)(3) of this Section 11.10(b)(i) is hereinafter referred to as a Sell Order. Inasmuch as a Broker-Dealer participates in an Auction as an Existing Holder or a Potential Holder only to represent the interests of a Beneficial Owner or Potential Beneficial Owner, whether it be its customers or itself, all discussion herein relating to the consequences of an Auction for Existing Holders and Potential Holders also applies to the underlying beneficial ownership interests represented.

(ii) (A) A Bid by a Beneficial Owner or an Existing Holder shall constitute an irrevocable offer to sell:

(1) the number of Outstanding AMPS specified in such Bid if the Applicable Rate determined on such Auction Date shall be less than the rate per annum specified in such Bid; or

(2) such number or a lesser number of Outstanding AMPS to be determined as set forth in Section 11.10(e)(i)(D) if the Applicable Rate determined on such Auction Date shall be equal to the rate per annum specified therein; or

(3) a lesser number of Outstanding AMPS to be determined as set forth in Section 11.10(e)(ii)(C) if such specified rate per annum shall be higher than the Maximum Applicable Rate and Sufficient Clearing Bids do not exist.

(B) A Sell Order by a Beneficial Owner or an Existing Holder shall constitute an irrevocable offer to sell:

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(1) the number of Outstanding AMPS specified in such Sell Order; or

(2) such number or a lesser number of Outstanding AMPS to be determined as set forth in Section 11.10(e)(ii)(C) if Sufficient Clearing Bids do not exist.

(C) A Bid by a Potential Holder shall constitute an irrevocable offer to purchase:

(1) the number of Outstanding AMPS specified in such Bid if the Applicable Rate determined on such Auction Date shall be higher than the rate per annum specified in such Bid; or

(2) such number or a lesser number of Outstanding AMPS to be determined as set forth in Section 11.10(e)(i)(E) if the Applicable Rate determined on such Auction Date shall be equal to the rate per annum specified therein.

(c) Submission of Orders by Broker-Dealers to Auction Agent.

(i) Each Broker-Dealer shall submit in writing or through the Auction Agent's auction processing system to the Auction Agent prior to the Submission Processing Deadline on each Auction Date all Orders that were (x) received by the Broker-Dealer from Beneficial Owners or Potential Beneficial Owners prior to the Submission Deadline or (y) initiated internally by the Broker-Dealer for its own account prior to the Submission Deadline, in each case designating itself (unless otherwise permitted by the Trust) as an Existing Holder in respect of shares subject to Orders submitted or deemed submitted to it by Beneficial Owners and as a Potential Holder in respect of shares subject to Orders submitted to it by Potential Beneficial Owners, and specifying with respect to each Order:

(A) the name of the Bidder placing such Order (which shall be the Broker-Dealer unless otherwise permitted by the Trust);

(B) the aggregate number of Outstanding AMPS that are the subject of such Order;

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(C) to the extent that such Bidder is a Beneficial Owner or an Existing Holder:

(1) the number of Outstanding AMPS, if any, subject to any Hold Order placed by such Beneficial Owner or Existing Holder;

(2) the number of Outstanding AMPS, if any, subject to any Bid placed by such Beneficial Owner or Existing Holder and the rate per annum specified in such Bid; and

(3) the number of Outstanding AMPS, if any, subject to any Sell Order placed by such Beneficial Owner or Existing Holder; and

(D) to the extent such Bidder is a Potential Holder, the rate per annum specified in such Potential Holder's Bid.

(ii) If any rate per annum specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent shall round such rate up to the next highest one-thousandth (.001) of 1%.

(iii) If an Order or Orders covering all of the Outstanding AMPS held by an Existing Holder are not submitted to the Auction Agent prior to the Submission Processing Deadline, the Auction Agent shall deem a Hold Order (in the case of any Auction other than an Auction relating to a Special Dividend Period longer than 91 days) or a Sell Order (in the case of an Auction relating to a Special Dividend Period of longer than 91 days) to have been submitted on behalf of such Existing Holder covering the number of Outstanding AMPS held by such Existing Holder and not subject to Orders submitted to the Auction Agent.

(iv) If one or more Orders on behalf of an Existing Holder covering in the aggregate more than the number of Outstanding AMPS held by such Existing Holder are submitted to the Auction Agent, such Order shall be considered valid as follows and in the following order of priority:

(A) any Hold Order submitted on behalf of such Existing Holder shall be considered valid up to and including the number of Outstanding AMPS held by such Existing Holder; provided that if more than one Hold Order is submitted on behalf of such Existing Holder and the number of AMPS subject to such Hold Orders exceeds the number of Outstanding AMPS held by such Existing Holder, the number of AMPS subject to each of such Hold Orders shall be reduced pro rata so that such Hold Orders, in the aggregate, will cover exactly the number of Outstanding AMPS held by such Existing Holder;

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(B) any Bids submitted on behalf of such Existing Holder shall be considered valid, in the ascending order of their respective rates per annum if more than one Bid is submitted on behalf of such Existing Holder, up to and including the excess of the number of Outstanding AMPS held by such Existing Holder over the number of AMPS subject to any Hold Order referred to in Section 11.10(c)(iv)(A) above (and if more than one Bid submitted on behalf of such Existing Holder specifies the same rate per annum and together they cover more than the remaining number of shares that can be the subject of valid Bids after application of Section 11.10(c)(iv)(A) above and of the foregoing portion of this Section 11.10(c)(iv)(B) to any Bid or Bids specifying a lower rate or rates per annum, the number of shares subject to each of such Bids shall be reduced pro rata so that such Bids, in the aggregate, cover exactly such remaining number of shares); and the number of shares, if any, subject to Bids not valid under this Section 11.10(c)(iv)(B) shall be treated as the subject of a Bid by a Potential Holder; and

(C) any Sell Order shall be considered valid up to and including the excess of the number of Outstanding AMPS held by such Existing Holder over the number of AMPS subject to Hold Orders referred to in Section 11.10(c)(iv)(A) and Bids referred to in Section 11.10(c)(iv)(B); provided that if more than one Sell Order is submitted on behalf of any Existing Holder and the number of AMPS subject to such Sell Orders is greater than such excess, the number of AMPS subject to each of such Sell Orders shall be reduced pro rata so that such Sell Orders, in the aggregate, cover exactly the number of AMPS equal to such excess.

(v) If more than one Bid is submitted on behalf of any Potential Holder, each Bid submitted shall be a separate Bid with the rate per annum and number of AMPS therein specified.

(vi) Any Order submitted by a Beneficial Owner as a Potential Beneficial Owner to its Broker-Dealer prior to the Submission Deadline, or by a Broker-Dealer to the Auction Agent, prior to the Submission Processing Deadline on any Auction Date shall be irrevocable.

(vii) The Trust shall not be responsible for a Broker-Dealer's failure to act in accordance with the instructions of Beneficial Owners or Potential Beneficial Owners or failure to comply with the provisions of this Section 11.10.

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(d) Determination of Sufficient Clearing Bids, Winning Bid Rate and Applicable Rate.

(i) Not earlier than the Submission Deadline on each Auction Date, the Auction Agent shall assemble all Orders submitted or deemed submitted to it by the Broker-Dealers (each such Order as submitted or deemed submitted by a Broker-Dealer being hereinafter referred to individually as a Submitted Hold Order, a Submitted Bid or a Submitted Sell Order, as the case may be, or, more generally, as a Submitted Order ) and shall determine:

(A) the excess of the total number of Outstanding AMPS over the number of Outstanding AMPS that are the subject of Submitted Hold Orders (such excess being hereinafter referred to as the Available AMPS );

(B) from the Submitted Orders whether the number of Outstanding AMPS that are the subject of Submitted Bids by Potential Holders specifying one or more rates per annum equal to or lower than the Maximum Applicable Rate exceeds or is equal to the sum of:

(1) the number of Outstanding AMPS that are the subject of Submitted Bids by Existing Holders specifying one or more rates per annum higher than the Maximum Applicable Rate, and

(2) the number of Outstanding AMPS that are subject to Submitted Sell Orders (if such excess or such equality exists (other than because the number of Outstanding AMPS in clause (1) above and this clause (2) are each zero because all of the Outstanding AMPS are the subject of Submitted Hold Orders), such Submitted Bids by Potential Holders being hereinafter referred to collectively as Sufficient Clearing Bids ); and

(C) if Sufficient Clearing Bids exist, the lowest rate per annum specified in the Submitted Bids (the Winning Bid Rate ) that if:

(1) each Submitted Bid from Existing Holders specifying the Winning Bid Rate and all other Submitted Bids from Existing Holders specifying lower rates per annum were rejected, thus entitling such Existing Holders to continue to hold the AMPS that are the subject of such Submitted Bids, and

(2) each Submitted Bid from Potential Holders specifying the Winning Bid Rate and all other Submitted Bids from Potential Holders specifying lower rates per annum were accepted, thus entitling the Potential Holders to purchase the AMPS that are the subject of such Submitted Bids, would result in the number of shares subject to all Submitted Bids specifying the Winning Bid Rate or a lower rate per annum being at least equal to the Available AMPS.

(ii) Promptly after the Auction Agent has made the determinations pursuant to Section 11.10(d)(i), the Auction Agent shall advise the Trust of the Maximum

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Applicable Rate and, based on such determinations, the Applicable Rate for the next succeeding Dividend Period as follows:

(A) if Sufficient Clearing Bids exist, that the Applicable Rate for the next succeeding Dividend Period shall be equal to the Winning Bid Rate;

(B) if Sufficient Clearing Bids do not exist (other than because all of the Outstanding AMPS are the subject of Submitted Hold Orders), that the Applicable Rate for the next succeeding Dividend Period shall be equal to the Maximum Applicable Rate; or

(C) if all of the Outstanding AMPS are the subject of Submitted Hold Orders, that the Dividend Period next succeeding the Auction shall automatically be the same length as the immediately preceding Dividend Period and the Applicable Rate for the next succeeding Dividend Period shall be equal to 80% of the Reference Rate on the date of the Auction.

(e) Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares. Existing Holders shall continue to hold the AMPS that are subject to Submitted Hold Orders, and, based on the determinations made pursuant to Section 11.10(d)(i), the Submitted Bids and Submitted Sell Orders shall be accepted or rejected and the Auction Agent shall take such other action as set forth below:

(i) If Sufficient Clearing Bids have been made, subject to the provisions of Section 11.10(e)(iii) and Section 11.10(e)(iv), Submitted Bids and Submitted Sell Orders shall be accepted or rejected in the following order of priority and all other Submitted Bids shall be rejected:

(A) the Submitted Sell Orders of Existing Holders shall be accepted and the Submitted Bid of each of the Existing Holders specifying any rate per annum that is higher than the Winning Bid Rate shall be accepted, thus requiring each such Existing Holder to sell the Outstanding AMPS that are the subject of such Submitted Sell Order or Submitted Bid;

(B) the Submitted Bid of each of the Existing Holders specifying any rate per annum that is lower than the Winning Bid Rate shall be rejected, thus entitling each such Existing Holder to continue to hold the Outstanding AMPS that are the subject of such Submitted Bid;

(C) the Submitted Bid of each of the Potential Holders specifying any rate per annum that is lower than the Winning Bid Rate shall be accepted;



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(D) the Submitted Bid of each of the Existing Holders specifying a rate per annum that is equal to the Winning Bid Rate shall be rejected, thus entitling each such Existing Holder to continue to hold the Outstanding AMPS that are the subject of such Submitted Bid, unless the number of Outstanding AMPS subject to all such Submitted Bids shall be greater than the number of Outstanding AMPS ( Remaining Shares ) equal to the excess of the Available AMPS over the number of Outstanding AMPS subject to Submitted Bids described in Section 11.10(e)(i)(B) and Section 11.10(e)(i)(C), in which event the Submitted Bids of each such Existing Holder shall be accepted, and each such Existing Holder shall be required to sell Outstanding AMPS, but only in an amount equal to the difference between (1) the number of Outstanding AMPS then held by such Existing Holder subject to such Submitted Bid and (2) the number of AMPS obtained by multiplying (x) the number of Remaining Shares by (y) a fraction the numerator of which shall be the number of Outstanding AMPS held by such Existing Holder subject to such Submitted Bid and the denominator of which shall be the sum of the number of Outstanding AMPS subject to such Submitted Bids made by all such Existing Holders that specified a rate per annum equal to the Winning Bid Rate; and

(E) the Submitted Bid of each of the Potential Holders specifying a rate per annum that is equal to the Winning Bid Rate shall be accepted but only in an amount equal to the number of Outstanding AMPS obtained by multiplying (x) the difference between the Available AMPS and the number of Outstanding AMPS subject to Submitted Bids described in Section 11.10(e)(i)(B), Section 11.10(e)(i)(C) and Section 11.10(e)(i)(D) by (y) a fraction the numerator of which shall be the number of Outstanding AMPS subject to such Submitted Bid and the denominator of which shall be the number of Outstanding AMPS subject to such Submitted Bids made by all such Potential Holders that specified rates per annum equal to the Winning Bid Rate.

(ii) If Sufficient Clearing Bids have not been made (other than because all of the Outstanding AMPS are subject to Submitted Hold Orders), subject to the provisions of Section 11.10(e)(iii), Submitted Orders shall be accepted or rejected as follows in the following order of priority and all other Submitted Bids shall be rejected:

(A) the Submitted Bid of each Existing Holder specifying any rate per annum that is equal to or lower than the Maximum Applicable Rate shall be rejected, thus entitling such Existing Holder to continue to hold the Outstanding AMPS that are the subject of such Submitted Bid;

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(B) the Submitted Bid of each Potential Holder specifying any rate per annum that is equal to or lower than the Maximum Applicable Rate shall be accepted, thus requiring such Potential Holder to purchase the Outstanding AMPS that are the subject of such Submitted Bid; and

(C) the Submitted Bids of each Existing Holder specifying any rate per annum that is higher than the Maximum Applicable Rate shall be accepted and the Submitted Sell Orders of each Existing Holder shall be accepted, in both cases only in an amount equal to the difference between (1) the number of Outstanding AMPS then held by such Existing Holder subject to such Submitted Bid or Submitted Sell Order and (2) the number of AMPS obtained by multiplying (x) the difference between the Available AMPS and the aggregate number of Outstanding AMPS subject to Submitted Bids described in Section 11.10(e)(ii)(A) and Section 11.10(e)(ii)(B) by (y) a fraction the numerator of which shall be the number of Outstanding AMPS held by such Existing Holder subject to such Submitted Bid or Submitted Sell Order and the denominator of which shall be the number of Outstanding AMPS subject to all such Submitted Bids and Submitted Sell Orders. If all of the Outstanding shares of a series of AMPS are subject to Submitted Hold Orders, all Submitted Bids for shares of such series shall be rejected.

(iii) If, as a result of the procedures described in Section 11.10(e), any Existing Holder would be entitled or required to sell, or any Potential Holder would be entitled or required to purchase, a fraction of an Auction Market Preferred Share on any Auction Date, the Auction Agent shall, in such manner as in its sole discretion it shall determine, round up or down the number of AMPS to be purchased or sold by any Existing Holder or Potential Holder on such Auction Date so that each Outstanding Auction Market Preferred Share purchased or sold by each Existing Holder or Potential Holder on such Auction Date shall be a whole Auction Market Preferred Share.

(iv) If, as a result of the procedures described in Section 11.10(e), any Potential Holder would be entitled or required to purchase less than a whole Auction Market Preferred Share on any Auction Date, the Auction Agent shall, in such manner as in its sole discretion it shall determine, allocate AMPS for purchase among Potential Holders so that only whole AMPS are purchased on such Auction Date by any Potential Holder, even if such allocation results in one or more of such Potential Holders not purchasing any AMPS on such Auction Date.

(v) Based on the results of each Auction, the Auction Agent shall determine, with respect to each Broker-Dealer that submitted Bids or Sell Orders on behalf of Existing Holders or Potential Holders, the aggregate number of Outstanding AMPS to be purchased and the aggregate number of the Outstanding AMPS to be sold by such Potential Holders and Existing Holders and, to the extent that such aggregate number of Outstanding shares to be purchased and such aggregate number of Outstanding shares to be sold differ, the Auction Agent shall determine to which other Broker-Dealer or Broker-Dealers acting for one or more purchasers such Broker-Dealer

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shall deliver, or from which other Broker-Dealer or Broker-Dealers acting for one or more sellers such Broker-Dealer shall receive, as the case may be, Outstanding AMPS.

(f) Miscellaneous.

(i) To the extent permitted by applicable law, the Trust may in its sole discretion interpret the provisions of this Section 11.10 to resolve any inconsistency or ambiguity, remedy any formal defect or make any other change or modification that does not substantially adversely affect the rights of Beneficial Owners of AMPS.

(ii) Unless otherwise permitted by the Trust, a Beneficial Owner or an Existing Holder (A) may sell, transfer or otherwise dispose of AMPS only pursuant to a Bid or Sell Order in accordance with the procedures described in this Section 11.10 or to or through a Broker-Dealer or to such other persons as may be permitted by the Trust, provided that in the case of all transfers other than pursuant to Auctions such Beneficial Owner or Existing Holder, its Broker-Dealer, if applicable, or its Agent Member advises the Auction Agent of such transfer and (B) except as otherwise required by law, shall have the ownership of the AMPS held by it maintained in book entry form by the Securities Depository in the account of its Agent Member, which in turn will maintain records of such Beneficial Owner's beneficial ownership. The Trust may not submit an Order in any Auction.

(iii) All of the Outstanding AMPS of a series shall be registered in the name of the nominee of the Securities Depository unless otherwise required by law or unless there is no Securities Depository. If there is no Securities Depository, at the Trust's option and upon its receipt of such documents as it deems appropriate, any AMPS may be registered in the Share Register in the name of the Beneficial Owner thereof and such Beneficial Owner thereupon will be entitled to receive certificates therefor and required to deliver certificates therefor upon transfer or exchange thereof.

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11.11 Securities Depository: Stock Certificates.

(a) If there is a Securities Depository, all of the AMPS of each series shall be issued to the Securities Depository and registered in the name of the Securities Depository or its nominee. Certificates may be issued as necessary to represent AMPS. All such certificates shall bear a legend to the effect that such certificates are issued subject to the provisions restricting the transfer of AMPS contained in these Bylaws. Unless the Trust shall have elected, during a Non-Payment Period, to waive this requirement, the Trust will also issue stop-transfer instructions to the Auction Agent for the AMPS. Except as provided in paragraph (b) below, the Securities Depository or its nominee will be the Holder, and no Beneficial Owner shall receive certificates representing its ownership interest in such shares.

(b) If the Applicable Rate applicable to all AMPS of a series shall be the Non-Payment Period Rate or there is no Securities Depository, the Trust may at its option issue one or more new certificates with respect to such shares (without the legend referred to in Section 11.11(a)) registered in the names of the Beneficial Owners or their nominees and rescind the stop-transfer instructions referred to in Section 11.11(a) with respect to such shares.

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**APPENDIX B**

**PROXY VOTING POLICIES**

**PACIFIC INVESTMENT MANAGEMENT COMPANY LLC**

**PROXY VOTING POLICIES AND PROCEDURES**

The following are general proxy voting policies and procedures ( Policies and Procedures ) adopted by Pacific Investment Management Company LLC ( PIMCO ), an investment adviser registered under the Investment Advisers Act of 1940, as amended ( Advisers Act ). PIMCO serves as the investment adviser to a wide range of domestic and international clients, including investment companies registered under the Investment Company Act of 1940, as amended ( 1940 Act ) and separate investment accounts for other clients. These Policies and Procedures are adopted to ensure compliance with Rule 206(4)-6 under the Advisers Act, other applicable fiduciary obligations of PIMCO and the applicable rules and regulations of the Securities and Exchange Commission ( SEC ) and interpretations of its staff. In addition to SEC requirements governing advisers, PIMCO s Policies and Procedures reflect the long-standing fiduciary standards and responsibilities applicable to investment advisers with respect to accounts subject to the Employee Retirement Income Security Act of 1974 ( ERISA ), as set forth in the Department of Labor s rules and regulations.<sup>3</sup>

PIMCO will implement these Policies and Procedures for each of its respective clients as required under applicable law, unless expressly directed by a client in writing to refrain from voting that client s proxies. PIMCO s authority to vote proxies on behalf of its clients is established by its advisory contracts, comparable documents or by an overall delegation of discretionary authority over its client s assets. Recognizing that proxy voting is a rare event in the realm of fixed income investing and is typically limited to solicitation of consent to changes in features of debt securities, these Policies and Procedures also apply to any voting rights and/or consent rights of PIMCO, on behalf of its clients, with respect to debt securities, including but not limited to, plans of reorganization, and waivers and consents under applicable indentures.<sup>4</sup>

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<sup>1</sup> These Policies and Procedures are adopted by PIMCO pursuant to Rule 206(4)-6 under the Advisers Act, effective August 6, 2003. *See Proxy Voting by Investment Advisers*, IA Release No. 2106 (January 31, 2003).

<sup>2</sup> These Policies and Procedures address proxy voting considerations under U.S. law and regulations and do not address the laws or requirements of other jurisdictions.

<sup>3</sup> Department of Labor Bulletin 94-2, 29 C.F.R. 2509.94-2 (July 29, 1994). If a client is subject to ERISA, PIMCO will be responsible for voting proxies with respect to the client s account, unless the client has expressly retained the right and obligation to vote the proxies, and provided prior written notice to PIMCO of this retention.

<sup>4</sup> For purposes of these Policies and Procedures, proxy voting includes any voting rights, consent rights or other voting authority of PIMCO on behalf of its clients.

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Set forth below are PIMCO's Policies and Procedures with respect to any voting or consent rights of advisory clients over which PIMCO has discretionary voting authority. These Policies and Procedures may be revised from time to time.

### **General Statements of Policy**

These Policies and Procedures are designed and implemented in a manner reasonably expected to ensure that voting and consent rights are exercised in the best interests of PIMCO's clients. Each proxy is voted on a case-by-case basis taking into consideration any relevant contractual obligations as well as other relevant facts and circumstances.

PIMCO may abstain from voting a client proxy under the following circumstances: (1) when the economic effect on shareholders' interests or the value of the portfolio holding is indeterminable or insignificant; or (2) when the cost of voting the proxies outweighs the benefits.

### **Conflicts of Interest**

PIMCO seeks to resolve any material conflicts of interest by voting in good faith in the best interest of its clients. If a material conflict of interest should arise, PIMCO will seek to resolve such conflict in the client's best interest by pursuing any one of the following courses of action:

1. convening an ad-hoc committee to assess and resolve the conflict;<sup>5</sup>
2. voting in accordance with the instructions/consent of a client after providing notice of and disclosing the conflict to that client;
3. voting the proxy in accordance with the recommendation of an independent third-party service provider;
4. suggesting that the client engage another party to determine how the proxies should be voted;
5. delegating the vote to an independent third-party service provider; or
6. voting in accordance with the factors discussed in these Policies and Procedures.

PIMCO will document the process of resolving any identified material conflict of interest.

### **Reporting Requirements and the Availability of Proxy Voting Records**

## Edgar Filing: PIMCO Floating Rate Strategy Fund - Form 497

Except to the extent required by applicable law or otherwise approved by PIMCO, PIMCO will not disclose to third parties how it voted a proxy on behalf of a client. However, upon

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<sup>5</sup> Any committee must be comprised of personnel who have no direct interest in the outcome of the potential conflict.

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request from an appropriately authorized individual, PIMCO will disclose to its clients or the entity delegating the voting authority to PIMCO for such clients (e.g., trustees or consultants retained by the client), how PIMCO voted such client's proxy. In addition, PIMCO provides its clients with a copy of these Policies and Procedures or a concise summary of these Policies and Procedures: (i) in Part II of Form ADV; (ii) together with a periodic account statement in a separate mailing; or (iii) any other means as determined by PIMCO. The summary will state that these Policies and Procedures are available upon request and will inform clients that information about how PIMCO voted that client's proxies is available upon request.

## **PIMCO Record Keeping**

PIMCO or its agent maintains proxy voting records as required by Rule 204-2(c) of the Advisers Act. These records include: (1) a copy of all proxy voting policies and procedures; (2) proxy statements (or other disclosures accompanying requests for client consent) received regarding client securities (which may be satisfied by relying on obtaining a copy of a proxy statement from the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system or a third party provided that the third party undertakes to provide a copy promptly upon request); (3) a record of each vote cast by PIMCO on behalf of a client; (4) a copy of any document created by PIMCO that was material to making a decision on how to vote proxies on behalf of a client or that memorializes the basis for that decision; and (5) a copy of each written client request for proxy voting records and any written response from PIMCO to any (written or oral) client request for such records. Additionally, PIMCO or its agent maintains any documentation related to an identified material conflict of interest.

Proxy voting books and records are maintained by PIMCO or its agent in an easily accessible place for a period of five years from the end of the fiscal year during which the last entry was made on such record, the first two years in the offices of PIMCO or its agent.

## **Review and Oversight**

PIMCO's proxy voting procedures are described below. PIMCO's Compliance Group will provide for the supervision and periodic review, no less than on a quarterly basis, of its proxy voting activities and the implementation of these Policies and Procedures.

Because PIMCO has contracted with State Street Investment Manager Solutions, LLC (IMS West) to perform portfolio accounting, securities processing and settlement processing on behalf of PIMCO, certain of the following procedures involve IMS West in administering and implementing the proxy voting process. IMS West will review and monitor the proxy voting process to ensure that proxies are voted on a timely basis.

1. *Transmit Proxy to PIMCO.* IMS West will forward to PIMCO's Middle Office Group each proxy received from registered owners of record (e.g., custodian bank or other third party service providers).

2. *Conflicts of Interest.* PIMCO's Middle Office Group will review each proxy to determine whether there may be a material conflict between PIMCO and its client. As part of this review, the group will determine whether the issuer of the security or proponent of the proposal is a client of PIMCO, or if a client has actively solicited PIMCO to support a





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particular position. If no conflict exists, this group will forward each proxy to the appropriate portfolio manager for consideration. However, if a conflict does exist, PIMCO's Middle Office Group will seek to resolve any such conflict in accordance with these Policies and Procedures.

3. *Vote.* The portfolio manager will review the information, will vote the proxy in accordance with these Policies and Procedures and will return the voted proxy to PIMCO's Middle Office Group.

4. *Review.* PIMCO's Middle Office Group will review each proxy that was submitted to and completed by the appropriate portfolio manager. PIMCO's Middle Office Group will forward the voted proxy back to IMS West with the portfolio manager's decision as to how it should be voted.

5. *Transmittal to Third Parties.* IMS West will document the portfolio manager's decision for each proxy received from PIMCO's Middle Office Group in a format designated by the custodian bank or other third party service provider. IMS West will maintain a log of all corporate actions, including proxy voting, which indicates, among other things, the date the notice was received and verified, PIMCO's response, the date and time the custodian bank or other third party service provider was notified, the expiration date and any action taken.

6. *Information Barriers.* Certain entities controlling, controlled by, or under common control with PIMCO ( Affiliates ) may be engaged in banking, investment advisory, broker-dealer and investment banking activities. PIMCO personnel and PIMCO's agents are prohibited from disclosing information regarding PIMCO's voting intentions to any Affiliate. Any PIMCO personnel involved in the proxy voting process who are contacted by an Affiliate regarding the manner in which PIMCO or its delegate intend to vote on a specific issue must terminate the contact and notify the Compliance Group immediately.

## **Categories of Proxy Voting Issues**

In general, PIMCO reviews and considers corporate governance issues related to proxy matters and generally supports proposals that foster good corporate governance practices. PIMCO considers each proposal on a case-by-case basis, taking into consideration various factors and all relevant facts and circumstances at the time of the vote. PIMCO may vote proxies as recommended by management on routine matters related to the operation of the issuer and on matters not expected to have a significant economic impact on the issuer and/or shareholders, because PIMCO believes the recommendations by the issuer generally are in shareholders' best interests, and therefore in the best economic interest of PIMCO's clients. The following is a non-exhaustive list of issues that may be included in proxy materials submitted to clients of PIMCO, and a non-exhaustive list of factors that PIMCO may consider in determining how to vote the client's proxies.

### ***Board of Directors***

1. *Independence.* PIMCO may consider the following factors when voting on director independence issues: (i) majority requirements for the board and the audit,

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nominating, compensation and/or other board committees; and (ii) whether the issuer adheres to and/or is subject to legal and regulatory requirements.

2. *Director Tenure and Retirement.* PIMCO may consider the following factors when voting on limiting the term of outside directors: (i) the introduction of new viewpoints on the board; (ii) a reasonable retirement age for the outside directors; and (iii) the impact on the board's stability and continuity.

3. *Nominations in Elections.* PIMCO may consider the following factors when voting on uncontested elections: (i) composition of the board; (ii) nominee availability and attendance at meetings; (iii) any investment made by the nominee in the issuer; and (iv) long-term corporate performance and the price of the issuer's securities.

4. *Separation of Chairman and CEO Positions.* PIMCO may consider the following factors when voting on proposals requiring that the positions of chairman of the board and the chief executive officer not be filled by the same person: (i) any potential conflict of interest with respect to the board's ability to review and oversee management's actions; and (ii) any potential effect on the issuer's productivity and efficiency.

5. *D&O Indemnification and Liability Protection.* PIMCO may consider the following factors when voting on proposals that include director and officer indemnification and liability protection: (i) indemnifying directors for conduct in the normal course of business; (ii) limiting liability for monetary damages for violating the duty of care; (iii) expanding coverage beyond legal expenses to acts that represent more serious violations of fiduciary obligation than carelessness (*e.g.* negligence); and (iv) providing expanded coverage in cases where a director's legal defense was unsuccessful if the director was found to have acted in good faith and in a manner that he or she reasonably believed was in the best interests of the company.

6. *Stock Ownership.* PIMCO may consider the following factors when voting on proposals on mandatory share ownership requirements for directors: (i) the benefits of additional vested interest in the issuer's stock; (ii) the ability of a director to fulfill his duties to the issuer regardless of the extent of his stock ownership; and (iii) the impact of limiting the number of persons qualified to be directors.

## ***Proxy Contests and Proxy Contest Defenses***

1. *Contested Director Nominations.* PIMCO may consider the following factors when voting on proposals for director nominees in a contested election: (i) background and reason for the proxy contest; (ii) qualifications of the director nominees; (iii) management's track record; (iv) the issuer's long-term financial performance within its industry; (v) assessment of what each side is offering shareholders; (vi) the likelihood that the proposed objectives and goals can be met; and (vii) stock ownership positions of the director nominees.

2. *Reimbursement for Proxy Solicitation Expenses.* PIMCO may consider the following factors when voting on reimbursement for proxy solicitation expenses: (i) identity of the persons who will pay the expenses; (ii) estimated total cost of solicitation; (iii) total

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expenditures to date; (iv) fees to be paid to proxy solicitation firms; and (v) when applicable, terms of a proxy contest settlement.

3. *Ability to Alter the Size of the Board by Shareholders.* PIMCO may consider whether the proposal seeks to fix the size of the board and/or require shareholder approval to alter the size of the board.

4. *Ability to Remove Directors by Shareholders.* PIMCO may consider whether the proposal allows shareholders to remove directors with or without cause and/or allow shareholders to elect directors and fill board vacancies.

5. *Cumulative Voting.* PIMCO may consider the following factors when voting on cumulative voting proposals: (i) the ability of significant stockholders to elect a director of their choosing; (ii) the ability of minority shareholders to concentrate their support in favor of a director(s) of their choosing; and (iii) any potential limitation placed on the director's ability to work for all shareholders.

6. *Supermajority Shareholder Requirements.* PIMCO may consider all relevant factors, including but not limited to limiting the ability of shareholders to effect change when voting on supermajority requirements to approve an issuer's charter or bylaws, or to approve a merger or other significant business combination that would require a level of voting approval in excess of a simple majority.

## ***Tender Offer Defenses***

1. *Classified Boards.* PIMCO may consider the following factors when voting on classified boards: (i) providing continuity to the issuer; (ii) promoting long-term planning for the issuer; and (iii) guarding against unsolicited takeovers.

2. *Poison Pills.* PIMCO may consider the following factors when voting on poison pills: (i) supporting proposals to require a shareholder vote on other shareholder rights plans; (ii) ratifying or redeeming a poison pill in the interest of protecting the value of the issuer; and (iii) other alternatives to prevent a takeover at a price clearly below the true value of the issuer.

3. *Fair Price Provisions.* PIMCO may consider the following factors when voting on proposals with respect to fair price provisions: (i) the vote required to approve the proposed acquisition; (ii) the vote required to repeal the fair price provision; (iii) the mechanism for determining fair price; and (iv) whether these provisions are bundled with other anti-takeover measures (e.g., supermajority voting requirements) that may entrench management and discourage attractive tender offers.

## ***Capital Structure***

1. *Stock Authorizations.* PIMCO may consider the following factors to help distinguish between legitimate proposals to authorize increases in common stock for expansion and other corporate purchases and those proposals designed primarily as an anti-takeover device: (i) the purpose and need for the stock increase; (ii) the percentage increase



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with respect to the authorization currently in place; (iii) voting rights of the stock; and (iv) overall capitalization structure of the issuer.

**2. Issuance of Preferred Stock.** PIMCO may consider the following factors when voting on the issuance of preferred stock: (i) whether the new class of preferred stock has unspecified voting, conversion, dividend distribution, and other rights; (ii) whether the issuer expressly states that the stock will not be used as a takeover defense or carry superior voting rights; (iii) whether the issuer specifies the voting, dividend, conversion, and other rights of such stock and the terms of the preferred stock appear reasonable; and (iv) whether the stated purpose is to raise capital or make acquisitions in the normal course of business.

**3. Stock Splits.** PIMCO may consider the following factors when voting on stock splits: (i) the percentage increase in the number of shares with respect to the issuer's existing authorized shares; and (ii) the industry that the issuer is in and the issuer's performance in that industry.

**4. Reversed Stock Splits.** PIMCO may consider the following factors when voting on reverse stock splits: (i) the percentage increase in the shares with respect to the issuer's existing authorized stock; and (ii) issues related to delisting the issuer's stock.

## ***Executive and Director Compensation***

**1. Stock Option Plans.** PIMCO may consider the following factors when voting on stock option plans: (i) whether the stock option plan expressly permits the repricing of options; (ii) whether the plan could result in earnings dilution of greater than a specified percentage of shares outstanding; (iii) whether the plan has an option exercise price below the market price on the day of the grant; (iv) whether the proposal relates to an amendment to extend the term of options for persons leaving the firm voluntarily or for cause; and (v) whether the stock option plan has certain other embedded features.

**2. Director Compensation.** PIMCO may consider the following factors when voting on director compensation: (i) whether director shares are at the same market risk as those of the issuer's shareholders; and (ii) how stock option programs for outside directors compare with the standards of internal stock option programs.

**3. Golden and Tin Parachutes.** PIMCO may consider the following factors when voting on golden and/or tin parachutes: (i) whether they will be submitted for shareholder approval; and (ii) the employees covered by the plan and the quality of management.

## ***State of Incorporation***

**State Takeover Statutes.** PIMCO may consider the following factors when voting on proposals to opt out of a state takeover statute: (i) the power the statute vests with the issuer's board; (ii) the potential of the statute to stifle bids; and (iii) the potential for the statute to empower the board to negotiate a better deal for shareholders.



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### ***Mergers and Restructurings***

1. *Mergers and Acquisitions.* PIMCO may consider the following factors when voting on a merger and/or acquisition: (i) anticipated financial and operating benefits as a result of the merger or acquisition; (ii) offer price; (iii) prospects of the combined companies; (iv) how the deal was negotiated; and (v) changes in corporate governance and the potential impact on shareholder rights. PIMCO may also consider what impact the merger or acquisition may have on groups/organizations other than the issuer's shareholders.

2. *Corporate Restructurings.* With respect to a proxy proposal that includes a spin-off, PIMCO may consider the tax and regulatory advantages, planned use of sale proceeds, market focus, and managerial incentives. With respect to a proxy proposal that includes an asset sale, PIMCO may consider the impact on the balance sheet or working capital and the value received for the asset. With respect to a proxy proposal that includes a liquidation, PIMCO may consider management's efforts to pursue alternatives, the appraisal value of assets, and the compensation plan for executives managing the liquidation.

### ***Investment Company Proxies***

For a client that is invested in an investment company, PIMCO votes each proxy of the investment company on a case-by-case basis and takes all reasonable steps to ensure that proxies are voted consistent with all applicable investment policies of the client and in accordance with any resolutions or other instructions approved by authorized persons of the client.

For a client that is invested in an investment company that is advised by PIMCO or its affiliates, if there is a conflict of interest which may be presented when voting for the client (*e.g.*, a proposal to approve a contract between PIMCO and the investment company), PIMCO will resolve the conflict by doing any one of the following: (i) voting in accordance with the instructions/consent of the client after providing notice of and disclosing the conflict to that client; (ii) voting the proxy in accordance with the recommendation of an independent third-party service provider; or (iii) delegating the vote to an independent third-party service provider.

1. *Election of Directors or Trustees.* PIMCO may consider the following factors when voting on the director or trustee nominees of a mutual fund: (i) board structure, director independence and qualifications, and compensation paid by the fund and the family of funds; (ii) availability and attendance at board and committee meetings; (iii) investments made by the nominees in the fund; and (iv) the fund's performance.

2. *Converting Closed-end Fund to Open-end Fund.* PIMCO may consider the following factors when voting on converting a closed-end fund to an open-end fund: (i) past performance as a closed-end fund; (ii) the market in which the fund invests; (iii) measures taken by the board to address any discount of the fund's shares; (iv) past shareholder activism; (v) board activity; and (vi) votes on related proposals.



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3. *Proxy Contests.* PIMCO may consider the following factors related to a proxy contest: (i) past performance of the fund; (ii) the market in which the fund invests; (iii) measures taken by the board to address past shareholder activism; (iv) board activity; and (v) votes on related proposals.

4. *Investment Advisory Agreements.* PIMCO may consider the following factors related to approval of an investment advisory agreement: (i) proposed and current fee arrangements/schedules; (ii) fund category/investment objective; (iii) performance benchmarks; (iv) share price performance as compared with peers; and (v) the magnitude of any fee increase and the reasons for such fee increase.

5. *Policies Established in Accordance with the 1940 Act.* PIMCO may consider the following factors: (i) the extent to which the proposed changes fundamentally alter the investment focus of the fund and comply with SEC interpretation; (ii) potential competitiveness; (iii) regulatory developments; and (iv) current and potential returns and risks.

6. *Changing a Fundamental Restriction to a Non-fundamental Restriction.* PIMCO may consider the following when voting on a proposal to change a fundamental restriction to a non-fundamental restriction: (i) reasons given by the board and management for the change; and (ii) the projected impact of the change on the fund's portfolio.

7. *Distribution Agreements.* PIMCO may consider the following when voting on a proposal to approve a distribution agreement: (i) fees charged to comparably sized funds with similar investment objectives; (ii) the distributor's reputation and past performance; and (iii) competitiveness of the fund among other similar funds in the industry.

8. *Names Rule Proposals.* PIMCO may consider the following factors when voting on a proposal to change a fund name, consistent with Rule 35d-1 of the 1940 Act: (i) whether the fund invests a minimum of 80% of its assets in the type of investments suggested by the proposed name; (ii) the political and economic changes in the target market; and (iii) current asset composition.

9. *Disposition of Assets/Termination/Liquidation.* PIMCO may consider the following when voting on a proposal to dispose of fund assets, terminate, or liquidate the fund: (i) strategies employed to salvage the fund; (ii) the fund's past performance; and (iii) the terms of the liquidation.

10. *Changes to Charter Documents.* PIMCO may consider the following when voting on a proposal to change a fund's charter documents: (i) degree of change implied by the proposal; (ii) efficiencies that could result; (iii) state of incorporation; and (iv) regulatory standards and implications.

11. *Changing the Domicile of a Fund.* PIMCO may consider the following when voting on a proposal to change the domicile of a fund: (i) regulations of both states; (ii) required fundamental policies of both states; and (iii) the increased flexibility available.

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12. *Change in Fund's Subclassification.* PIMCO may consider the following when voting on a change in a fund's subclassification from diversified to non-diversified or to permit concentration in an industry: (i) potential competitiveness; (ii) current and potential returns; (iii) risk of concentration; and (iv) consolidation in the target industry.

### ***Distressed and Defaulted Securities***

1. *Waivers and Consents.* PIMCO may consider the following when determining whether to support a waiver or consent to changes in provisions of indentures governing debt securities which are held on behalf of clients: (i) likelihood that the granting of such waiver or consent will potentially increase recovery to clients; (ii) potential for avoiding cross-defaults under other agreements; and (iii) likelihood that deferral of default will give the obligor an opportunity to improve its business operations.

2. *Voting on Chapter 11 Plans of Liquidation or Reorganization.* PIMCO may consider the following when determining whether to vote for or against a Chapter 11 plan in a case pending with respect to an obligor under debt securities which are held on behalf of clients: (i) other alternatives to the proposed plan; (ii) whether clients are treated appropriately and in accordance with applicable law with respect to their distributions; (iii) whether the vote is likely to increase or decrease recoveries to clients.

### ***Miscellaneous Provisions***

1. *Such Other Business.* Proxy ballots sometimes contain a proposal granting the board authority to transact such other business as may properly come before the meeting. PIMCO may consider the following factors when developing a position on proxy ballots that contain a proposal granting the board authority to transact such other business as may properly come before the meeting: (i) whether the board is limited in what actions it may legally take within such authority; and (ii) PIMCO's responsibility to consider actions before supporting them.

2. *Equal Access.* PIMCO may consider the following factors when voting on equal access: (i) the opportunity for significant company shareholders to evaluate and propose voting recommendations on proxy proposals and director nominees, and to nominate candidates to the board; and (ii) the added complexity and burden of providing shareholders with access to proxy materials.

3. *Charitable Contributions.* PIMCO may consider the following factors when voting on charitable contributions: (i) the potential benefits to shareholders; and (ii) the potential impact on the issuer's resources that could have been used to increase shareholder value.

4. *Special Interest Issues.* PIMCO may consider the following factors when voting on special interest issues: (i) the long-term benefit to shareholders of promoting corporate accountability and responsibility on social issues; (ii) management's responsibility with respect to special interest issues; (iii) any economic costs and restrictions on

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management; (iv) a client's instruction to vote proxies in a specific manner and/or in a manner different from these Policies and Procedures; and (v) the responsibility to vote proxies for the greatest long-term shareholder value.

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