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Highland Credit Strategies Fund  
Form N-14 8C/A  
April 17, 2008

As filed with the Securities and Exchange Commission on April 17, 2008  
1933 Act File No. 333-149424

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM N-14

[ X ] REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933  
[X] Pre-Effective Amendment No. 1  
[ ] Post-Effective Amendment No. \_\_\_

Highland Credit Strategies Fund  
(Exact Name of Registrant as Specified in Charter)

Two Galleria Tower  
13455 Noel Road, Suite 800  
Dallas, Texas 75240  
(Address of Principal Executive Offices)

(877) 665-1287  
(Registrant's Telephone Number, including Area Code)

James D. Dondero, President  
Highland Credit Strategies Fund  
Two Galleria Tower  
13455 Noel Road, Suite 800  
Dallas, Texas 75240  
(Name and Address of Agent for Service)

Copies of Communications to:  
Jennifer R. Gonzalez, Esq.  
Kirkpatrick & Lockhart Preston Gates Ellis LLP  
1601 K Street, NW  
Washington, DC 20006

Approximate Date of Proposed Public Offering: As soon as practicable after the  
effective date of this Registration Statement

Calculation of Registration Fee Under the Securities Act of 1933:

Title of Securities Being Registered	Amount Being Registered (1)	Proposed Maximum Offering Price Per Unit (1)	Proposed Maximum Aggregate Offering Price (1)
Common Stock (par value \$0.001)	10,695,187.17	\$14.96 (2)	\$160,000,000

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- (1) Estimated solely for the purpose of calculating the registration fee.
- (2) Net asset value per share for common stock on February 22, 2008.
- (3) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission acting pursuant to said section 8(a), may determine.

PROSPECT STREET HIGH INCOME PORTFOLIO INC.  
PROSPECT STREET INCOME SHARES INC.  
Two Galleria Tower  
13455 Noel Road, Suite 800  
Dallas, Texas 75240

JOINT ANNUAL MEETING OF STOCKHOLDERS TO BE HELD JUNE 6, 2008

April [\_\_], 2008

Dear Stockholder:

You are being asked to vote on (1) a proposed reorganization of Prospect Street High Income Portfolio Inc. ("High Income Portfolio") or Prospect Street Income Shares Inc. ("Income Shares"), as applicable (each an "Acquired Fund" and together as the "Acquired Funds"), into Highland Credit Strategies Fund ("Acquiring Fund") (collectively, the Acquired Funds and the Acquiring Fund being referred to herein as the "Funds") and (2) the election of directors of each Acquired Fund.

The Board of Directors of each Acquired Fund has called a joint annual meeting of stockholders of the Acquired Funds (the "Meeting") to be held at Galleria Tower I, 13355 Noel Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6, 2008, at 8:00 a.m. Central Time, so that stockholders can vote on an Agreement and Plan of Reorganization ("Agreement") and the election of directors. Each Agreement provides for the participating Acquired Fund to transfer its assets to the Acquiring Fund in exchange for common shares and cash (in lieu of fractional shares) of the Acquiring Fund and the assumption by the Acquiring Fund of the Acquired Fund's liabilities and the dissolution of the Acquired Fund under applicable state law ("Reorganization"). Although holders of preferred stock are being asked to vote on the Reorganizations, prior to a Reorganization, it is anticipated that the preferred stock of a participating Acquired Fund will be redeemed, with preferred stockholders receiving a liquidation preference of \$25,000 per share plus any accumulated and unpaid dividends. As a result of a Reorganization, a common stockholder of the participating Acquired Fund will become a common shareholder of the Acquiring Fund. The attached combined Proxy Statement and Prospectus includes detailed information about the proposed Reorganization and Agreement for each Acquired Fund. AFTER CAREFUL CONSIDERATION, THE BOARD OF EACH ACQUIRED FUND UNANIMOUSLY RECOMMENDS THAT YOU SUPPORT THE REORGANIZATION AND VOTE "FOR" THE APPLICABLE PROPOSED AGREEMENT AND "FOR" EACH NOMINEE FOR DIRECTOR.

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The investment objective of each Acquired Fund is similar to that of the Acquiring Fund, although the Acquiring Fund has a greater focus on capital appreciation and each Fund's investment policies, strategies and risks are different, particularly with respect to Income Shares and the Acquiring Fund. Highland Capital Management, L.P. is the investment adviser to each Fund.

Your vote is very important to us regardless of the number of shares you own. Whether or not you plan to attend the Meeting in person, please read the Proxy Statement and Prospectus and cast your vote promptly. To vote, simply date, sign and return the proxy card in the enclosed postage-paid envelope or follow the instructions on the proxy card for voting by touch-tone telephone or on the Internet.

It is important that your vote be received no later than the time of the Meeting.

Sincerely,

R. Joseph Dougherty  
Chairman of the Board  
Prospect Street High Income Portfolio Inc.  
Prospect Street Income Shares Inc.

### IMPORTANT NOTICE

TO STOCKHOLDERS OF  
PROSPECT STREET HIGH INCOME PORTFOLIO INC.  
AND  
PROSPECT STREET INCOME SHARES INC.

### QUESTIONS & ANSWERS

Although we recommend that you read the complete Proxy Statement and Prospectus ("Proxy Statement/Prospectus"), we have provided for your convenience a brief overview of the proposals to be voted on at an annual meeting of stockholders.

### APPROVAL OF REORGANIZATIONS OF THE ACQUIRED FUNDS

Q: WHAT IS BEING PROPOSED AT THE STOCKHOLDER MEETING?

A: STOCKHOLDERS OF PROSPECT STREET HIGH INCOME PORTFOLIO INC. AND PROSPECT STREET INCOME SHARES INC.: You are being asked to approve a proposed reorganization (each a "Reorganization" and, together, the "Reorganizations") of Prospect Street High Income Portfolio Inc. ("High Income Portfolio") or Prospect Street Income Shares Inc. ("Income Shares"), as applicable (each an "Acquired Fund" and together as the "Acquired Funds"), into Highland Credit Strategies Fund ("Acquiring Fund") (collectively, the Acquired Funds and the Acquiring Fund being referred to herein as the "Funds"), a closed-end fund that pursues a similar investment objective and is managed by Highland Capital Management, L.P. ("Highland"), the same investment adviser as that of the Acquired Funds. Stockholders are also being asked to vote on the election of directors. Electing directors at this meeting would avoid the expense of holding two stockholder meetings within a short period of time.

Q: WHY IS EACH REORGANIZATION BEING RECOMMENDED?

A: The Board of Directors of each Acquired Fund has determined that the Reorganization in which its Fund would participate would benefit its common stockholders. The Board of Trustees of the Acquiring Fund has determined that

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the Reorganizations would benefit its common shareholders. The investment objective of each Acquired Fund and the Acquiring Fund are similar, although each Fund seeks to achieve its objective in different ways. High Income Portfolio seeks to provide high current income, while seeking to preserve stockholders' capital. Income Shares seeks to provide a high level of current income, with capital appreciation as a secondary objective. The Acquiring Fund seeks to provide both current income and capital appreciation and therefore has a greater focus on capital appreciation. Each Fund is managed by the same investment adviser and has the same members on its Board.

Although holders of preferred stock are being asked to vote on the Reorganizations, prior to a Reorganization, it is anticipated that the preferred stock of an Acquired Fund will be redeemed, with preferred stockholders receiving a liquidation preference of \$25,000 per share plus any accumulated and unpaid dividends. A Reorganization will not be completed unless, before the final stockholder vote thereon, the participating Acquired Fund commences, and irrevocably commits to complete as expeditiously as possible, the process for redeeming its preferred stock.

In reaching this determination, the Board of Directors of each Acquired Fund also considered that if stockholders approve the Reorganization(s), Highland would contractually agree to waive a portion of the Acquiring Fund's advisory fee and administration fee for two years so that Highland would receive no additional benefit from the Reorganization(s) for two years. The waivers are intended to offset the additional revenue Highland would receive on each Acquired Fund's assets (calculated as of the date of its reorganization) due to the difference between the advisory fee rates of each Acquired Fund and the Acquiring Fund and the fact that the Acquired Funds do not pay an administration fee to Highland. However, even with the contractual fee waivers, the annual operating expenses of the combined Fund are expected to be higher than High Income Portfolio's current annual operating expenses and, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than each Acquired Fund's current annual operating expenses. This is primarily due to the Acquiring Fund's higher advisory and administration fees. As of each Fund's last fiscal year, the total annual operating expenses, as a percentage of average net assets, of High Income Portfolio, Income Shares and

Credit Strategies Fund were 3.34%, 3.99% and 4.06%, respectively. Assuming each Reorganization is approved, the estimated total annual operating expenses of the combined Fund would be 4.03% of average net assets and, with the contractual fee waivers described above, the estimated net annual operating expenses of the combined Fund would be 3.88% of average net assets.

The Proxy Statement/Prospectus contains further explanation of the reasons that the Boards of Directors/Trustees of the Funds unanimously recommend the Reorganizations.

Q: HOW DOES THE ACQUIRING FUND'S INVESTMENT STRATEGY DIFFER FROM MY FUND?

A: The Acquiring Fund is registered as a non-diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the "1940 Act"). The Acquiring Fund invests at least 80% of its assets in the following categories of securities and instruments of corporations and other business entities: (i) secured and unsecured floating and fixed rate loans; (ii) bonds and other debt obligations; (iii) debt obligations of stressed, distressed and bankrupt issuers; (iv) structured products, including but not limited to, mortgage-backed and other asset-backed securities and collateralized debt obligations; and (v) equities. A significant portion of the Acquiring Fund's assets may be invested in securities rated below investment grade (Ba/BB or lower), which are commonly referred to as "junk securities." The Acquiring

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Fund's broader investment mandate allows it to invest in more types and potentially more risky securities than either Acquired Fund. See "Risk Factors and Special Considerations" for more information.

**STOCKHOLDERS OF HIGH INCOME PORTFOLIO:** High Income Portfolio is registered as a diversified, closed-end management investment company under the 1940 Act. The investment strategy of the Acquiring Fund is similar to High Income Portfolio's since both invest primarily in below investment grade securities, but the Acquiring Fund has a greater focus on bank loans. In addition, the Acquiring Fund is able to invest in more types of securities and it invests approximately 80% of its assets in senior loans as of the date hereof.

**STOCKHOLDERS OF INCOME SHARES:** Income Shares is registered as a diversified, closed-end management investment company under the 1940 Act. The investment strategy of Income Shares differs from that of the Acquiring Fund. Income Shares invests in higher quality securities, since it invests at least 50% of its total assets in debt securities rated in the four highest categories (Baa/BBB or higher) by a rating agency or nonrated debt securities deemed by Highland to be of comparable quality. A significant portion of the Acquiring Fund's assets is invested in securities rated below investment grade (Ba/BB or lower) and it currently invests approximately 80% of its assets in senior loans as of the date hereof.

**Q: HOW WILL THE REORGANIZATIONS AFFECT ME?**

**A:** If stockholders approve the Reorganizations of both Acquired Funds, the assets and liabilities of the Acquired Funds will be combined with those of the Acquiring Fund and the Acquired Funds will dissolve. As noted above, although holders of preferred stock are being asked to vote on the Reorganizations, the preferred stock of an Acquired Fund will be redeemed prior to its Reorganization.

**COMMON STOCKHOLDERS OF THE ACQUIRED FUNDS:** If you are a holder of common stock of an Acquired Fund, you will receive newly issued common shares of the Acquiring Fund (though you may receive cash for fractional common shares), the aggregate net asset value of which will equal the aggregate net asset value, taking into account your Fund's proportionate share of the costs of the Reorganizations, of the common stock you held immediately prior to your Fund's Reorganization. The Acquiring Fund common shares received by Acquired Fund common stockholders will trade on New York Stock Exchange and will likely trade at a discount from net asset value, which might be greater or less than the trading discount of an Acquired Fund's common stock at the time of the closing of its Reorganization.

**PREFERRED STOCKHOLDERS OF THE ACQUIRED FUNDS:** Although holders of preferred stock are being asked to vote on the Reorganizations, if you are a holder of preferred stock, prior to an Acquired Fund's Reorganization you will receive the liquidation preference of the preferred stock you hold plus any accumulated and unpaid dividends because the preferred stock will be redeemed prior to the Reorganization.

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**Q: WILL I HAVE TO PAY ANY SALES LOAD, COMMISSION OR OTHER SIMILAR FEE IN CONNECTION WITH THE REORGANIZATIONS?**

**A:** You will pay no sales loads or commissions in connection with the Reorganizations. However, part of the costs associated with the Reorganizations will be borne by the Acquired Funds and thus indirectly by their common stockholders.

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Q: WILL MY DIVIDENDS BE AFFECTED BY THE PROPOSED REORGANIZATION?

A: COMMON STOCKHOLDERS OF INCOME SHARES: If you are a common stockholder of Income Shares, you receive distributions on a quarterly basis. As shareholders of the Acquiring Fund, you will receive distributions on a monthly basis. The Acquiring Fund's current yield as of January 31, 2008 on a net asset value basis is higher than that of Income Shares. It is expected that the shareholders of the Acquiring Fund will not see any material change in its yield as a result of the Reorganizations, although there can be no assurance that this will be the case.

COMMON STOCKHOLDERS OF HIGH INCOME PORTFOLIO: If you are a common stockholder of High Income Portfolio, you receive distributions on a monthly basis. As a shareholder of the Acquiring Fund, you will also receive distributions on a monthly basis. The Acquiring Fund's current yield as of January 31, 2008 on a net asset value basis is higher than that of High Income Portfolio. It is expected that the shareholders of Acquiring Fund will not see any material change in its yield as a result of the Reorganizations, although there can be no assurance that this will be the case.

PREFERRED STOCKHOLDERS OF THE ACQUIRED FUNDS: If you are a preferred stockholder of an Acquired Fund, at the time you receive the liquidation preference of the preferred stock you hold you will also receive any accumulated and unpaid dividends.

The Acquiring Fund will not permit any holder of certificated common stock of an Acquired Fund at the time of the Reorganization to reinvest dividends or other distributions, transfer shares of the Acquiring Fund or pledge shares of the Acquiring Fund until the certificates for stock of the Acquired Fund have been surrendered to PFPC, Inc., the Acquiring Fund's transfer agent, or, in the case of lost certificates, until an adequate surety bond has been posted. To obtain information on how to return your stock certificates for an Acquired Fund if and when the Reorganizations are completed, please call PFPC, Inc. at 877-665-1287.

If a shareholder is not, for the reasons above, permitted to reinvest dividends or other distributions on shares of the Acquiring Fund, the Acquiring Fund will pay all such dividends and other distributions in cash, notwithstanding any election the shareholder may have made previously to reinvest dividends and other distributions on stock of an Acquired Fund.

Q: WILL I HAVE TO PAY ANY FEDERAL INCOME TAXES AS A RESULT OF THE REORGANIZATIONS?

A: Each Reorganization is intended to qualify as a "reorganization" within the meaning of Section 368(a)(1) of the Internal Revenue Code of 1986, as amended. If the Reorganizations so qualify, in general, stockholders of the Acquired Funds will recognize no gain or loss upon the receipt solely of shares of the Acquiring Fund in connection with the Reorganizations. However, stockholders of the Acquired Funds may recognize gain or loss with respect to cash such holders receive pursuant to the Reorganization in lieu of fractional shares. Additionally, the Acquired Funds will recognize no gain or loss as a result of the Reorganization or as a result of their dissolution. Neither the Acquiring Fund nor its shareholders will recognize any gain or loss in connection with the Reorganizations.

Q: WHAT HAPPENS IF STOCKHOLDERS OF ONE ACQUIRED FUND DO NOT APPROVE ITS REORGANIZATION BUT STOCKHOLDERS OF THE OTHER ACQUIRED FUND DO APPROVE ITS REORGANIZATION?

A: The Reorganizations are not contingent upon each other. An unfavorable vote on a proposed Reorganization by the stockholders of one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund, if

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that Reorganization is approved by its stockholders.

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Q: HOW DOES THE BOARD OF DIRECTORS OF EACH ACQUIRED FUND SUGGEST THAT I VOTE?

A: After careful consideration, the Board of Directors of each Acquired Fund unanimously recommends that you vote "FOR" the Reorganization proposed for your Fund and "FOR" each nominee for director.

### GENERAL

Q: HOW DO I VOTE MY PROXY?

A: You may use the enclosed postage-paid envelope to mail your proxy card or you may attend the meeting in person. You may also vote by phone by calling the proxy solicitor at (800) 283-8518.

Q: WHO DO I CALL IF I HAVE QUESTIONS?

A: We will be pleased to answer your questions about this proxy solicitation. Please call (800) 283-8518 with any questions.

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PROSPECT STREET HIGH INCOME PORTFOLIO INC.  
PROSPECT STREET INCOME SHARES INC.  
(EACH, A "FUND")

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS  
TO BE HELD JUNE 6, 2008

This is the formal agenda for your Fund's stockholder meeting. It tells you what matters will be voted on and the time and place of the meeting in case you want to attend in person.

To the stockholders of each Fund:

A joint stockholder meeting for the Funds will be held at Galleria Tower I, 13355 Noel Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6, 2008, at 8:00 a.m. Central Time, to consider the following:

1. (A) For stockholders of Prospect Street High Income Portfolio Inc. ("High Income Portfolio"), a proposal to approve an Agreement and Plan of Reorganization between High Income Portfolio and Highland Credit Strategies Fund (the "Acquiring Fund") pursuant to which High Income Portfolio will transfer its assets to Acquiring Fund in exchange for Acquiring Fund shares (and cash in lieu of certain fractional shares) and the Acquiring Fund's assumption of High Income Portfolio's liabilities and High Income Portfolio will dissolve under applicable state law. THE BOARD OF DIRECTORS OF HIGH INCOME PORTFOLIO UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THIS PROPOSAL.

(B) For stockholders of Prospect Street Income Shares Inc. ("Income Shares"), a proposal to approve an Agreement and Plan of Reorganization between Income Shares and the Acquiring Fund pursuant to which Income Shares will transfer its assets to Acquiring Fund in exchange for Acquiring Fund shares (and cash in lieu of certain fractional shares) and the Acquiring Fund's assumption of Income Shares' liabilities and Income Shares will dissolve under applicable state law. THE BOARD OF DIRECTORS OF INCOME SHARES UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THIS PROPOSAL.

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2. (A) For stockholders of High Income Portfolio, to elect Timothy K. Hui and Scott F. Kavanaugh as Class II Directors of High Income Portfolio, each to serve for a three-year term expiring at the 2011 annual meeting and until his successor is duly elected and qualified. THE BOARD OF DIRECTORS OF HIGH INCOME PORTFOLIO UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THESE NOMINEES FOR DIRECTOR.

(B) For stockholders of Income Shares, to elect R. Joseph Dougherty as a Class I Director of Income Shares, to serve for a three-year term expiring at the 2011 annual meeting and until his successor is duly elected and qualified. THE BOARD OF DIRECTORS OF INCOME SHARES UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR THIS NOMINEE FOR DIRECTOR.

3. Any other business that may properly come before the meeting.

Stockholders of record as of the close of business on April 14, 2008, are entitled to vote at the meeting or any adjournment thereof. Your attention is called to the accompanying Proxy Statement and Prospectus. Regardless of whether you plan to attend the meeting, PLEASE COMPLETE, SIGN, DATE AND RETURN THE ENCLOSED PROXY CARD PROMPTLY so that a quorum will be present and your shares may be voted. You may also vote by calling the proxy solicitor at (800) 283-8518. If you are present at the meeting, you may change your vote, if desired, at that time.

YOUR VOTE IS IMPORTANT, REGARDLESS OF THE NUMBER OF SHARES YOU OWN. YOU CAN VOTE EASILY AND QUICKLY BY MAIL OR BY TELEPHONE. A SELF-ADDRESSED, POSTAGE-PAID ENVELOPE HAS BEEN ENCLOSED FOR YOUR CONVENIENCE. YOU MAY ALSO VOTE BY CALLING THE NUMBER ON THE PROXY CARD. PLEASE HELP AVOID THE EXPENSE OF A FOLLOW-UP MAILING BY VOTING TODAY.

By order of the Boards of Directors,

M. Jason Blackburn  
Secretary

Dated: April [\_\_], 2008

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PROXY STATEMENT OF  
PROSPECT STREET HIGH INCOME PORTFOLIO INC. ("HIGH INCOME PORTFOLIO")  
PROSPECT STREET INCOME SHARES INC. ("INCOME SHARES")  
(EACH, AN "ACQUIRED FUND")

AND

PROSPECTUS FOR  
COMMON SHARES OF  
HIGHLAND CREDIT STRATEGIES FUND  
("CREDIT STRATEGIES FUND" OR THE "ACQUIRING FUND")

The address of the Acquired Funds and the Acquiring Fund (each, a "Fund") is Two Galleria Tower, 13455 Noel Road, Suite 800, Dallas, Texas 75240 and the telephone number of each Fund is 1-877-665-1287.



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This Proxy Statement and Prospectus ("Proxy Statement/Prospectus") contains the information stockholders of each Acquired Fund should know before voting on the proposed reorganizations (each a "Reorganization" and, together, the "Reorganizations") and election of the nominees for director for each Acquired Fund ("Directors"). Please read it carefully and retain it for future reference. For ease of reading, "shares" and "shareholders" has been used in certain places in the Proxy Statement/Prospectus to describe, respectively, the stock of each Acquired Fund and holders of stock of each Acquired Fund.

### HOW THE REORGANIZATIONS WILL WORK

- o Each Acquired Fund will redeem its preferred shares prior to its Reorganization. A Reorganization will not be completed unless, before the final shareholder vote thereon, the participating Acquired Fund commences, and irrevocably commits to complete as expeditiously as possible, the process for redeeming its preferred shares. Pursuant to each Reorganization, an Acquired Fund will transfer all of its assets to the Acquiring Fund, which will assume each Acquired Fund's liabilities.
- o If each Reorganization is approved by its respective shareholders, the Acquiring Fund will issue newly issued common shares of beneficial interest, with \$0.001 par value ("Acquiring Fund Common Shares"), and cash (in lieu of certain fractional shares) in an aggregate amount equal to the value of each Acquired Fund's net assets attributable to its common shares. These shares will be distributed to each Acquired Fund's common shareholders in proportion to their holdings immediately prior to the Reorganization.
- o Each Acquired Fund will be dissolved and its shareholders will become shareholders of the Acquiring Fund.
- o The Reorganization of an Acquired Fund is conditioned upon the approval of its shareholders. However, the Reorganizations are not contingent upon each other and the Reorganization of one Acquired Fund will proceed, if approved by its shareholders, even if the Reorganization for the other Acquired Fund is not approved. If a Reorganization is not approved by an Acquired Fund, that Fund will continue to exist and its Board of Directors will consider what additional action, if any, to take.
- o Each Reorganization is intended to result in no income or recognized gain or loss for federal income tax purposes to the Acquiring Fund, the Acquired Fund or the shareholders of the Funds, except for distributions of net realized capital gains, if any, resulting from the sale of an Acquired Fund's assets in connection with its Reorganization. In addition, shareholders of the Acquired Funds may recognize gain or loss with respect to cash such holders receive pursuant to the Reorganization in lieu of fractional shares.

SHARES OF THE ACQUIRING FUND HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION (THE "SEC"). THE SEC HAS NOT PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROXY STATEMENT/PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

### RATIONALE FOR THE REORGANIZATIONS

The Board of Directors of each Acquired Fund and the Board of Trustees of the

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Acquiring Fund (each a "Board") believes that reorganizing each Acquired Fund into the Acquiring Fund, a fund with a similar investment objective and having a combined portfolio with greater assets, offers you potential benefits. These potential benefits and Board considerations include:

- o EXCHANGE OF COMMON SHARES AT NET ASSET VALUE ("NAV"). On its closing date, a Reorganization will result in the Acquired Fund shareholders receiving shares of the Acquiring Fund and cash (in lieu of certain fractional shares) based on the Acquired Fund's NAV (I.E., the Acquired Fund will get its NAV's worth of common shares of the Acquiring Fund and cash (in lieu of certain fractional shares)). It should be noted, however, that shares of the Acquiring Fund received in a Reorganization will likely trade at a market discount from NAV following the Reorganization, so that an Acquired Fund common shareholder may not be able to sell these shares for their NAV. It should also be noted that since inception shares of the Acquiring Fund generally have traded at a smaller discount or wider premium from NAV than shares of either Acquired Fund. However, since late December until the Board approved the Reorganization in February 2008, Acquiring Fund shares have frequently traded at a larger discount from NAV than shares of either Acquired Fund. The Acquiring Fund commenced a rights offering in late December and completed the rights offering on January 28, 2008. Historically, rights offerings have increased the discount from NAV for a fund.
- o INCREASED USE OF CAPITAL LOSSES. Each Acquired Fund has sustained substantial capital losses in recent years, which are available as "capital loss carryovers" ("CLCs") in the current and future taxable years (through their respective taxable years ending in 2013), but is not expected to be able to generate enough capital gains to be offset by those CLCs before they expire. SEE "Further Information on the Reorganizations - Federal Income Tax Consequences of the Reorganizations." Because of its larger size and investment policies and strategies, the Acquiring Fund is expected to be better able to use those CLCs to offset post-Reorganization gains of the combined Fund, although there can be no assurance that this will be the case. The Acquiring Fund's use of such CLCs, however, will be significantly limited due to the application of loss limitation rules under the federal tax law.
- o ENHANCED COMMON SHARE LIQUIDITY. Following the Reorganizations, the substantially larger trading market in the common shares of the Acquiring Fund, as compared to that of each Acquired Fund prior to the Reorganizations, may provide Acquired Fund shareholders with enhanced market liquidity. Trading discounts can result from many different factors, however, and there is no assurance that a larger trading market for Acquiring Fund's common shares will have the effect of reducing or maintaining trading discounts.
- o INCREASED ASSET SIZE. The Acquiring Fund will obtain additional assets without incurring the commission expenses and generally greater other expenses associated with offering new shares. In addition, the Acquiring Fund is obtaining the additional portfolio securities of the Acquired Funds without the commensurate brokerage costs, dealer spreads or other trading expenses. It is also obtaining these securities in a manner that is likely to minimize the market impact of such acquisition on the short-term prices of these securities. However, the increase in Acquiring Fund shares as a result of the Reorganization(s) may also cause Acquiring Fund shares to trade at a larger discount from NAV.
- o ECONOMIES OF SCALE IN CERTAIN EXPENSES. A combined Fund offers

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economies of scale that may lead to a reduction in certain expenses. With these reduced expenses and the contractual fee waivers offered by the Funds' adviser, as described below, the annual operating expenses of the combined Fund may be lower than the current annual operating expenses of Income Shares, although they are expected to be higher than High Income Portfolio's current annual operating expenses. In addition, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than either Acquired Fund's current annual operating expenses. Each Fund incurs New York Stock Exchange ("NYSE") listing fees, costs for legal, auditing, and custodial services, and miscellaneous fees. Many of these expenses overlap and there may be an opportunity to reduce them over time if

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the Funds are combined. However, it is not expected that these economies of scale will be substantial.

- o PORTFOLIO MANAGEMENT EFFICIENCIES. Each Reorganization would permit Acquired Fund shareholders to pursue similar investment goals in a larger Fund. The greater asset size of the combined Fund may allow it, relative to each Acquired Fund, to obtain better net prices on securities trades and achieve greater diversification of portfolio holdings.
- o SHAREHOLDERS' ABILITY TO MARGIN. Currently, stocks that trade below \$5.00 are not marginable. The Reorganization would permit shareholders of High Income Portfolio and Income Shares (if their shares continue to trade below \$5.00) to receive shares that they could margin. Additionally, marginable securities may be more liquid than those that are not marginable as many institutional/large investors are believed to avoid stocks that are not marginable.

Each Board also considered that if shareholders approve a Reorganization, Highland Capital Management, L.P. ("Adviser" or "Highland") would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years so that Highland would receive no additional benefit from the Reorganization for two years. The waivers are intended to offset the additional revenue Highland would receive on each Acquired Fund's assets (calculated as of the date of its Reorganization and including the value of its preferred shares that historically have been outstanding) due to the difference between the advisory fee rates of each Acquired Fund and Credit Strategies Fund and the fact that the Acquired Funds do not pay an administration fee to Highland. However, even with the contractual fee waivers, the annual operating expenses of the combined Fund are expected to be higher than High Income Portfolio's current annual operating expenses and, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than either Acquired Fund's current annual operating expenses. As of each Fund's last fiscal year, the total annual operating expenses, as a percentage of average net assets, of High Income Portfolio, Income Shares and Credit Strategies Fund were 3.34%, 3.99% and 4.06%, respectively. Assuming each Reorganization is approved, the estimated total annual operating expenses of the combined Fund would be 4.03% of average net assets and, with the contractual fee waivers described above, the estimated net annual operating expenses of the combined Fund would be 3.88% of average net assets.

The Board of each Acquired Fund unanimously recommends that you vote FOR the Reorganization of your Fund into Credit Strategies Fund. For further information, please see the individual description of the proposal affecting your Fund contained in the Proxy Statement/Prospectus.

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### WHO BEARS THE EXPENSES ASSOCIATED WITH THE PROXY STATEMENT/PROSPECTUS

The costs associated with the Reorganizations will be borne by each of the Acquired Funds and the Acquiring Fund in proportion to their respective net assets determined at the close of regular trading on the NYSE on the date of the Reorganizations' closing, provided that if they close at different times, that determination will be made as of the date that the first Reorganization closes. The costs associated with the election of Directors will be borne by each of the Acquired Funds.

### WHO IS ELIGIBLE TO VOTE

Shareholders of record on April 14, 2008 are entitled to attend and vote at the meeting or any adjourned meeting. Each share is entitled to one vote. Shares represented by properly executed proxy cards, unless revoked before or at the meeting, will be voted according to shareholders' instructions. If you sign a proxy card but do not fill in a vote, your shares will be voted for the Reorganization and for the election of the nominees for Director. If any other business comes before the meeting, your shares will be voted at the discretion of the persons named as proxies.

The common shares of the Acquiring Fund are listed on the NYSE under the ticker symbol "HCF" and will continue to be so listed subsequent to the Reorganizations. The common shares of High Income Portfolio and Income Shares are listed on the NYSE under the ticker symbols "PHY" and "CNN," respectively.

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Shares of the Acquiring Fund are not deposits or obligations of, or guaranteed or endorsed by, any bank or other depository institution. These shares are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board or any other government agency.

### WHERE TO GET MORE INFORMATION

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Credit Strategies Fund's annual  
report to shareholders dated  
December 31, 2007

High Income Portfolio's annual report to  
shareholders dated October 31, 2007

Previously sent to the shareholders  
of each respective Fund and on file  
with the SEC or available at no  
charge by calling our toll free  
number: 877-665-1287.

Income Shares' annual report to  
shareholders dated December 31, 2007

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A Statement of Additional Information  
dated April [\_\_\_], 2008, which relates to  
this Proxy Statement/Prospectus and the  
Reorganizations, has been filed with the  
SEC and contains additional information  
about the Acquired Funds and the  
Acquiring Fund

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On file with the SEC or available  
at no charge by calling our toll  
free number: 877-665-1287. The  
statement of additional information  
is incorporated by reference into  
(and therefore legally part of)  
this Proxy Statement/Prospectus.  
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To ask questions about this Proxy  
Statement/Prospectus

Call our toll-free telephone  
number: 877-665-1287.

The date of this Proxy Statement/Prospectus is April [\_\_\_], 2008.

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### INTRODUCTION

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This Proxy Statement/Prospectus is being used by each Acquired Fund's Board to solicit proxies to be voted at the annual meeting of each Acquired Fund's shareholders ("Meeting"). The Meeting will be held at Galleria Tower I, 13355 Noel Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6, 2008, at 8:00 a.m. Central Time. At the Meeting, each Acquired Fund will consider a proposal to approve an Agreement and Plan of Reorganization providing for the Reorganization of the Acquired Fund into the Acquiring Fund and for election of Directors of each Acquired Fund. This Proxy Statement/Prospectus is being mailed to your Fund's shareholders on or about [April 25, 2008].

For each proposal, this Proxy Statement/Prospectus includes information that is specific to that proposal. A comparison summary is provided with respect to each proposal. You should read carefully the sections of the proxy statement related specifically to your Fund(s), the information relevant to the proposals, as well as the Appendices and the enclosed materials, because they contain details that are not in the summary.

### SUMMARY OF INFORMATION RELATED TO PROPOSAL 1

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The following is a summary of certain information regarding proposal 1 contained elsewhere in this Proxy Statement/Prospectus and is qualified in its entirety by reference to the more complete information contained in this Proxy Statement/Prospectus and in the Statement of Additional Information. Shareholders should read the entire Proxy Statement/Prospectus carefully.

#### PROPOSALS 1(A) AND 1(B): REORGANIZATIONS OF THE ACQUIRED FUNDS

THE PROPOSED REORGANIZATIONS. The Board of each Fund, including the Trustees/Directors who are not "interested persons" (as defined in the Investment Company Act of 1940, as amended (the "1940 Act")) of each Fund, has unanimously approved the Agreement and Plan of Reorganization to which its Fund is a participant. If the shareholders of an Acquired Fund approve the applicable Agreement and Plan of Reorganization, then common shareholders of that Acquired Fund will receive Acquiring Fund Common Shares and cash (in lieu of certain fractional shares), and the Acquiring Fund will acquire all of the assets of the Acquired Fund and assume all of the liabilities of that Acquired Fund. The Acquired Fund will then terminate its registration under the 1940 Act and dissolve under applicable state law. The aggregate value of Acquiring Fund

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Common Shares and any cash you receive in a Reorganization will equal the aggregate value, taking into account your Fund's proportionate share of the costs of the Reorganizations, of your Acquired Fund Common Shares held immediately prior to your Fund's Reorganization. Acquired Fund common shareholders will receive cash for any Acquiring Fund fractional shares they otherwise would be entitled to receive other than with respect to shares held in a Dividend Reinvestment Plan account.

The closing date of each proposed Reorganization may differ, and the newly issued Acquiring Fund Common Shares may be issued on different closing dates.

In addition, prior to a Reorganization, preferred shareholders of an Acquired Fund will receive the liquidation preference associated with their preferred shares plus any accumulated and unpaid dividends. A Reorganization will not be completed unless, before the final shareholder vote thereon, the participating Acquired Fund commences, and irrevocably commits to complete as expeditiously as possible, the process for redeeming its preferred shares.

### SUMMARY OF FUND COMPARISONS

INVESTMENT OBJECTIVES AND POLICIES. Each Acquired Fund is registered as a diversified, closed-end management investment company under the 1940 Act. The Acquiring Fund is registered as a non-diversified, closed-end management investment company under the 1940 Act. The investment objective of each Acquired Fund is similar to that of Credit Strategies Fund, although each Fund's investment policies, strategies and risks are different, particularly with respect to Income Shares and Credit Strategies Fund. High Income Portfolio seeks to provide high current income, while seeking to preserve shareholders' capital. Income Shares seeks to provide a high level of current income, with capital appreciation as a secondary objective. Credit Strategies Fund seeks to provide both current income and capital appreciation. The Acquiring Fund seeks to provide

both current income and capital appreciation and therefore has a greater focus on capital appreciation. Highland is the investment adviser to each Fund and each Fund's valuation policies are the same.

High Income Portfolio invests at least 65% of its total assets in high-yield, fixed-income securities rated in the lower categories (Ba/BB or lower) by a rating agency or nonrated fixed-income securities deemed by the Adviser to be of comparable quality. High Income Portfolio typically invests a substantially higher percentage of its assets in such securities.

Income Shares invests at least 50% of its total assets in debt securities rated in the four highest categories (Baa/BBB or higher) by a rating agency or nonrated debt securities deemed by the Adviser to be of comparable quality.

Credit Strategies Fund invests at least 80% of its assets in the following categories of securities and instruments of corporations and other business entities: (i) secured and unsecured floating and fixed rate loans; (ii) bonds and other debt obligations; (iii) debt obligations of stressed, distressed and bankrupt issuers; (iv) structured products, including but not limited to, mortgage-backed and other asset-backed securities and collateralized debt obligations; and (v) equities. A significant portion of Credit Strategies Fund's assets may be invested in securities rated below investment grade (Ba/BB or lower), which are commonly referred to as "junk securities" or "high-yield securities."

Please refer to Proposal 1 for a further comparison of investment objectives and policies.

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DIVIDENDS AND OTHER DISTRIBUTIONS. Holders of common shares of Income Shares receive distributions on a quarterly basis; holders of common shares of High Income Portfolio and Credit Strategies Fund receive distributions on a monthly basis. Credit Strategies Fund's current yield as of January 31, 2008 on a net asset value basis is higher than that of either Acquired Fund. It is expected that the shareholders of Credit Strategies Fund will not see any material change in its yield as a result of the Reorganizations, although there can be no assurance that this will be the case.

Holders of preferred shares of an Acquired Fund will also receive any accumulated and unpaid dividends, at the time they receive the liquidation preference of the preferred shares they hold.

PURCHASE AND SALE. Purchase and sale procedures for the common shares of the Funds are similar. Investors typically purchase and sell common shares of the Funds on the NYSE through a registered broker-dealer. Each Acquired Fund's series of preferred shares are purchased and sold at separate auctions conducted on a regular basis (unless a Fund elects, subject to certain conditions, to declare a special dividend period). Credit Strategies Fund does not have any preferred shares and does not plan to have any immediately after the Reorganizations.

REDEMPTION PROCEDURES. Redemption procedures for the Funds are similar. The common shares of each Fund have no redemption rights. However, the Board of each Fund may consider open market share repurchases of, or tendering for, common shares to seek to reduce or eliminate any discount in the market place of the common shares from the NAV thereof. Each Fund's ability to repurchase, or tender for, its common shares may be limited by the 1940 Act asset coverage requirements and, in the Acquired Funds' case, by any rating agency requirements required due to the issuance of preferred shares.

Provided certain conditions are met, the preferred shares are redeemable at the option of each Acquired Fund, at a price equal to \$25,000 per share plus, in each case, accumulated and unpaid dividends (including additional dividends, if any) on the redemption date. As noted above, the preferred shares will be redeemed prior to each Reorganization.

EXPENSES. With the contractual fee waivers offered by Highland, the estimated annual operating expenses of Credit Strategies Fund may be lower than the current annual operating expenses of Income Shares, although they are expected to be higher than High Income Portfolio's current annual operating expenses. The higher expenses are due, in part, to Credit Strategies Fund leveraging by borrowing pursuant to a credit facility rather than by issuing preferred shares. While the use of a credit facility has been more expensive, it provides Credit Strategies Fund greater flexibility to change the amount of its leverage depending on market conditions. Over time, this flexibility may enable Credit

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Strategies Fund to achieve greater performance, although there is no guarantee or assurance as to the future performance of Credit Strategies Fund.

LEVERAGE. Each Acquired Fund employs leverage through the issuance of preferred shares. The Acquiring Fund employs leverage through borrowings through a credit facility. As of March 31, 2008, the leverage as a percentage of total assets of High Income Portfolio, Income Shares and Credit Strategies Fund was 31.7%, 35.4% and 29.5%, respectively.

PERFORMANCE AND PREMIUM/DISCOUNT PROFILE. Each Acquired Fund has been in existence for more than ten years. The Acquiring Fund commenced investment



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operations in June 2006 and has a limited operating history and history of public trading.

Credit Strategies Fund's 1-year performance as of December 31, 2007 on a net asset value basis is better than Income Shares and its overall historical premium/discount profile is better than that of each Acquired Fund. However, more recently, Credit Strategies Fund's common shares have traded at a larger discount from NAV than the common shares of either Acquired Fund. The Acquiring Fund also completed a rights offering on January 28, 2008. There is no guarantee or assurance as to the future performance of Credit Strategies Fund. In addition, although Credit Strategies Fund should provide increased liquidity to shareholders of each Acquired Fund due to its substantially larger trading market, there can be no assurance that will be the case.

**BACKGROUND AND REASONS FOR THE PROPOSED REORGANIZATIONS.** The Reorganizations seek to combine two smaller funds (High Income Portfolio and Income Shares) into one larger fund (Credit Strategies Fund) to achieve certain economies of scale and other operational efficiencies. The Reorganizations will combine the assets of these Funds by reorganizing the Acquired Funds with and into the Acquiring Fund. The Board of each Acquired Fund, based upon its evaluation of all relevant information, anticipates that the common shareholders of its respective Acquired Fund should benefit from its Reorganization. The Board of the Acquiring Fund, based upon its evaluation of all relevant information, anticipates that each Reorganization should benefit holders of Acquiring Fund Common Shares. The combined Fund resulting from the Reorganizations will have a larger asset base than any of the Funds has currently; certain fixed administrative costs, such as costs of, legal expenses, audit fees and other expenses, will be spread across this larger asset base, thereby potentially lowering those costs for common shareholders of the combined Fund. However, it is not expected that these economies of scale will be substantial.

In addition, if shareholders approve the Reorganization(s), Highland would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years so that Highland would receive no additional benefit from the Reorganization(s) for two years. The waivers are intended to offset the additional revenue Highland would receive on each Acquired Fund's assets (calculated as of the date of its reorganization) due to the difference between the advisory fee rates of each Acquired Fund and Credit Strategies Fund and the fact that the Acquired Funds do not pay an administration fee to Highland. Assuming Income Shares' shareholders approve its Reorganization and the Reorganization took place on January 31, 2008, the amount of such waivers over two years would be \$1,223,194. Assuming High Income Portfolio's shareholders approve its Reorganization and the Reorganization took place on January 31, 2008, the amount of such waivers over two years would be \$1,425,446. All shareholders of the combined Fund would benefit from such waivers.

The Board of each Acquired Fund has determined that participation in the applicable Reorganization is in the best interests of the Fund and that the interests of its shareholders will not be diluted as a result of that Reorganization. Similarly, the Acquiring Fund's Board has determined that participation in each Reorganization is in the best interests of its common shareholders and that the interests of such shareholders will not be diluted as a result of each Reorganization. Preferred shareholders of the Acquired Funds will not participate in the Reorganizations. As noted above, the preferred shares will be redeemed prior to each Reorganization. In addition, as a result of the Reorganizations, shareholders of each Fund, particularly the shareholders of the Acquired Funds, will have a smaller percentage of ownership in the larger combined Fund than they did in any of the separate Funds.

**RATIONALE FOR THE REORGANIZATIONS.** The Board of each Fund believes that reorganizing each Acquired Fund into the Acquiring Fund, a fund with a similar

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investment objective, and having a combined portfolio with greater assets, offers you potential benefits. These potential benefits and Board considerations include:

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- o EXCHANGE OF COMMON SHARES AT NAV. On its closing date, a Reorganization will result in the Acquired Fund shareholders receiving shares of the Acquiring Fund and cash (in lieu of certain fractional shares) based on the Acquired Fund's NAV (I.E., the Acquired Fund will get its NAV's worth of common shares of the Acquiring Fund and cash (in lieu of certain fractional shares)). It should be noted, however, that shares of the Acquiring Fund received in a Reorganization will likely trade at a market discount from NAV following the Reorganization, so that an Acquired Fund common shareholder may not be able to sell these shares for their NAV. It should also be noted that since inception shares of the Acquiring Fund generally have traded at a smaller discount or wider premium from NAV than shares of either Acquired Fund. However, since late December until the Board approved the Reorganization in February 2008, Acquiring Fund shares have frequently traded at a larger discount from NAV than shares of either Acquired Fund. The Acquiring Fund commenced a rights offering in late December and completed the rights offering on January 28, 2008. Historically, rights offerings have increased the discount from NAV for a fund.
- o INCREASED USE OF CAPITAL LOSSES. Each Acquired Fund has sustained substantial capital losses in recent years, which are available as CLCs in the current and future taxable years (through their respective taxable years ending in 2013), but is not expected to be able to generate enough capital gains to be offset by those CLCs before they expire. SEE "Further Information on the Reorganizations - Federal Income Tax Consequences of the Reorganizations." Because of its larger size and investment policies and strategies, the Acquiring Fund is expected to be better able to use those CLCs to offset post-Reorganization gains of the combined Fund, although there can be no assurance that this will be the case. The Acquiring Fund's use of such CLCs, however, will be significantly limited due to the application of loss limitation rules under the federal tax law.
- o ENHANCED COMMON SHARE LIQUIDITY. Following the Reorganizations, the substantially larger trading market in the common shares of the Acquiring Fund, as compared to that of each Acquired Fund prior to the Reorganizations, may provide Acquired Fund shareholders with enhanced market liquidity. Trading discounts can result from many different factors, however, and there is no assurance that a larger trading market for Acquiring Fund's common shares will have the effect of reducing or maintaining trading discounts.
- o INCREASED ASSET SIZE. The Acquiring Fund will obtain additional assets without incurring the commission expenses and generally greater other expenses associated with offering new shares. In addition, the Acquiring Fund is obtaining the additional portfolio securities of the Acquired Funds without the commensurate brokerage costs, dealer spreads or other trading expenses. It is also obtaining these securities in a manner that is likely to minimize the market impact of such acquisition on the short-term prices of these securities. However, the increase in Acquiring Fund shares as a result of the Reorganization(s) may also cause Acquiring Fund shares to trade at a larger discount from NAV.

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- o ECONOMIES OF SCALE IN CERTAIN EXPENSES. A combined Fund offers economies of scale that may lead to a reduction in certain expenses. With these reduced expenses and the contractual fee waivers offered by Highland, which is described below, the annual operating expenses of the combined Fund may be lower than the current annual operating expenses of Income Shares, although they are expected to be higher than High Income Portfolio's current annual operating expenses. In addition, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than either Acquired Fund's current annual operating expenses. Each Fund incurs NYSE listing fees, costs for legal, auditing, and custodial services, and miscellaneous fees. Many of these expenses overlap and there may be an opportunity to reduce them over time if the Funds are combined. However, it is not expected that these economies of scale will be substantial.
- o PORTFOLIO MANAGEMENT EFFICIENCIES. Each Reorganization would permit Acquired Fund shareholders to pursue similar investment goals in a larger Fund. The greater asset size of the combined Fund may allow it, relative to each Acquired Fund, to obtain better net prices on securities trades and achieve greater diversification of portfolio holdings.

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- o SHAREHOLDERS' ABILITY TO MARGIN. Currently, stocks that trade below \$5.00 are not marginable. The Reorganization would permit shareholders of High Income Portfolio and Income Shares (if their shares continue to trade below \$5.00) to receive shares that they could margin. Additionally, marginable securities may be more liquid than those that are not marginable as many institutional/large investors are believed to avoid stocks that are not marginable.

Each Board also considered that if shareholders approve a Reorganization, Highland would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years so that Highland would receive no additional benefit from the Reorganization for two years. The waivers are intended to offset the additional revenue Highland would receive on each Acquired Fund's assets (calculated as of the date of its Reorganization and including the value of its preferred shares that historically have been outstanding) due to the difference between the advisory fee rates of each Acquired Fund and Credit Strategies Fund and the fact that the Acquired Funds do not pay an administration fee to Highland. However, even with the contractual fee waivers, the annual operating expenses of the combined Fund are expected to be higher than High Income Portfolio's current annual operating expenses and, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than either Acquired Fund's current annual operating expenses. As of each Fund's last fiscal year, the total annual operating expenses, as a percentage of average net assets, of High Income Portfolio, Income Shares and Credit Strategies Fund were 3.34%, 3.99% and 4.06%, respectively. Assuming each Reorganization is approved, the estimated total annual operating expenses of the combined Fund would be 4.03% of average net assets and, with the contractual fee waivers described above, the estimated net annual operating expenses of the combined Fund would be 3.88% of average net assets.

The Board of each Acquired Fund unanimously recommends that you vote FOR the Reorganization of your Fund into Credit Strategies Fund. For further information, please see the individual description of the proposal affecting

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your Fund contained in the Proxy Statement/Prospectus.

EXPENSES ASSOCIATED WITH THE REORGANIZATIONS. The costs associated with the Reorganizations will be borne by each of the Acquired Funds and the Acquiring Fund in proportion to their respective net assets determined at the close of regular trading on the NYSE on the date of the Reorganizations' closing, provided that if they close at different times, that determination will be made as of the date that the first Reorganization closes.

TAX CONSEQUENCES. Each Reorganization is intended to qualify as a "reorganization" within the meaning of Section 368(a)(1) of the Internal Revenue Code of 1986, as amended ("Code"). If the Reorganizations so qualify, in general, shareholders of the Acquired Funds will recognize no gain or loss upon the receipt solely of shares of the Acquiring Fund in connection with the Reorganizations. However, shareholders of the Acquired Funds may recognize gain or loss with respect to cash they receive pursuant to the Reorganization in lieu of fractional Acquiring Fund shares. Additionally, the Acquired Funds will recognize no gain or loss as a result of the Reorganization or as a result of their dissolution. Neither the Acquiring Fund nor its shareholders will recognize any gain or loss in connection with the Reorganizations.

REQUIRED VOTE. Shareholder approval of each Reorganization requires, with respect to each respective Acquired Fund, the vote of: (1) the holders of at least a majority of the common and preferred shares entitled to vote, voting as a single class; and (2) the holders of at least a majority of the preferred shares entitled to vote, voting as a separate class.

THE BOARD OF EACH ACQUIRED FUND UNANIMOUSLY RECOMMENDS THAT YOU VOTE FOR YOUR FUND'S PROPOSED REORGANIZATION.

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### RISK FACTORS AND SPECIAL CONSIDERATIONS RELATED TO PROPOSAL 1

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Because each of Credit Strategies Fund and High Income Portfolio, under normal market conditions, invests a substantial amount of its assets in below investment grade securities (Income Shares also invests in below investment grade securities but to a lesser extent), any general risks inherent in such investments are equally applicable to Credit Strategies Fund and High Income Portfolio and will apply to Credit Strategies Fund after the Reorganizations. The general risks of investing in Credit Strategies Fund are described below and the general risks that are unique to an Acquired Fund are indicated as such below. The Reorganizations themselves are not expected to adversely affect the right of common shareholders of any of the Funds. Preferred shareholders of the Acquired Funds will not participate in the Reorganizations. As noted above, the preferred shares will be redeemed prior to each Reorganization. For information regarding the percentage limitations, if any, of an investment described in the risks listed below, see "Comparison of the Funds: Investment Objectives and Policies."

LIMITED OPERATING HISTORY. Credit Strategies Fund is a recently organized, non-diversified, closed-end management investment company. It commenced investment operations in June 2006 and has a limited operating history and history of public trading that investors can use to evaluate its investment performance and volatility.

THIS DOES NOT APPLY TO EITHER ACQUIRED FUND SINCE THEY ARE NOT RECENTLY ORGANIZED.

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INVESTMENT AND MARKET DISCOUNT RISK. An investment in Credit Strategies Fund's common shares is subject to investment risk, including the possible loss of the entire amount that you invest. As with any stock, the price of Credit Strategies Fund's shares will fluctuate with market conditions and other factors. If shares are sold, the price received may be more or less than the original investment. Common shares are designed for long-term investors and should not be treated as trading vehicles. Shares of closed-end management investment companies frequently trade at a discount to their NAV.

RISKS OF NON-DIVERSIFICATION AND OTHER FOCUSED STRATEGIES. While the Adviser will invest in a number of fixed-income and equity instruments issued by different issuers and plans to employ multiple investment strategies with respect to Credit Strategies Fund's portfolio, it is possible that a significant amount of Credit Strategies Fund's investments could be invested in the instruments of only a few companies or other issuers or that at any particular point in time one investment strategy could be more heavily weighted than the others. The focus of Credit Strategies Fund's portfolio in any one issuer would subject Credit Strategies Fund to a greater degree of risk with respect to defaults by such issuer or other adverse events affecting that issuer, and the focus of the portfolio in any one industry or group of industries (but not to the extent of 25% of Credit Strategies Fund's total assets) would subject Credit Strategies Fund to a greater degree of risk with respect to economic downturns relating to such industry. The focus of Credit Strategies Fund's portfolio in any one investment strategy would subject Credit Strategies Fund to a greater degree of risk than if Credit Strategies Fund's portfolio were varied in its investments with respect to several investment strategies.

THE GENERAL RISKS OF NON-DIVERSIFICATION DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY ARE DIVERSIFIED, CLOSED-END MANAGEMENT INVESTMENT COMPANIES UNDER THE 1940 ACT.

ILLIQUIDITY OF INVESTMENTS. The investments made by Credit Strategies Fund may be illiquid, and consequently, Credit Strategies Fund may not be able to sell such investments at prices that reflect the Adviser's assessment of their fair value or the amount paid for such investments by Credit Strategies Fund. Illiquidity may result from the absence of an established market for the investments as well as legal, contractual or other restrictions on their resale by Credit Strategies Fund and other factors. Furthermore, the nature of Credit Strategies Fund's investments, especially those in financially stressed and distressed companies, may require a long holding period prior to being able to determine whether the investment will be profitable or not. There is no limit on the amount of Credit Strategies Fund's portfolio that can be invested in illiquid securities.

CREDIT STRATEGIES FUND HAS NO LIMIT ON THE AMOUNT OF ASSETS THAT CAN BE INVESTED IN ILLIQUID SECURITIES. AS SUCH, THE GENERAL RISKS OF INVESTING IN ILLIQUID SECURITIES ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND, WHICH HAVE LIMITS ON INVESTING IN ILLIQUID SECURITIES.

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RISKS OF INVESTING IN SENIOR LOANS. Senior loans, such as bank loans, are typically at the most senior level of the capital structure, and are sometimes secured by specific collateral, including, but not limited to, trademarks, patents, accounts receivable, inventory, equipment, buildings, real estate, franchises and common and preferred stock of the obligor or its affiliates. A portion of Credit Strategies Fund's investments may consist of loans and participations therein originated by banks and other financial institutions, typically referred to as "bank loans." Credit Strategies Fund's investments may include loans of a type generally incurred by borrowers in connection with highly leveraged transactions, often to finance internal growth, acquisitions,

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mergers or stock purchases, or for other reasons. As a result of the additional debt incurred by the borrower in the course of the transaction, the borrower's creditworthiness is often judged by the rating agencies to be below investment grade. Such loans are typically private corporate loans which are negotiated by one or more commercial banks or financial institutions and syndicated among a group of commercial banks and financial institutions. In order to induce the lenders to extend credit and to offer a favorable interest rate, the borrower often provides the lenders with extensive information about its business which is not generally available to the public.

Bank loans often contain restrictive covenants designed to limit the activities of the borrower in an effort to protect the right of lenders to receive timely payments of principal and interest. Such covenants may include restrictions on dividend payments, specific mandatory minimum financial ratios, limits on total debt and other financial tests. Bank loans usually have shorter terms than subordinated obligations and may require mandatory prepayments from excess cash flow, asset dispositions and offerings of debt and/or equity securities. The bank loans and other debt obligations to be acquired by Credit Strategies Fund are likely to be below investment grade.

Credit Strategies Fund may acquire interests in bank loans and other debt obligations either directly (by way of sale or assignment) or indirectly (by way of participation). The purchaser of an assignment typically succeeds to all the rights and obligations of the assigning institution and becomes a lender under the credit agreement with respect to the debt obligation; however, its rights can be more restricted than those of the assigning institution, and, in any event, Credit Strategies Fund may not be able unilaterally to enforce all rights and remedies under the loan and any associated collateral. A participation interest in a portion of a debt obligation typically results in a contractual relationship only with the institution participating out the interest, not with the borrower. In purchasing participations, Credit Strategies Fund generally will have no right to enforce compliance by the borrower with either the terms of the loan agreement or any rights of setoff against the borrower, and Credit Strategies Fund may not directly benefit from the collateral supporting the debt obligation in which it has purchased the participation. As a result, Credit Strategies Fund will be exposed to the credit risk of both the borrower and the institution selling the participation.

Purchasers of bank loans are predominantly commercial banks, investment trusts and investment banks. As secondary market trading volumes increase, new bank loans frequently adopt standardized documentation to facilitate loan trading, which should improve market liquidity. There can be no assurance, however, that future levels of supply and demand in bank loan trading will provide an adequate degree of liquidity or that the current level of liquidity will continue. Because of the provision to holders of such loans of confidential information relating to the borrower, the unique and customized nature of the loan agreement, the limited universe of eligible purchasers and the private syndication of the loan, bank loans are not as easily purchased or sold as a publicly traded security, and historically the trading volume in the bank loan market has been small relative to the high-yield debt market.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN SENIOR LOANS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS OF INVESTING IN SENIOR LOANS ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

SECOND LIEN LOANS RISK. Second lien loans are subject to the same risks associated with investment in senior loans and non-investment grade securities. See "Non-Investment Grade Securities Risk." However, second lien loans are second in right of payment to senior loans and therefore are subject to additional risk that the cash flow of the borrower and any property securing the loan may be insufficient to meet scheduled payments after giving effect to the senior secured obligations of the borrower. Second lien loans are expected to

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have greater price volatility than senior loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in second lien loans, which would create greater credit risk exposure.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN SECOND LIENS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS OF INVESTING IN SECOND LIENS ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

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OTHER SECURED LOANS RISK. Secured loans other than senior loans and second lien loans are subject to the same risks associated with investment in senior loans, second lien loans and non-investment grade securities. However, such loans may rank lower in right of payment than any outstanding senior loans and second lien loans of the borrower and therefore are subject to additional risk that the cash flow of the borrower and any property securing the loan may be insufficient to meet scheduled payments after giving effect to the higher ranking secured obligations of the borrower. Lower ranking secured loans are expected to have greater price volatility than senior loans and second lien loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in lower ranking secured loans, which would create greater credit risk exposure.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN OTHER SECURED LOANS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS OF INVESTING IN OTHER SECURED LOANS ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

UNSECURED LOANS RISK. Unsecured loans are subject to the same risks associated with investment in senior loans, second lien loans, other secured loans and non-investment grade securities. However, because unsecured loans have lower priority in right of payment to any higher ranking obligations of the borrower and are not backed by a security interest in any specific collateral, they are subject to additional risk that the cash flow of the borrower and available assets may be insufficient to meet scheduled payments after giving effect to any higher ranking obligations of the borrower. Unsecured loans are expected to have greater price volatility than senior loans, second lien loans and other secured loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in unsecured loans, which would create greater credit risk exposure.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN UNSECURED LOANS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS OF INVESTING IN UNSECURED LOANS ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

RISKS OF INVESTING IN OBLIGATIONS OF STRESSED, DISTRESSED AND BANKRUPT ISSUERS. Credit Strategies Fund is authorized to invest in the securities and other obligations of stressed, distressed and bankrupt issuers, including debt obligations that are in covenant or payment default. There is no limit on the amount of Credit Strategies Fund's portfolio that can be invested in stressed, distressed or bankrupt issuers, and Credit Strategies Fund may invest for purposes of control. Such investments generally trade significantly below par and are considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments. Typically such workout or bankruptcy proceedings result in only partial recovery of cash payments or an exchange of the defaulted obligation for other debt or equity securities of the issuer or its affiliates, which may in turn be illiquid or speculative.

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There are a number of significant risks inherent in the bankruptcy process. First, many events in a bankruptcy are the product of contested matters and adversary proceedings and are beyond the control of the creditors. While creditors are generally given an opportunity to object to significant actions, there can be no assurance that a bankruptcy court in the exercise of its broad powers would not approve actions that would be contrary to the interests of Credit Strategies Fund. Second, a bankruptcy filing by an issuer may adversely and permanently affect the issuer. The issuer may lose its market position and key employees and otherwise become incapable of restoring itself as a viable entity. If for this or any other reason the proceeding is converted to a liquidation, the value of the issuer may not equal the liquidation value that was believed to exist at the time of the investment. Third, the duration of a bankruptcy proceeding is difficult to predict. A creditor's return on investment can be adversely affected by delays while the plan of reorganization is being negotiated, approved by the creditors and confirmed by the bankruptcy court and until it ultimately becomes effective. Fourth, the administrative costs in connection with a bankruptcy proceeding are frequently high and would be paid out of the debtor's estate prior to any return to creditors. For example, if a proceeding involves protracted or difficult litigation, or turns into a liquidation, substantial assets may be devoted to administrative costs. Fifth, bankruptcy law permits the classification of "substantially similar" claims in determining the classification of claims in a reorganization. Because the standard for classification is vague, there exists the risk that Credit Strategies Fund's influence with respect to the class of securities or other obligations it owns can be lost by increases in the number and amount of claims in that class or by different classification and treatment. Sixth, in the early stages of the bankruptcy process it is often difficult to estimate the extent of, or even to identify, any contingent claims that might be made. Seventh, especially in the case of investments made prior to the commencement of

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bankruptcy proceedings, creditors can lose their ranking and priority if they exercise "domination and control" over a debtor and other creditors can demonstrate that they have been harmed by such actions. Eighth, certain claims that have priority by law (for example, claims for taxes) may be substantial.

In any investment involving stressed and distressed debt obligations, there exists the risk that the transaction involving such debt obligations will be unsuccessful, take considerable time or will result in a distribution of cash or a new security or obligation in exchange for the stressed and distressed debt obligations, the value of which may be less than Credit Strategies Fund's purchase price of such debt obligations. Furthermore, if an anticipated transaction does not occur, Credit Strategies Fund may be required to sell its investment at a loss. Given the substantial uncertainties concerning transactions involving stressed and distressed debt obligations in which Credit Strategies Fund invests, there is a potential risk of loss by Credit Strategies Fund of its entire investment in any particular investment.

Investments in companies undergoing a workout or operating under Chapter 11 of the Bankruptcy Code are also, in certain circumstances, subject to certain additional liabilities which may exceed the value of Credit Strategies Fund's original investment in a company. For example, under certain circumstances, creditors who have inappropriately exercised control over the management and policies of a debtor may have their claims subordinated or disallowed or may be found liable for damages suffered by parties as a result of such actions. The Adviser's active management style may present a greater risk in this area than would a more passive approach. In addition, under certain circumstances, payments to Credit Strategies Fund and distributions by Credit Strategies Fund or payments on the debt may be reclaimed if any such payment is later determined to have been a fraudulent conveyance or a preferential payment.



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The Adviser, on behalf of Credit Strategies Fund, may participate on committees formed by creditors to negotiate with the management of financially troubled companies that may or may not be in bankruptcy or may negotiate directly with debtors with respect to restructuring issues. If Credit Strategies Fund does choose to join a committee, Credit Strategies Fund would likely be only one of many participants, all of whom would be interested in obtaining an outcome that is in their individual best interests. There can be no assurance that Credit Strategies Fund would be successful in obtaining results most favorable to it in such proceedings, although Credit Strategies Fund may incur significant legal and other expenses in attempting to do so. As a result of participation by Credit Strategies Fund on such committees, Credit Strategies Fund may be deemed to have duties to other creditors represented by the committees, which might thereby expose Credit Strategies Fund to liability to such other creditors who disagree with Credit Strategies Fund's actions. Participation by Credit Strategies Fund on such committees may cause Credit Strategies Fund to be subject to certain restrictions on its ability to trade in a particular investment and may also make Credit Strategies Fund an "insider" or an "underwriter" for purposes of the federal securities laws. Either circumstance will restrict Credit Strategies Fund's ability to trade in or acquire additional positions in a particular investment when it might otherwise desire to do so.

**RISKS OF INVESTING IN HIGH-YIELD SECURITIES.** A portion of Credit Strategies Fund's investments will consist of investments that may generally be characterized as "high-yield securities" or "junk securities." Such securities are typically rated below investment grade by one or more nationally recognized statistical rating organizations or are unrated but of comparable credit quality to obligations rated below investment grade, and have greater credit and liquidity risk than more highly rated obligations. High-yield securities are generally unsecured and may be subordinate to other obligations of the obligor. The lower rating of high-yield securities reflects a greater possibility that adverse changes in the financial condition of the issuer or in general economic conditions (including, for example, a substantial period of rising interest rates or declining earnings) or both may impair the ability of the issuer to make payment of principal and interest. Many issuers of high-yield securities are highly leveraged, and their relatively high debt to equity ratios create increased risks that their operations might not generate sufficient cash flow to service their obligations. Overall declines in the below investment grade bond and other markets may adversely affect such issuers by inhibiting their ability to refinance their obligations at maturity.

High-yield securities are often issued in connection with leveraged acquisitions or recapitalizations in which the issuers incur a substantially higher amount of indebtedness than the level at which they had previously operated. High-yield securities that are debt instruments have historically experienced greater default rates than has been the case for investment grade securities. Credit Strategies Fund may also invest in equity securities issued by entities whose obligations are unrated or are rated below investment grade.

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Credit Strategies Fund is authorized to invest in obligations of issuers which are generally trading at significantly higher yields than had been historically typical of the applicable issuer's obligations. Such investments may include debt obligations that have a heightened probability of being in covenant or payment default in the future. Such investments generally are considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments. Typically such workout or bankruptcy proceedings result in only partial recovery of cash payments or an exchange of the defaulted security

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for other debt or equity securities of the issuer or its affiliates, which may in turn be illiquid or speculative.

High-yield securities purchased by Credit Strategies Fund will be subject to certain additional risks to the extent that such obligations may be unsecured and subordinated to substantial amounts of senior indebtedness, all or a significant portion of which may be secured. Moreover, such obligations purchased by Credit Strategies Fund may not be protected by financial covenants or limitations upon additional indebtedness and are unlikely to be secured by collateral.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN HIGH-YIELD SECURITIES THAN INCOME SHARES. AS SUCH, THE GENERAL RISKS OF INVESTING IN HIGH-YIELD SECURITIES ARE GREATER FOR CREDIT STRATEGIES FUND THAN INCOME SHARES.

INSOLVENCY CONSIDERATIONS WITH RESPECT TO ISSUERS OF DEBT OBLIGATIONS. Various laws enacted for the protection of creditors may apply to the debt obligations held by Credit Strategies Fund. The information in this paragraph is applicable with respect to U.S. issuers subject to United States bankruptcy laws. Insolvency considerations may differ with respect to other issuers. If a court in a lawsuit brought by an unpaid creditor or representative of creditors of an issuer of a debt obligation, such as a trustee in bankruptcy, were to find that the issuer did not receive fair consideration or reasonably equivalent value for incurring the indebtedness constituting the debt obligation and, after giving effect to such indebtedness, the issuer (i) was insolvent, (ii) was engaged in a business for which the remaining assets of such issuer constituted unreasonably small capital or (iii) intended to incur, or believed that it would incur, debts beyond its ability to pay such debts as they mature, such court could determine to invalidate, in whole or in part, such indebtedness as a fraudulent conveyance, to subordinate such indebtedness to existing or future creditors of such issuer, or to recover amounts previously paid by such issuer in satisfaction of such indebtedness. The measure of insolvency for purposes of the foregoing will vary. Generally, an issuer would be considered insolvent at a particular time if the sum of its debts were then greater than all of its property at a fair valuation, or if the present fair saleable value of its assets was then less than the amount that would be required to pay its probable liabilities on its existing debts as they became absolute and matured. There can be no assurance as to what standard a court would apply in order to determine whether the issuer was "insolvent" after giving effect to the incurrence of the indebtedness constituting the debt obligation or that, regardless of the method of valuation, a court would not determine that the issuer was "insolvent" upon giving effect to such incurrence. In addition, in the event of the insolvency of an issuer of a debt obligation, payments made on such debt obligation could be subject to avoidance as a "preference" if made within a certain period of time (which may be as long as one year) before insolvency. Similarly, a court might apply the doctrine of equitable subordination to subordinate the claim of a lending institution against an issuer, to claims of other creditors of the borrower, when the lending institution, another investor, or any of their transferees, is found to have engaged in unfair, inequitable, or fraudulent conduct. In general, if payments on a debt obligation are avoidable, whether as fraudulent conveyances or preferences, such payments can be recaptured either from the initial recipient (such as the Fund) or from subsequent transferees of such payments (such as investors in the Fund). To the extent that any such payments are recaptured from Credit Strategies Fund the resulting loss will be borne by the investors. However, a court in a bankruptcy or insolvency proceeding would be able to direct the recapture of any such payment from such a recipient or transferee only to the extent that such court has jurisdiction over such recipient or transferee or its assets. Moreover, it is likely that avoidable payments could not be recaptured directly from any such recipient or transferee that has given value in exchange for its note, in good faith and without knowledge that the payments were avoidable. Although the Adviser will

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seek to avoid conduct that would form the basis for a successful cause of action based upon fraudulent conveyance, preference or equitable subordination, these determinations are made in hindsight, and, in any event, there can be no assurance as to whether any lending institution or other investor from which Credit Strategies Fund acquired the debt obligations engaged in any such conduct (or any other conduct that would subject the debt obligations and the issuer to insolvency laws) and, if it did, as to whether such creditor claims could be asserted in a U.S. court (or in the courts of any other country) against Credit Strategies Fund.

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**RISKS OF INVESTING IN STRESSED, DISTRESSED OR BANKRUPT COMPANIES.** Credit Strategies Fund may invest in companies that are stressed, in distress, or bankrupt. As such, they are subject to a multitude of legal, industry, market, economic and governmental forces that make analysis of these companies inherently difficult. Further, the Adviser relies on company management, outside experts, market participants and personal experience to analyze potential investments for Credit Strategies Fund. There can be no assurance that any of these sources will prove credible, or that the Adviser's analysis will produce conclusions that lead to profitable investments.

**LEVERAGE RISK.** Credit Strategies Fund has the ability to use leverage through the issuance of preferred shares, borrowings from a credit facility or both. Credit Strategies Fund currently leverages through borrowings from a credit facility and has no present intention of issuing preferred shares. The use of leverage, which can be described as exposure to changes in price at a ratio greater than the amount of equity invested, either through the issuance of preferred shares, borrowings or other forms of market exposure, magnifies both the favorable and unfavorable effects of price movements in the investments made by Credit Strategies Fund. Insofar as Credit Strategies Fund continues to employ leverage in its investment operations, Credit Strategies Fund will be subject to substantial risks of loss.

- o **Credit Facility.** Credit Strategies Fund currently leverages through borrowings from a credit facility. Credit Strategies Fund has entered into a revolving credit agreement with The Bank of Nova Scotia ("Scotia") to borrow up to \$380,000,000 (the "Loan Agreement"). Such borrowings constitute financial leverage. The Loan Agreement contains covenants that limit Credit Strategies Fund's ability to, without the prior consent of Scotia: (i) pay dividends in certain circumstances, (ii) incur additional debt or (iii) adopt or carry out any plan of liquidation, reorganization, incorporation, recapitalization, merger or consolidation or sell, transfer or otherwise dispose of all or a substantial part of its assets. For instance, Credit Strategies Fund agreed not to purchase assets not contemplated by the investment policies and restrictions in effect when the Loan Agreement became effective. Furthermore, Credit Strategies Fund may not incur additional debt from any other party, except for in limited circumstances (E.G., in the ordinary course of business). In addition, the Loan Agreement contains a covenant requiring asset coverage ratios that may be more stringent than those required by the 1940 Act. Such restrictions shall apply only so long as the Loan Agreement remains in effect. Any senior security representing indebtedness, as defined in Section 18(g) of the 1940 Act, must have asset coverage of at least 300%. Debt incurred under the Loan Agreement will be considered a senior security for this purpose.

The Loan Agreement has customary covenant, negative covenant and default provisions. This credit facility with Scotia is not convertible into any other securities of Credit Strategies Fund.

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Outstanding amounts would be payable at maturity or such earlier times as required by the Loan Agreement. Credit Strategies Fund may be required to prepay outstanding amounts under the credit facility or incur a penalty rate of interest in the event of the occurrence of certain events of default. Credit Strategies Fund is expected to indemnify the lenders under the credit facility against certain liabilities they may incur in connection with the credit facility. Credit Strategies Fund is required to pay commitment fees under the terms of any such facility. With the use of borrowings, there is a risk that the interest rates paid by Credit Strategies Fund on the amount it borrows will be higher than the return on Credit Strategies Fund's investments. The credit facility with Scotia may in the future be replaced or refinanced by one or more credit facilities having substantially different terms or by the issuance of preferred shares.

- o Preferred Share Risk. Preferred share risk is the risk associated with the issuance of the preferred shares to leverage the common shares. If preferred shares are issued, the NAV and market value of the common shares will be more volatile, and the yield to the holders of common shares will tend to fluctuate with changes in the shorter-term dividend rates on the preferred shares. If the dividend rate on the preferred shares approaches the net rate of return on Credit Strategies Fund's investment portfolio, the benefit of leverage to the holders of the common shares would be reduced. If the dividend rate on the preferred shares exceeds the net rate of return on Credit Strategies Fund's portfolio, the leverage will result in a lower rate of return to the holders of common shares than if Credit Strategies Fund had not issued preferred shares.

In addition, Credit Strategies Fund will pay (and the holders of common shares will bear) all costs and expenses relating to the issuance and ongoing maintenance of the preferred shares, including higher advisory fees. Accordingly, Credit Strategies Fund cannot

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assure you that the issuance of preferred shares will result in a higher yield or return to the holders of the common shares.

Similarly, any decline in the NAV of Credit Strategies Fund's investments will be borne entirely by the holders of common shares. Therefore, if the market value of Credit Strategies Fund's portfolio declines, the leverage will result in a greater decrease in NAV to the holders of common shares than if Credit Strategies Fund were not leveraged. This greater NAV decrease will also tend to cause a greater decline in the market price for the common shares. Credit Strategies Fund might be in danger of failing to maintain the required asset coverage of the preferred shares or of losing its ratings on the preferred shares or, in an extreme case, Credit Strategies Fund's current investment income might not be sufficient to meet the dividend requirements on the preferred shares. In order to counteract such an event, Credit Strategies Fund might need to liquidate investments in order to fund a redemption of some or all of the preferred shares. Liquidation at times of low prices may result in capital loss and may reduce returns to the holders of common shares.

- o Preferred Shareholders may have disproportionate influence over Credit Strategies Fund. If preferred shares are issued, holders of preferred shares may have differing interests than holders of common shares and holders of preferred shares may at times have disproportionate influence over Credit Strategies Fund's affairs. If preferred shares

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are issued, holders of preferred shares, voting separately as a single class, would have the right to elect two members of the board of trustees at all times. The remaining members of the board of trustees would be elected by holders of common shares and preferred shares, voting as a single class. The 1940 Act also requires that, in addition to any approval by shareholders that might otherwise be required, the approval of the holders of a majority of any outstanding preferred shares, voting separately as a class, would be required to (i) adopt any plan of reorganization that would adversely affect the preferred shares and (ii) take any action requiring a vote of security holders under Section 13(a) of the 1940 Act, including, among other things, changes in Credit Strategies Fund's subclassification as a closed-end investment company or changes in its fundamental investment restrictions.

- o Portfolio Guidelines of Rating Agencies for Preferred Share and/or Credit Facility. In order to obtain and maintain the required ratings of loans from a credit facility, Credit Strategies Fund will be required to comply with investment quality, diversification and other guidelines established by Moody's Investors Service, Inc. ("Moody's") and/or Standard & Poor's Ratings Services ("S&P") or the credit facility, respectively. Such guidelines will likely be more restrictive than the restrictions otherwise applicable to Credit Strategies Fund as described herein. Credit Strategies Fund does not anticipate that such guidelines would have a material adverse effect on Credit Strategies Fund's common shareholders or its ability to achieve its investment objectives. Credit Strategies Fund anticipates that any preferred shares that it issues would be initially given the highest ratings by Moody's ("Aaa") or by S&P ("AAA"), but no assurance can be given that such ratings will be obtained. No minimum rating is required for the issuance of preferred shares by Credit Strategies Fund. Moody's and S&P receive fees in connection with their ratings issuances.

CREDIT STRATEGIES FUND CURRENTLY USES LEVERAGE THROUGH BORROWINGS FROM A CREDIT FACILITY AND EACH ACQUIRED FUND CURRENTLY USES LEVERAGE THROUGH THE ISSUANCE OF PREFERRED SHARES. AS DISCUSSED ABOVE, THE GENERAL RISKS OF LEVERAGE ARE SOMEWHAT DIFFERENT FOR A CREDIT FACILITY AS COMPARED TO PREFERRED SHARES.

COMMON STOCK RISK. Credit Strategies Fund will have exposure to common stocks. Although common stocks have historically generated higher average total returns than fixed income securities over the long-term, common stocks also have experienced significantly more volatility in those returns. Therefore, Credit Strategies Fund's exposure to common stocks could result in worse performance than would be the case had Credit Strategies Fund been invested solely in debt securities. An adverse event, such as an unfavorable earnings report, may depress the value of a particular common stock held by Credit Strategies Fund. Also, the price of common stocks is sensitive to general movements in the stock market and a drop in the stock market may depress the price of common stocks to which Credit Strategies Fund has exposure. Common stock prices fluctuate for several reasons, including changes in investors' perceptions of the financial condition of an issuer or the general condition of the relevant stock market, or when political or economic events affecting the issuers occur. In addition, common stock prices may be particularly sensitive to rising interest rates, as the cost of capital rises and borrowing costs increase.

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CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN COMMON STOCKS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS OF INVESTING IN COMMON STOCKS ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

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**DIVIDEND RISK.** Dividends on common stock are not fixed but are declared at the discretion of an issuer's board of directors. There is no guarantee that the issuers of the common stocks in which Credit Strategies Fund invests will declare dividends in the future or that if declared they will remain at current levels or increase over time.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN COMMON STOCKS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS RELATED TO DIVIDENDS IS GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

**SMALL AND MID-CAP SECURITIES RISK.** Credit Strategies Fund may invest in companies with small or medium capitalizations. Securities issued by smaller and medium companies can be more volatile than, and perform differently from, larger company securities. There may be less trading in a smaller or medium company's securities, which means that buy and sell transactions in those securities could have a larger impact on the security's price than is the case with larger company securities. Smaller and medium companies may have fewer business lines; changes in any one line of business, therefore, may have a greater impact on a smaller or medium company's security price than is the case for a larger company. In addition, smaller or medium company securities may not be well known to the investing public.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN COMMON STOCKS THAN EACH ACQUIRED FUND. AS SUCH, THE GENERAL RISKS OF INVESTING IN SMALL AND MID-CAP SECURITIES ARE GREATER FOR CREDIT STRATEGIES FUND THAN EACH ACQUIRED FUND.

**NON-U.S. SECURITIES RISK.** Credit Strategies Fund may invest up to 20% of its total assets in non-U.S. securities, including emerging market securities. Investing in non-U.S. securities involves certain risks not involved in domestic investments, including, but not limited to: (i) fluctuations in foreign exchange rates; (ii) future foreign economic, financial, political and social developments; (iii) different legal systems; (iv) the possible imposition of exchange controls or other foreign governmental laws or restrictions; (v) lower trading volume; (vi) much greater price volatility and illiquidity of certain non-U.S. securities markets; (vii) different trading and settlement practices; (viii) less governmental supervision; (ix) changes in currency exchange rates; (x) high and volatile rates of inflation; (xi) fluctuating interest rates; (xii) less publicly available information; and (xiii) different accounting, auditing and financial recordkeeping standards and requirements.

Certain countries in which Credit Strategies Fund may invest, especially emerging market countries, historically have experienced, and may continue to experience, high rates of inflation, high interest rates, exchange rate fluctuations, large amounts of external debt, balance of payments and trade difficulties and extreme poverty and unemployment. Many of these countries are also characterized by political uncertainty and instability. These risks are especially evident in the Middle East and West Africa. The cost of servicing external debt will generally be adversely affected by rising international interest rates because many external debt obligations bear interest at rates which are adjusted based upon international interest rates. In addition, with respect to certain foreign countries, there is a risk of: (i) the possibility of expropriation or nationalization of assets; (ii) confiscatory taxation; (iii) difficulty in obtaining or enforcing a court judgment; (iv) economic, political or social instability; and (v) diplomatic developments that could affect investments in those countries.

Because Credit Strategies Fund will invest in securities denominated or quoted in currencies other than the U.S. dollar, changes in foreign currency exchange rates may affect the value of securities in Credit Strategies Fund and the unrealized appreciation or depreciation of investments. Currencies of certain

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countries may be volatile and therefore may affect the value of securities denominated in such currencies, which means that Credit Strategies Fund's NAV or current income could decline as a result of changes in the exchange rates between foreign currencies and the U.S. dollar. Certain investments in non-U.S. securities also may be subject to foreign withholding taxes. These risks often are heightened for investments in smaller, emerging capital markets. In addition, individual foreign economies may differ favorably or unfavorably from the U.S. economy in such respects as: (i) growth of gross domestic product; (ii) rates of inflation; (iii) capital reinvestment; (iv) resources; (v) self-sufficiency; and (vi) balance of payments position.

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As a result of these potential risks, Highland may determine that, notwithstanding otherwise favorable investment criteria, it may not be practicable or appropriate to invest in a particular country. Credit Strategies Fund may invest in countries in which foreign investors, including Highland, have had no or limited prior experience.

THE GENERAL RISKS OF INVESTING IN NON-U.S. SECURITIES ARE GREATER FOR CREDIT STRATEGIES FUND THAN HIGH INCOME PORTFOLIO SINCE HIGH INCOME PORTFOLIO CAN INVEST UP TO 10% OF ITS TOTAL ASSETS IN FOREIGN SECURITIES. THE GENERAL RISKS OF INVESTING IN NON-U.S. SECURITIES DO NOT APPLY TO INCOME SHARES SINCE IT GENERALLY DOES NOT INVEST IN NON-U.S. SECURITIES.

EMERGING MARKETS RISK. Credit Strategies Fund may invest up to 20% of its total assets in securities of issuers based in emerging markets. Investing in securities of issuers based in underdeveloped emerging markets entails all of the risks of investing in securities of non-U.S. issuers to a heightened degree. Emerging market countries generally include every nation in the world except the United States, Canada, Japan, Australia, New Zealand and most countries located in Western Europe. 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 markets 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 Credit Strategies Fund's investment opportunities including restrictions on investing in issuers or industries deemed sensitive to relevant national interests.

THE GENERAL RISKS OF INVESTING IN NON-U.S. SECURITIES ARE GREATER FOR CREDIT STRATEGIES FUND THAN HIGH INCOME PORTFOLIO SINCE HIGH INCOME PORTFOLIO CAN INVEST UP TO 10% OF ITS TOTAL ASSETS IN FOREIGN SECURITIES. THE GENERAL RISKS OF INVESTING IN NON-U.S. SECURITIES DO NOT APPLY TO INCOME SHARES SINCE IT GENERALLY DOES NOT INVEST IN NON-U.S. SECURITIES.

THE GENERAL RISKS OF INVESTING IN EMERGING MARKETS DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN EMERGING MARKETS.

FOREIGN CURRENCY RISK. Because Credit Strategies Fund may invest in securities denominated or quoted in currencies other than the U.S. dollar, changes in foreign currency exchange rates may affect the value of securities owned by Credit Strategies Fund, the unrealized appreciation or depreciation of investments and gains on and income from investments. Currencies of certain countries may be volatile and therefore may affect the value of securities denominated in such currencies, which means that Credit Strategies Fund's NAV could decline as a result of changes in the exchange rates between foreign currencies and the U.S. dollar. These risks often are heightened for investments in smaller, emerging capital markets. In addition, Credit Strategies Fund may enter into foreign currency transactions in an attempt to enhance total return which may further expose Credit Strategies Fund to the risks of foreign currency movements and other risks. The use of foreign currency transactions can result

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in Credit Strategies Fund incurring losses as a result of the imposition of exchange controls, suspension of settlements or the inability of Credit Strategies Fund to deliver or receive a specified currency.

THE GENERAL RISKS RELATED TO FOREIGN CURRENCY IS GREATER FOR CREDIT STRATEGIES FUND THAN HIGH INCOME PORTFOLIO SINCE HIGH INCOME PORTFOLIO CAN INVEST UP TO 10% OF ITS TOTAL ASSETS IN FOREIGN SECURITIES. THE GENERAL RISKS RELATED TO FOREIGN CURRENCY DO NOT APPLY TO INCOME SHARES SINCE IT GENERALLY DOES NOT INVEST IN NON-U.S. SECURITIES.

INVESTMENTS IN UNSEASONED COMPANIES. Credit Strategies Fund may invest in the securities of smaller, less seasoned companies. These investments may present greater opportunities for growth, but also involve greater risks than customarily are associated with investments in securities of more established companies. Some of the companies in which Credit Strategies Fund may invest will be start-up companies which may have insubstantial operational or earnings history or may have limited products, markets, financial resources or management depth. Some may also be emerging companies at the research and development stage with no products or technologies to market or approved for marketing. Securities of emerging companies may lack an active secondary market and may be subject to more abrupt or erratic price movements than securities of larger, more established companies or stock market averages in general. Competitors of certain companies may have substantially greater financial resources than many of the companies in which Credit Strategies Fund may invest.

INITIAL PUBLIC OFFERINGS (IPOS) RISK. Credit Strategies Fund may invest in shares of companies through IPOs. IPOs and companies that have recently gone public have the potential to produce substantial gains for Credit Strategies

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Fund. However, there is no assurance that Credit Strategies Fund will have access to profitable IPOs. The investment performance of Credit Strategies Fund during periods when it is unable to invest significantly or at all in IPOs may be lower than during periods when Credit Strategies Fund is able to do so. Securities issued in IPOs are subject to many of the same risks as investing in companies with smaller market capitalizations. Securities issued in IPOs have no trading history, and information about the companies may be available for limited periods of time. In addition, the prices of securities sold in IPOs may be highly volatile or may decline shortly after the IPO.

SECURITIES LENDING RISK. Credit Strategies Fund may lend its portfolio securities (up to a maximum of one-third of its total assets) to banks or dealers which meet the creditworthiness standards established by the Board. Securities lending is subject to the risk that loaned securities may not be available to Credit Strategies Fund on a timely basis and Credit Strategies Fund may, therefore, lose the opportunity to sell the securities at a desirable price. Any loss in the market price of securities loaned by Credit Strategies Fund that occurs during the term of the loan would be borne by Credit Strategies Fund and would adversely affect Credit Strategies Fund's performance. Also, there may be delays in recovery, or no recovery, of securities loaned or even a loss of rights in the collateral should the borrower of the securities fail financially while the loan is outstanding. Although Credit Strategies Fund generally has the ability to recall loaned securities pursuant to a securities lending arrangement in the event that a shareholder vote is held, there is a risk that any delay in recovery of such security will result in the holder of such security being unable to vote. All of the aforementioned risks may be greater for non-U.S. securities.

RISKS ASSOCIATED WITH OPTIONS ON SECURITIES. There are several risks associated with transactions in options on securities. For example, there are significant



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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 objectives. 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.

As the writer of a covered call option, Credit Strategies Fund foregoes, 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 strike price of the call, but has retained the risk of loss should the price of the underlying security decline. As Credit Strategies Fund writes covered calls over more of its portfolio, its ability to benefit from capital appreciation becomes more limited. 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.

When Credit Strategies Fund writes covered put options, it bears the risk of loss if the value of the underlying stock declines below the exercise price minus the put premium. If the option is exercised, Credit Strategies Fund could incur a loss if it is required to purchase the stock underlying the put option at a price greater than the market price of the stock at the time of exercise plus the put premium Credit Strategies Fund received when it wrote the option. While Credit Strategies Fund's potential gain in writing a covered put option is limited to distributions earned on the liquid assets securing the put option plus the premium received from the purchaser of the put option, Credit Strategies Fund risks a loss equal to the entire exercise price of the option minus the put premium.

THE GENERAL RISKS OF INVESTING IN OPTIONS ON SECURITIES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN OPTIONS ON SECURITIES.

EXCHANGE-LISTED OPTION RISKS. There can be no assurance that a liquid market will exist when Credit Strategies Fund seeks to close out an option position on an options exchange. Reasons for the absence of a liquid secondary market on an exchange include the following: (i) there may be insufficient trading interest in certain options; (ii) restrictions may be imposed by an exchange on opening transactions or closing transactions or both; (iii) trading halts, suspensions or other restrictions may be imposed with respect to particular classes or series of options; (iv) unusual or unforeseen circumstances may interrupt normal operations on an exchange; (v) the facilities of an exchange or the Options Clearing Corporation may not at all times be adequate to handle current trading volume; or (vi) one or more exchanges could, for economic or other reasons, decide or be compelled at some future date to discontinue the trading of options (or a particular class or series of options). If trading were discontinued, the secondary market on that exchange (or in that class or series of options) would cease to exist. However, outstanding options on that exchange that had been issued by the Options Clearing Corporation as a result of trades on that

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exchange would continue to be exercisable in accordance with their terms. If Credit Strategies 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.

The hours of trading for options on an exchange may not conform to the hours during which the underlying securities are traded. To the extent that the options markets close before the markets for the underlying securities,

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significant price and rate movements can take place in the underlying markets that cannot be reflected in the options markets. Call options are marked to market daily and their value will be affected by changes in the value and dividend rates of the underlying common stocks, an increase in interest rates, changes in the actual or perceived volatility of the stock market and the underlying common stocks and the remaining time to the options' expiration. Additionally, the exercise price of an option may be adjusted downward before the option's expiration as a result of the occurrence of certain corporate events affecting the underlying equity security, such as extraordinary dividends, stock splits, merger or other extraordinary distributions or events. A reduction in the exercise price of an option would reduce Credit Strategies Fund's capital appreciation potential on the underlying security.

THE GENERAL RISKS OF INVESTING IN EXCHANGE-LISTED OPTIONS DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN EXCHANGE-LISTED OPTIONS.

OVER-THE-COUNTER OPTION RISK. Credit Strategies Fund may write (sell) unlisted ("OTC" or "over-the-counter") options, and options written by Credit Strategies Fund with respect to non-U.S. securities, indices or sectors generally will be OTC options. OTC options differ from exchange-listed options in that they are two-party contracts, with exercise price, premium and other terms negotiated between buyer and seller, and generally do not have as much market liquidity as exchange-listed options. The counterparties to these transactions typically will be major international banks, broker-dealers and financial institutions. Credit Strategies Fund may be required to treat as illiquid those securities being used to cover certain written OTC options. The OTC options written by Credit Strategies Fund will not be issued, guaranteed or cleared by the Options Clearing Corporation. In addition, Credit Strategies Fund's ability to terminate the OTC options may be more limited than with exchange-traded options. Banks, broker-dealers or other financial institutions participating in such transaction may fail to settle a transaction in accordance with the terms of the option as written. In the event of default or insolvency of the counterparty, Credit Strategies Fund may be unable to liquidate an OTC option position.

THE GENERAL RISKS OF INVESTING IN OVER-THE-COUNTER OPTIONS DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN OVER-THE-COUNTER OPTIONS.

INDEX OPTION RISK. Credit Strategies Fund may sell index put and call options from time to time. The purchaser of an index put option has the right to any depreciation in the value of the index below the exercise price of the option on or before the expiration date. The purchaser of an index call option has the right to any appreciation in the value of the index over the exercise price of the option on or before the expiration date. Because the exercise of an index option is settled in cash, sellers of index call options, such as Credit Strategies Fund, cannot provide in advance for their potential settlement obligations by acquiring and holding the underlying securities. Credit Strategies Fund will lose money if it is required to pay the purchaser of an index option the difference between the cash value of the index on which the option was written and the exercise price and such difference is greater than the premium received by Credit Strategies Fund for writing the option. The value of index options written by Credit Strategies Fund, which will be priced daily, will be affected by changes in the value and dividend rates of the underlying common stocks in the respective index, changes in the actual or perceived volatility of the stock market and the remaining time to the options' expiration. The value of the index options also may be adversely affected if the market for the index options becomes less liquid or smaller. Distributions paid by Credit Strategies Fund on its common shares may be derived in part from the net index option premiums it receives from selling index put and call options, less the cost of paying settlement amounts to purchasers of the options that exercise their options. Net index option premiums can vary widely over the short term and long term.

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THE GENERAL RISKS OF INVESTING IN INDEX OPTIONS DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN INDEX OPTIONS.

INTEREST RATE RISK. Interest rate risk is the risk that debt securities, and Credit Strategies Fund's net assets, may decline in value because of changes in interest rates. Generally, debt securities will decrease in value when interest rates rise and increase in value when interest rates decline. This means that

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the NAV of the common shares will fluctuate with interest rate changes and the corresponding changes in the value of Credit Strategies Fund's debt security holdings.

PREPAYMENT RISK. If interest rates fall, the principal on bonds held by Credit Strategies Fund may be paid earlier than expected. If this happens, the proceeds from a prepaid security may be reinvested by Credit Strategies Fund in securities bearing lower interest rates, resulting in a possible decline in Credit Strategies Fund's income and distributions to shareholders. Credit Strategies Fund may invest in pools of mortgages or other assets issued or guaranteed by private issuers or U.S. government agencies and instrumentalities. Mortgage-related securities are especially sensitive to prepayment risk because borrowers often refinance their mortgages when interest rates drop.

ASSET-BACKED SECURITIES RISK. Payment of interest and repayment of principal on asset-backed securities may be largely dependent upon the cash flows generated by the assets backing the securities and, in certain cases, supported by letters of credit, surety bonds or other credit enhancements. Asset-backed security values may also be affected by the creditworthiness of the servicing agent for the pool, the originator of the loans or receivables or the entities providing the credit enhancement. In addition, the underlying assets are subject to prepayments that shorten the securities' weighted average maturity and may lower their return.

THE GENERAL RISKS OF INVESTING IN ASSET-BACKED SECURITIES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN ASSET-BACKED SECURITIES.

MORTGAGE-BACKED SECURITIES RISK. A mortgage-backed security, which represents an interest in a pool of assets such as mortgage loans, will mature when all the mortgages in the pool mature or are prepaid. Therefore, mortgage-backed securities do not have a fixed maturity, and their expected maturities may vary when interest rates rise or fall.

When interest rates fall, homeowners are more likely to prepay their mortgage loans. An increased rate of prepayments on Credit Strategies Fund's mortgage-backed securities will result in an unforeseen loss of interest income to Credit Strategies Fund as Credit Strategies Fund may be required to reinvest assets at a lower interest rate. Because prepayments increase when interest rates fall, the price of mortgage-backed securities does not increase as much as other fixed income securities when interest rates fall.

When interest rates rise, homeowners are less likely to prepay their mortgage loans. A decreased rate of prepayments lengthens the expected maturity of a mortgage-backed security. Therefore, the prices of mortgage-backed securities may decrease more than prices of other fixed income securities when interest rates rise.

Timely payment of interest and principal of mortgage backed securities may be supported by various forms of private insurance or guarantees, including individual loan, title, pool and hazard insurance purchased by the issuer. There can be no assurance that the private insurers can meet their obligations under

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the policies. An unexpectedly high rate of defaults on the mortgages held by a mortgage pool may adversely affect the value of a mortgage-backed security and could result in losses to Credit Strategies Fund. The risk of such defaults is generally higher in the case of mortgage pools that include sub-prime mortgages. Sub-prime mortgages refer to loans made to borrowers with weakened credit histories or with a lower capacity to make timely payments on their mortgages.

THE GENERAL RISKS OF INVESTING IN MORTGAGE-BACKED SECURITIES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN MORTGAGE-BACKED SECURITIES.

NON-INVESTMENT GRADE SECURITIES RISK. There is no limit on the amount of Credit Strategies Fund's portfolio that may be invested in below investment grade securities. Non-investment grade securities are commonly referred to as "junk securities." Investments in lower grade securities will expose Credit Strategies Fund to greater risks than if Credit Strategies Fund owned only higher grade debt securities. Because of the substantial risks associated with lower grade securities, you could lose money on your investment in common shares of Credit Strategies Fund, both in the short-term and the long-term. Lower grade securities, though high yielding, are characterized by high risk. They may be subject to certain risks with respect to the issuing entity and to greater market fluctuations than certain lower yielding, higher rated securities. The retail secondary market for lower grade debt securities may be less liquid than

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that of higher rated debt securities. Adverse conditions could make it difficult at times for Credit Strategies Fund to sell certain securities or could result in lower prices than those used in calculating Credit Strategies Fund's NAV.

CREDIT STRATEGIES FUND CAN INVEST A GREATER PERCENTAGE OF ITS ASSETS IN NON-INVESTMENT GRADE SECURITIES THAN INCOME SHARES. AS SUCH, THE GENERAL RISKS OF INVESTING IN NON-INVESTMENT GRADE SECURITIES ARE GREATER FOR CREDIT STRATEGIES FUND THAN INCOME SHARES.

DERIVATIVES RISK. Derivative transactions in which Credit Strategies Fund may engage for hedging and speculative purposes or to enhance total return, including engaging in transactions such as options, futures, swaps, foreign currency transactions including forward foreign currency contracts, currency swaps or options on currency and currency futures and other derivatives transactions ("Derivative Transactions"), also involve certain risks and special considerations. Derivatives allow an investor to hedge or speculate upon the price movements of a particular security, financial benchmark currency or index at a fraction of the cost of investing in the underlying asset. The value of a derivative depends largely upon price movements in the underlying asset. Therefore, many of the risks applicable to trading the underlying asset are also applicable to derivatives of such asset. However, there are a number of other risks associated with derivatives trading, including the imperfect correlation between the value of such instruments and the underlying assets, the possible default of the other party to the transaction or illiquidity of the derivative instruments. Furthermore, the ability to successfully use Derivative Transactions depends on the Adviser's ability to predict pertinent market movements, which cannot be assured. Because many derivatives are "leveraged," and thus provide significantly more market exposure than the money paid or deposited when the transaction is entered into, a relatively small adverse market movement can not only result in the loss of the entire investment, but may also expose the Credit Strategies Fund to the possibility of a loss exceeding the original amount invested. The use of Derivative Transactions may result in losses greater than if they had not been used, may require Credit Strategies Fund to sell or purchase portfolio securities at inopportune times or for prices other than current market values, may limit the amount of

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appreciation Credit Strategies Fund can realize on an investment or may cause Credit Strategies Fund to hold a security that it might otherwise sell. The use of foreign currency transactions can result in Credit Strategies Fund's incurring losses as a result of the imposition of exchange controls, suspension of settlements or the inability of Credit Strategies Fund to deliver or receive a specified currency. Additionally, amounts paid by Credit Strategies Fund as premiums and cash or other assets held in margin accounts with respect to Derivative Transactions are not otherwise available to Credit Strategies Fund for investment purposes.

To the extent that Credit Strategies Fund purchases options pursuant to a hedging strategy, Credit Strategies Fund will be subject to the following additional risks. If a put or call option purchased by Credit Strategies 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), Credit Strategies 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. If restrictions on exercise were imposed, Credit Strategies Fund might be unable to exercise an option it had purchased. If Credit Strategies 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.

THE GENERAL RISKS OF INVESTING IN DERIVATIVES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN DERIVATIVES.

MARKET RISK GENERALLY. The profitability of a significant portion of Credit Strategies Fund's investment program depends to a great extent upon correctly assessing the future course of the price movements of securities and other investments and the movements of interest rates. There can be no assurance that the Adviser will be able to predict accurately these price and interest rate movements. With respect to certain investment strategies Credit Strategies Fund utilizes, there is a high degree of market risk.

REINVESTMENT RISK. Credit Strategies Fund reinvests the cash flows received from a security. The additional income from such reinvestment, sometimes called interest-on-interest, is dependent on the prevailing interest rate levels at the time of reinvestment. There is a risk that the interest rate at which interim cash flows can be reinvested will fall. Reinvestment risk is greater for longer

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holding periods and for securities with large, early cash flows such as high-coupon bonds. Reinvestment risk also applies generally to the reinvestment of the proceeds Credit Strategies Fund receives upon the maturity or sale of a portfolio security.

TIMING RISK. Many agency, corporate and municipal bonds, and most mortgage-backed securities, contain a provision that allows the issuer to "call" all or part of the issue before the bond's maturity date, often after 5 or 10 years. The issuer usually retains the right to refinance the bond in the future if market interest rates decline below the coupon rate. There are three disadvantages to the call provision. First, the cash flow pattern of a callable bond is not known with certainty. Second, because an issuer is more likely to call the bonds when interest rates have dropped, Credit Strategies Fund is exposed to reinvestment risk, i.e., Credit Strategies Fund may have to reinvest at lower interest rates the proceeds received when the bond is called. Finally,

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the capital appreciation potential of a bond will be reduced because the price of a callable bond may not rise much above the price at which the issuer may call the bond.

**INFLATION RISK.** Inflation risk results from the variation in the value of cash flows from a security due to inflation, as measured in terms of purchasing power. For example, if Credit Strategies Fund purchases a bond in which it can realize a coupon rate of 5%, but the rate of inflation increases from 2% to 6%, then the purchasing power of the cash flow has declined. For all but adjustable bonds or floating rate bonds, Credit Strategies Fund is exposed to inflation risk because the interest rate the issuer promises to make is fixed for the life of the security. To the extent that interest rates reflect the expected inflation rate, floating rate bonds have a lower level of inflation risk. In addition, during any periods of rising inflation, dividend rates of any variable rate preferred shares issued by the Fund would likely increase, which would tend to further reduce returns to common shareholders.

**ARBITRAGE RISKS.** Credit Strategies Fund may engage in capital structure arbitrage and other arbitrage strategies. Arbitrage strategies entail various risks including the risk that external events, regulatory approvals and other factors will impact the consummation of announced corporate events and/or the prices of certain positions. In addition, hedging is an important feature of capital structure arbitrage. There is no guarantee that the Adviser will be able to hedge Credit Strategies Fund's portfolio in the manner necessary to employ successfully Credit Strategies Fund's strategy.

THE GENERAL RISKS OF USING ARBITRAGE STRATEGIES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT USE ARBITRAGE STRATEGIES.

**SHORT SALES RISK.** Short sales by Credit Strategies Fund that are not made "against the box" theoretically involve unlimited loss potential since the market price of securities sold short may increase without limit. Short selling involves selling securities which may or may not be owned and borrowing the same securities for delivery to the purchaser, with an obligation to replace the borrowed securities at a later date. Short selling allows Credit Strategies Fund to profit from declines in market prices to the extent such decline exceeds the transaction costs and the costs of borrowing the securities. However, since the borrowed securities must be replaced by purchases at market prices in order to close out the short position, any appreciation in the price of the borrowed securities would result in a loss. There can be no assurance that the securities necessary to cover a short position will be available for purchase. Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss. Credit Strategies Fund may mitigate such losses by replacing the securities sold short before the market price has increased significantly. Under adverse market conditions, Credit Strategies Fund might have difficulty purchasing securities to meet its short sale delivery obligations, and might have to sell portfolio securities to raise the capital necessary to meet its short sale obligations at a time when fundamental investment considerations would not favor such sales.

THE GENERAL RISKS OF USING SHORT SALES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT USE SHORT SALES.

**RISKS OF INVESTING IN STRUCTURED FINANCE SECURITIES.** A portion of Credit Strategies Fund's investments may consist of equipment trust certificates, collateralized mortgage obligations, collateralized bond obligations, collateralized loan obligations or similar instruments. Structured finance securities may present risks similar to those of the other types of debt obligations in which Credit Strategies Fund may invest and, in fact, such risks may be of greater significance in the case of structured finance securities. Moreover, investing in structured finance securities may entail a variety of

unique risks. Among other risks, structured finance securities may be subject to prepayment risk. In addition, the performance of a structured finance security will be affected by a variety of factors, including its priority in the capital structure of the issuer thereof, the availability of any credit enhancement, the level and timing of payments and recoveries on and the characteristics of the underlying receivables, loans or other assets that are being securitized, remoteness of those assets from the originator or transferor, the adequacy of and ability to realize upon any related collateral and the capability of the servicer of the securitized assets. In addition, the complex structure of the security may not be fully understood at the time of investment and may produce unexpected investment results. Investments in structured finance securities may also be subject to illiquidity risk. Collateralized mortgage obligations may have risks similar to those of mortgage-backed securities. See "Mortgage-Backed Securities Risk" for more information.

RISKS OF INVESTING IN PREFERRED SECURITIES. There are special risks associated with investing in preferred securities, including:

- o Deferral. Preferred securities may include provisions that permit the issuer, at its discretion, to defer distributions for a stated period without any adverse consequences to the issuer. If Credit Strategies Fund owns a preferred security that is deferring its distributions, Credit Strategies Fund may be required to report income for tax purposes although it has not yet received such income.
- o Subordination. Preferred securities are subordinated to bonds and other debt instruments in a company's capital structure in terms of priority to corporate income and liquidation payments, and therefore will be subject to greater credit risk than more senior debt instruments.
- o Liquidity. Preferred securities may be substantially less liquid than many other securities, such as common stocks or U.S. government securities.
- o Limited Voting Rights. Generally, preferred security holders have no voting rights with respect to the issuing company unless preferred dividends have been in arrears for a specified number of periods, at which time the preferred security holders may elect a number of trustees to the issuer's board. Generally, once all the arrearages have been paid, the preferred security holders no longer have voting rights.

THE GENERAL RISKS OF INVESTING IN PREFERRED SECURITIES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN PREFERRED SECURITIES.

RISKS OF INVESTING IN SYNTHETIC SECURITIES. In addition to credit risks associated with holding non-investment grade loans and high-yield debt securities, with respect to synthetic securities Credit Strategies Fund will usually have a contractual relationship only with the counterparty of such synthetic securities, and not the Reference Obligor (as defined below) on the Reference Obligation (as defined below). Credit Strategies Fund generally will have no right to directly enforce compliance by the Reference Obligor with the terms of the Reference Obligation or any rights of set-off against the Reference Obligor, nor have any voting rights with respect to the Reference Obligation. Credit Strategies Fund will not benefit directly from any collateral supporting the Reference Obligation or have the benefit of the remedies on default that would normally be available to a holder of such Reference Obligation. In addition, in the event of insolvency of its counterparty, Credit Strategies Fund will be treated as a general creditor of such counterparty and will not have any claim with respect to the credit risk of the counterparty as well as that of the

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Reference Obligor. As a result, a large amount of synthetic securities with any one counterparty subjects the holders of such synthetic securities to an additional degree of risk with respect to defaults by such counterparty as well as by the Reference Obligor. The Adviser may not perform independent credit analyses of the counterparties, any such counterparty, or an entity guaranteeing such counterparty, individually or in the aggregate. A "Reference Obligation" is the debt security or other obligation upon which the synthetic security is based. A "Reference Obligor" is the obligor on a Reference Obligation. There is no maximum amount of Credit Strategies Fund's assets that may be invested in these securities.

THE GENERAL RISKS OF INVESTING IN SYNTHETIC SECURITIES DO NOT APPLY TO EACH ACQUIRED FUND SINCE THEY GENERALLY DO NOT INVEST IN SYNTHETIC SECURITIES.

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VALUATION RISK. Fair value is defined as the amount for which assets could be sold in an orderly disposition over a reasonable period of time, taking into account the nature of the asset. Fair value pricing, however, involves judgments that are inherently subjective and inexact, since fair valuation procedures are used only when it is not possible to be sure what value should be attributed to a particular asset or when an event will affect the market price of an asset and to what extent. As a result, there can be no assurance that fair value pricing will reflect actual market value and it is possible that the fair value determined for a security will be materially different from the value that actually could be or is realized upon the sale of that asset.

MARKET DISRUPTION AND GEOPOLITICAL RISK. The aftermath of the war in Iraq and the continuing occupation of Iraq, instability in the Middle East and terrorist attacks in the United States and around the world may have resulted in market volatility and may have long-term effects on the U.S. and worldwide financial markets and may cause further economic uncertainties in the United States and worldwide. Terrorism in the U.S. and around the world has had a similar global impact and has increased geopolitical risk. The Adviser does not know how long the securities markets will continue to be affected by these events and cannot predict the effects of the occupation or similar events in the future on the U.S. economy and securities markets. Given the risks described above, an investment in the common shares of Credit Strategies Fund may not be appropriate for all investors. You should carefully consider your ability to assume these risks before making an investment in Credit Strategies Fund.

RISKS OF INVESTING IN A FUND WITH ANTI-TAKEOVER PROVISIONS. Credit Strategies Fund's Agreement and Declaration of Trust includes provisions that could limit the ability of other entities or persons to acquire control of Credit Strategies Fund or convert Credit Strategies Fund to open-end status. These provisions could deprive the holders of common shares of opportunities to sell their common shares at a premium over the then current market price of the common shares or at NAV.

KEY ADVISER PERSONNEL RISK. Credit Strategies Fund's ability to identify and invest in attractive opportunities is dependent upon Highland, its investment adviser. If one or more key individuals leave Highland, Highland may not be able to hire qualified replacements or may require an extended time to do so. This situation could prevent Credit Strategies Fund from achieving its investment objectives.

### PROPOSAL 1(A) AND 1(B): REORGANIZATIONS OF THE ACQUIRED FUNDS

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The Reorganizations seek to combine two smaller funds (High Income Portfolio and



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Income Shares) into one larger fund (Credit Strategies Fund) to achieve certain economies of scale and other operational efficiencies. Each Acquired Fund is registered as a diversified, closed-end management investment company under the 1940 Act. The Acquiring Fund is registered as a non-diversified, closed-end management investment company under the 1940 Act. Highland is the investment adviser to each Fund.

The investment objective of each Acquired Fund is similar to that of Credit Strategies Fund, although each Fund seeks to achieve its objective in different ways. High Income Portfolio seeks to provide high current income, while seeking to preserve shareholders' capital. Income Shares seeks to provide a high level of current income, with capital appreciation as a secondary objective. Credit Strategies Fund seeks to provide both current income and capital appreciation and therefore has a greater focus on capital appreciation.

High Income Portfolio invests at least 65% of its total assets in high-yield, fixed-income securities rated in the lower categories (Ba/BB or lower) by a rating agency or nonrated fixed-income securities deemed by the Adviser to be of comparable quality. High Income Portfolio typically invests a substantially higher percentage of its assets in such securities.

Income Shares invests at least 50% of its total assets in debt securities rated in the four highest categories (Baa/BBB or higher) by a rating agency or nonrated debt securities deemed by the Adviser to be of comparable quality.

Credit Strategies Fund invests at least 80% of its assets in the following categories of securities and instruments of corporations and other business entities: (i) secured and unsecured floating and fixed rate loans; (ii) bonds and other debt obligations; (iii) debt obligations of stressed, distressed and bankrupt issuers; (iv) structured products, including but not limited to, mortgage-backed and other asset-backed securities and collateralized debt obligations; and (v) equities. A significant portion of Credit Strategies Fund's

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assets may be invested in securities rated below investment grade (Ba/BB or lower), which are commonly referred to as "junk securities" or "high-yield securities."

The investment policies of each Fund are different, particularly with respect to investments in senior loans. Credit Strategies Fund invests more heavily in senior loans than either Acquired Fund. Income Shares invests a greater proportion of its assets in investment grade securities than Credit Strategies Fund. Credit Strategies Fund also has the ability to invest in certain types of securities in which the Acquired Funds may not invest. Please see the charts below comparing each Acquired Fund's investment objectives and policies to that of Credit Strategies Fund for more information.

### DESCRIPTION OF THE REORGANIZATIONS

You are being asked to approve an Agreement and Plan of Reorganization to which your Fund is a party, a form of which is attached to this Proxy Statement/Prospectus as Appendix A (each, an "Agreement"). Additional information about each Reorganization and Agreement is set forth below under "Further Information on the Reorganizations." The Agreements provide for Reorganizations on the following terms:

- o Pursuant to each Reorganization, the Acquiring Fund will acquire all of the assets and assume all of the liabilities of the participating Acquired Fund. This will result in the addition of each Acquired Fund's assets to the Acquiring Fund's portfolio. The NAV of each Fund

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will be the most recently calculated NAV prior to the closing of its Reorganization.

- o The Acquiring Fund will issue and cause to be listed on the NYSE newly issued Acquiring Fund Common Shares (and cash in lieu of certain fractional shares) in an amount equal to the value of each Acquired Fund's net assets attributable to its common shares (taking into account the Acquired Fund's proportionate share of the costs of the Reorganizations). Those shares will be distributed to common shareholders of record of each Acquired Fund in proportion to their holdings of that Acquired Fund's shares immediately prior to the Reorganization. Acquired Fund common shareholders will receive cash for any Acquiring Fund fractional shares they otherwise would be entitled to receive other than with respect to shares held in a Dividend Reinvestment Plan account. As a result, common shareholders of each Acquired Fund will end up as common shareholders of the Acquiring Fund.
  
- o After the Reorganization, the participating Acquired Fund will then (1) de-register with the SEC, (2) de-list from the NYSE, and (3) dissolve under Maryland corporate law.

In addition, prior to a Reorganization, preferred shareholders of an Acquired Fund will receive the liquidation preference associated with their preferred shares plus any accumulated and unpaid dividends. A Reorganization will not be completed unless, before the final shareholder vote thereon, the participating Acquired Fund commences, and irrevocably commits to complete as expeditiously as possible, the process for redeeming its preferred shares.

The distribution of Acquiring Fund Common Shares pursuant to the Reorganization of an Acquired Fund will be accomplished by opening new accounts on the books of the Acquiring Fund in the names of that Acquired Fund's common shareholders of record as of the closing date of the Reorganization and transferring the Acquiring Fund Common Shares to those accounts. Each such account for a former common shareholder of an Acquired Fund will be credited with the PRO RATA number of Acquiring Fund Common Shares (rounded down, in the case of fractional shares held other than in a Dividend Reinvestment Plan account, to the next largest number of whole shares) due such shareholder. If fractional Acquiring Fund Common Shares otherwise would have been credited to an account, the Acquiring Fund will issue cash for such fractional shares (except for shares held in a Dividend Reinvestment Plan account). See "Further Information on the Reorganizations -- Additional Terms of the Agreement and Plan of Reorganization" below for a description of the procedures to be followed by the Acquired Funds' shareholders to obtain Acquiring Fund Common Shares (and cash in lieu of fractional shares, if any).

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### REASONS FOR THE PROPOSED REORGANIZATIONS

The Boards of the Funds considered the Reorganizations over several meetings held on September 7, 2007, November 6, 2007, December 14, 2007 and February 20, 2008. At the meeting held on February 20, 2008, the Board of each Fund, including the Trustees/Directors who are not "interested persons" (as defined in the 1940 Act) of each Fund, unanimously approved the Agreement(s) to which its Fund is a participant.

The Board of each Acquired Fund has determined that participation in the applicable Reorganization is in the best interests of the Fund and that the interests of its shareholders will not be diluted as a result of that

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Reorganization. Similarly, the Acquiring Fund's Board has determined that participation in each Reorganization is in the best interests of its common shareholders and that the interests of such shareholders will not be diluted as a result of each Reorganization. Preferred shareholders of the Acquired Funds will not participate in the Reorganizations. As noted above, the preferred shares will be redeemed prior to each Reorganization. In addition, as a result of the Reorganizations, shareholders of each Fund, particularly the shareholders of the Acquired Funds, will have a smaller percentage of ownership in the larger combined Fund than they did in any of the separate Funds.

The Board of each Fund believes that reorganizing each Acquired Fund into the Acquiring Fund, a fund with a similar investment objective, and having a combined portfolio with greater assets, offers you potential benefits. The Board considered the following matters, among others, in approving the proposals:

- o EXCHANGE OF COMMON SHARES AT NAV. On its closing date, a Reorganization will result in the Acquired Fund shareholders receiving shares of the Acquiring Fund and cash (in lieu of certain fractional shares) based on the Acquired Fund's NAV (I.E., the Acquired Fund will get its NAV's worth of common shares of the Acquiring Fund and cash (in lieu of certain fractional shares)). It should be noted, however, that shares of the Acquiring Fund received in a Reorganization will likely trade at a market discount from NAV following the Reorganization, so that an Acquired Fund common shareholder may not be able to sell these shares for their NAV. It should also be noted that since inception shares of the Acquiring Fund generally have traded at a smaller discount or wider premium from NAV than shares of either Acquired Fund. However, since late December until the Board approved the Reorganization in February 2008, Acquiring Fund shares have frequently traded at a larger discount from NAV than shares of either Acquired Fund. The Acquiring Fund commenced a rights offering in late December and completed the rights offering on January 28, 2008. Historically, rights offerings have increased the discount from NAV for a fund.
- o INCREASED USE OF CAPITAL LOSSES. Each Acquired Fund has sustained substantial capital losses in recent years, which are available as CLCs in the current and future taxable years (through their respective taxable years ending in 2013), but is not expected to be able to generate enough capital gains to be offset by those CLCs before they expire. SEE "Further Information on the Reorganizations - Federal Income Tax Consequences of the Reorganizations." Because of its larger size and investment policies and strategies, the Acquiring Fund is expected to be better able to use those CLCs to offset post-Reorganization gains of the combined Fund, although there can be no assurance that this will be the case. The Acquiring Fund's use of such CLCs, however, will be significantly limited due to the application of loss limitation rules under the federal tax law.
- o ENHANCED COMMON SHARE LIQUIDITY. Following the Reorganizations, the substantially larger trading market in the common shares of the Acquiring Fund, as compared to that of each Acquired Fund prior to the Reorganizations, may provide Acquired Fund shareholders with enhanced market liquidity. Trading discounts can result from many different factors, however, and there is no assurance that a larger trading market for Acquiring Fund's common shares will have the effect of reducing or maintaining trading discounts.
- o INCREASED ASSET SIZE. The Acquiring Fund will obtain additional assets without incurring the commission expenses and generally greater other expenses associated with offering new shares. In addition, the Acquiring Fund is obtaining the additional portfolio securities of the

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Acquired Funds without the commensurate brokerage costs, dealer spreads or other trading expenses. It is also obtaining these

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securities in a manner that is likely to minimize the market impact of such acquisition on the short-term prices of these securities. However, the increase in Acquiring Fund shares as a result of the Reorganization(s) may also cause Acquiring Fund shares to trade at a larger discount from NAV.

- o ECONOMIES OF SCALE IN CERTAIN EXPENSES. A combined Fund offers economies of scale that may lead to a reduction in certain expenses. With these reduced expenses and the contractual fee waivers offered by Highland, which is described below, the annual operating expenses of the combined Fund may be lower than the current annual operating expenses of Income Shares, although they are expected to be higher than High Income Portfolio's current annual operating expenses. In addition, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than either Acquired Fund's current annual operating expenses. Each Fund incurs NYSE listing fees, costs for legal, auditing, and custodial services, and miscellaneous fees. Many of these expenses overlap and there may be an opportunity to reduce them over time if the Funds are combined. However, it is not expected that these economies of scale will be substantial.
- o PORTFOLIO MANAGEMENT EFFICIENCIES. Each Reorganization would permit Acquired Fund shareholders to pursue similar investment goals in a larger Fund. The greater asset size of the combined Fund may allow it, relative to each Acquired Fund, to obtain better net prices on securities trades and achieve greater diversification of portfolio holdings.
- o SHAREHOLDERS' ABILITY TO MARGIN. Currently, stocks that trade below \$5.00 are not marginable. The Reorganization would permit shareholders of High Income Portfolio and Income Shares (if their shares continue to trade below \$5.00) to receive shares that they could margin. Additionally, marginable securities may be more liquid than those that are not marginable as many institutional/large investors are believed to avoid stocks that are not marginable.

Each Board also considered that if shareholders approve a Reorganization, Highland would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years so that Highland would receive no additional benefit from the Reorganization for two years. The waivers are intended to offset the additional revenue Highland would receive on each Acquired Fund's assets (calculated as of the date of its Reorganization and including the value of its preferred shares that historically have been outstanding) due to the difference between the advisory fee rates of each Acquired Fund and Credit Strategies Fund and the fact that the Acquired Funds do not pay an administration fee to Highland. However, even with the contractual fee waivers, the annual operating expenses of the combined Fund are expected to be higher than High Income Portfolio's current annual operating expenses and, after the waivers expire, the annual operating expenses of the combined Fund are expected to be higher than either Acquired Fund's current annual operating expenses. As of each Fund's last fiscal year, the total annual operating expenses, as a percentage of average net assets, of High Income Portfolio, Income Shares and Credit Strategies Fund were 3.34%, 3.99% and 4.06%, respectively. Assuming each Reorganization is approved, the estimated total

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annual operating expenses of the combined Fund would be 4.03% of average net assets and, with the contractual fee waivers described above, the estimated net annual operating expenses of the combined Fund would be 3.88% of average net assets.

The Boards of each Fund also considered that the Adviser would benefit from the Reorganizations. For example, the Adviser may achieve cost savings due to the Acquiring Fund's lower fixed costs, which may result in reduced costs resulting from a consolidated portfolio management effort. The Boards believe, however, that these savings will not amount to a significant economic benefit to the Adviser.

### COMPARATIVE FEES AND EXPENSE RATIOS

The Acquiring Fund's PRO FORMA annual operating expenses, which reflect the contractual fee waivers offered by Highland and the proceeds of a rights offering completed by the Acquiring Fund on January 28, 2008, may be lower than the current annual operating expenses of Income Shares, although they are expected to be higher than High Income Portfolio's annual operating expenses. In addition, a combined Fund offers economies of scale that may lead to a reduction in certain expenses. The Acquiring Fund's higher expenses are due, in part, to its leveraging by borrowing pursuant to a credit facility rather than by issuing preferred shares. While the use of a credit facility has been more expensive, it provides the Acquiring Fund greater flexibility to change the amount of its leverage depending on market conditions. Over time, this flexibility may enable the Acquiring Fund to achieve greater performance, although there is no guarantee or assurance as to the future performance of Credit Strategies Fund.

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Credit Strategies Fund's 1-year performance as of December 31, 2007 on a net asset value basis is better than Income Shares and its overall historical premium/discount profile is better than that of each Acquired Fund. However, more recently, Acquiring Fund Common Shares have traded at a larger discount from NAV than shares of either Acquired Fund. The Acquiring Fund also completed a rights offering on January 28, 2008. There is no guarantee or assurance as to the future performance, liquidity or premium/discount profile of Credit Strategies Fund.

A full comparison of advisory fee rates and expense ratios is included below.

### COMPARATIVE PERFORMANCE

The Boards also considered details of the relative performance of each Acquired Fund and the Acquiring Fund.

### BOARD'S EVALUATION AND RECOMMENDATION

For the reasons described herein, the Board of each Acquired Fund, including the Directors who are not "interested persons" (as defined in the 1940 Act) of that Fund, the Acquiring Fund or the Adviser, approved the Reorganization in which that Acquired Fund would participate. In particular, the Directors determined that participation in the Reorganization involving that Fund is in its best interests and that the interests of its shareholders would not be diluted as a result of the Reorganization. Similarly, the Board of the Acquiring Fund, including the Trustees who are not "interested persons" (as defined in the 1940 Act) of any Fund or the Adviser, approved each Reorganization. They also determined that participation in each Reorganization is in the Acquiring Fund's best interests and that the interests of its shareholders would not be diluted as a result of each Reorganization.

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### REQUIRED VOTE

With respect to the applicable Acquired Fund, approval of the proposal requires the vote of: (1) the holders of at least a majority of the common and preferred shares entitled to vote, voting as a single class; and (2) the holders of at least a majority of the preferred shares entitled to vote, voting as a separate class.

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THE DIRECTORS OF EACH ACQUIRED FUND UNANIMOUSLY RECOMMEND  
THAT SHAREHOLDERS VOTE FOR THE RESPECTIVE PROPOSAL TO APPROVE  
THE AGREEMENT AND PLAN OF REORGANIZATION.  
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### PROPOSAL 2(A) AND 2(B): ELECTION OF DIRECTORS OF EACH ACQUIRED FUND

Shareholders of each Acquired Fund are also being asked to vote on the election of directors as discussed below. Electing directors at this Meeting would avoid the expense of holding two shareholder meetings within a short period of time.

#### PROPOSAL 2(A) - ELECTION OF DIRECTORS: HIGH INCOME PORTFOLIO ONLY

At the Meeting, High Income Portfolio's common shareholders are being asked to elect Scott F. Kavanaugh as a Class II Director of High Income Portfolio, and High Income Portfolio's preferred shareholders are being asked to elect Timothy K. Hui as a Class II Director of High Income Portfolio, each to serve for a three-year term until the 2011 annual meeting of shareholders and until his successor is duly elected and qualified. Messrs. Kavanaugh and Hui are currently serving as Class II Directors of High Income Portfolio, and each has agreed to continue to serve as a Class II Director, if elected. If either Mr. Kavanaugh or Mr. Hui is not available for election at the time of the Meeting, the persons named as proxies will vote for such substitute nominee as the Nominating Committee may select.

High Income Portfolio's Board is divided into three classes with the term of office of one class expiring each year. Class I is comprised of one Director, and Classes II and III are each comprised of two Directors. R. Joseph Dougherty is currently the Class I Director and was elected to serve a three-year term at High Income Portfolio's annual meeting of shareholders held on May 25, 2007. Messrs. Hui and Kavanaugh are Class II Directors and will continue to serve as Class II Directors if elected at the Meeting. James F. Leary and Bryan A. Ward are currently Class III Directors and were each elected to serve a three-year term at High Income Portfolio's annual meeting of shareholders held on May 19, 2006.

#### PROPOSAL 2(B) - ELECTION OF DIRECTORS: INCOME SHARES ONLY

At the Meeting, Income Shares' common shareholders and preferred shareholders are being asked to elect R. Joseph Dougherty as a Class I Director of Income Shares, to serve for a three-year term until the 2011 annual meeting of shareholders and until his successor is duly elected and qualified. Mr. Dougherty is currently serving as a Class I Director of Income Shares and has agreed to continue to serve as a Class I Director, if elected. If Mr. Dougherty is not available for election at the time of the Meeting, the persons named as proxies will vote for such substitute nominee as the Board may select.

Income Shares' Board is divided into three classes with the term of office of one class expiring each year. Class I is comprised of one Director, and Classes

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II and III are each comprised of two Directors. Mr. Dougherty is currently the Class I Director and will continue to serve as the Class I Director if elected at the Meeting. Messrs. Hui and Kavanaugh are currently serving as Class II Directors and were elected to serve a three-year term at Income Shares' annual meeting of shareholders held on May 19, 2006. Messrs. Leary and Ward are currently serving as Class III Directors and were elected to serve a three-year term at Income Shares' annual meeting of shareholders held on May 25, 2007.

### VOTING FOR DIRECTORS

#### HIGH INCOME PORTFOLIO AND INCOME SHARES

The shareholders of any outstanding preferred shares, as a separate class, have the right to elect two Directors; the shareholders of the common shares, as a separate class, have the right to elect two Directors; and the holders of the preferred shares and the common shares, voting together as a single class, have the right to elect the remaining Director of each of High Income Portfolio or Income Shares. High Income Portfolio's Nominating Committee has designated Scott F. Kavanaugh as the Class II Director to be elected by the common shareholders and Timothy K. Hui as the Class II Director to be elected by the preferred shareholders. Income Shares' Board has designated R. Joseph Dougherty as the Class II Director to be elected by the common shareholders and preferred shareholders.

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In addition, during any period in which High Income Portfolio or Income Shares has not paid dividends on the preferred shares in an amount equal to two full years of dividends ("Voting Period"), the preferred shareholders, voting as a separate class, are entitled to elect (in addition to the two Directors set forth above) the smallest number of additional Directors as is necessary to assure that a majority of the Directors has been elected by the preferred shareholders. If High Income Portfolio or Income Shares has not so paid dividends, the terms of office of all persons who are Directors of High Income Portfolio or Income Shares at the time of the commencement of a Voting Period will continue, notwithstanding the election by the preferred shareholders of the number of Directors that such shareholders are entitled to elect. The additional Directors elected by the preferred shareholders, together with the incumbent Directors, will constitute the duly elected Directors of High Income Portfolio or Income Shares. When all dividends in arrears on the Preferred Shares have been paid or provided for, the terms of office of the additional Directors elected by the preferred shareholders will terminate.

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#### INFORMATION ABOUT NOMINEES FOR DIRECTOR AND CONTINUING DIRECTORS

Set forth below is the name and certain biographical and other information for each nominee for each Director, as reported to each of High Income Portfolio and Income Shares by each such person:

NAME (AGE)	POSITION(S) HELD WITH THE FUNDS, LENGTH OF TIME SERVED AND TERM	PRINCIPAL OCCUPATION(S)	NUMBER OF PORTFOLIOS IN THE HIGHLAND FUND COMPLEX (2) OVERSEEN BY	OTHER
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ADDRESS (1)	OF OFFICE	DURING THE PAST FIVE YEARS	DIRECTOR	DIRECTORS
CLASS I - CONTINUING DIRECTOR FOR HIGH INCOME PORTFOLIO AND NOMINEE FOR INCOME SHARES (INTERESTED DIRECTOR (4))				
R. JOSEPH DOUGHERTY (37) (High Income Portfolio and Income Shares preferred shares and common shares designee)	Director and Chairman of the Board of High Income Portfolio since May 2004 (with a term expiring at the 2010 annual meeting) and Senior Vice President of High Income Portfolio since January 2000; Director and Chairman of the Board of Income Shares since May 2004 and Senior Vice President of Income Shares since July 2001, current Income Shares Nominee for a term to expire at the 2011 annual meeting.	Senior Portfolio Manager of the Adviser since 2000; Director/Trustee, Chairman of the Board and Senior Vice President of the funds in the Highland Fund Complex.	12	No
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CLASS II -NOMINEES FOR HIGH INCOME PORTFOLIO, CONTINUING DIRECTORS FOR INCOME SHARES (NON-INTERESTED DIRECTORS (3))				
TIMOTHY K. HUI (59) (High Income Portfolio and Income Shares preferred shares designee)	Director of High Income Portfolio since January 2000, current High Income Portfolio Nominee for a term to expire at the 2011 annual meeting; Director of Income Shares since July 2001 (with a term expiring at the 2009 annual meeting).	Vice President since February 2008, Dean of Educational Resources from July 2006 to January 2008; Assistant Provost for Graduate Education, July 2004 to June 2006; and Assistant Provost for Educational Resources, July 2001 to June 2004, Philadelphia Biblical University.	12	Non
SCOTT F. KAVANAUGH (47) (High Income Portfolio and	Director of High Income Portfolio since January 2000, current High Income Portfolio	Vice-Chairman, President and Chief Operating Officer, Keller Financial Group since September	12	Non



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Income Shares common shares designee)	Nominee for a term to expire at the 2011 annual meeting; Director of Income Shares since July 2001 (with a term expiring at the 2009 annual meeting).	2007; Chairman and Chief Executive Officer, First Foundation Bank since September 2007; Private Investor since February 2004; Sales Representative at Round Hill Securities, March 2003 to January 2004; Executive at Provident Funding Mortgage Corporation, February 2003 to July 2003; Executive Vice President, Director and CAO, Commercial Capital Bank, January 2000 to February 2003; Managing Principal and Chief Operating Officer, Financial Institutional Partners Mortgage Company and the Managing Principal and President of Financial Institutional Partners, LLC (an investment banking firm), April 1998 to February 2003.
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CLASS III - CONTINUING DIRECTORS FOR HIGH INCOME PORTFOLIO AND INCOME  
(NON-INTERESTED DIRECTORS (3))

JAMES F. LEARY (78) (High Income Portfolio and Income Shares common shares designee)	Director of High Income Portfolio since January 2000 (with a term expiring at the 2009 annual meeting); Director of Income Shares since July 2001 (with a term expiring at the 2010 annual meeting).	Managing Director, Benefit Capital Southwest, Inc. (a financial consulting firm) since January 1999.	12	Board Mem Capstone Funds (7 portfo
BRYAN A. WARD (53) (High Income Portfolio and Income Shares preferred shares designee)	Director of High Income Portfolio since November 2001 (with a term expiring at the 2009 annual meeting); Director of Income Shares since November 2001 (with a term	Senior Manager, Accenture, LLP (a consulting firm) since January 2002.	12	None

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expiring at the 2010  
annual meeting).

- (1) The address of each Director is 13455 Noel Road, Suite 800, Dallas, Texas 75240.
- (2) The "Highland Fund Complex" consists of all of the registered investment companies and the one business development company that are advised by the Adviser as of the date of this combined proxy statement.
- (3) "Non-Interested" Directors are those who are not "interested persons" of High Income Portfolio or Income Shares as described under Section 2(a)(19) of the 1940 Act.
- (4) Mr. Dougherty is deemed to be an "interested person" of High Income Portfolio and Income Shares under the 1940 Act because of his position with the Adviser. Each Director other than Mr. Dougherty is a "Non-Interested" Director.

In addition to Mr. Dougherty, the other executive officers of High Income Portfolio and Income Shares are James D. Dondero, Mark K. Okada, M. Jason Blackburn and Michael Colvin. Set forth below are the names and certain biographical and other information for Messrs. Dondero, Okada, Blackburn and Colvin as reported by them to High Income Portfolio and Income Shares. Such officers serve at the pleasure of the Directors or until their successors have been duly elected and qualified. The Directors may fill any vacancy in office or add any additional officers at any time.

NAME (AGE) ADDRESS*	POSITION(S), LENGTH OF TIME SERVED AND TERM OF OFFICE	PRINCIPAL OCCUPATION(S) DURING THE PAST FIVE YEARS
JAMES D. DONDERO (45)	President of High Income Portfolio since January 2000 and Income Shares since July 2001.	President and Director of Strand Advisors, Inc. ("Strand"), the General Partner of the Adviser; Chairman of the Board of Directors of Highland Financial Partners, L.P.; a President of the funds in the Highland Fund Complex.

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MARK K. OKADA (46)	Executive Vice President of High Income Portfolio since January 2000 and Income Shares since July 2001.	Executive Vice President of Strand; Chief Investment Officer of the Adviser; and Executive Vice President of the funds in the Highland Fund Complex.
R. JOSEPH DOUGHERTY (37)	Senior Vice President of High Income Portfolio since January 2000 and Income Shares since July 2001.	Executive Vice President of Strand; Chief Investment Officer of the Adviser; and Executive Vice President of the funds in the Highland Fund Complex.
M. JASON BLACKBURN (32)	Secretary and Treasurer of High Income Portfolio and Income Shares since March 2003.	Assistant Controller of the Adviser since November 2001 and Secretary and Treasurer of the funds in the Highland Fund Complex.
MICHAEL COLVIN (38)	Chief Compliance Officer of High Income Portfolio and Income Shares since July 2007.	General Counsel and Chief Compliance Officer of the Adviser since June 2007 and Chief Compliance Officer of the funds in the Highland Fund Complex since July 2007; Shareholder in the Corporate and Securities Group at Greenberg Traurig, LLP, January 2007 to June 2007; and Partner (from January 2003 to January 2007) and Associate (from 1995 to 2002) in the Private Equity Practice Group at Weil, Gotshal & Manges, LLP

### OWNERSHIP OF SHARES

Please see Appendix C to the Proxy Statement/Prospectus for information regarding the holdings of each Director in High Income Portfolio and Income Shares and for information regarding the persons who owned of record or beneficially 5% or more of the outstanding common shares or preferred shares of High Income Portfolio and Income Shares.

### BOARD MEETINGS AND COMMITTEE MEETINGS

During the fiscal year ended October 31, 2007 for High Income Portfolio and December 31, 2007 for Income Shares, the Directors of High Income Portfolio and Income Shares, identified in the table set forth in "Remuneration of Directors and Executive Officers" below, convened 10 and 12 times, respectively. During those specified fiscal years for High Income Portfolio and Income Shares, each Director attended at least 75% of the aggregate of all meetings of the Board and Committees on which he serves. Although High Income Portfolio and Income Shares do not have a formal policy regarding Directors' attendance at annual meetings of shareholders, one of the five Directors attended last year's annual meetings of shareholders.

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The Board of High Income Portfolio and Income Shares each has four committees; the Audit Committee, the Nominating Committee, the Litigation Committee and the Qualified Legal Compliance Committee, each of which is currently comprised of all of the Board members who are not "interested persons" of High Income Portfolio and Income Shares, as defined in the 1940 Act (the "Non-Interested Directors"), who are also "independent" as defined by the NYSE.

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THE AUDIT COMMITTEE. Pursuant to each Audit Committee Charter adopted by High Income Portfolio's and Income Shares' Board, the function of the Audit Committee of each of High Income Portfolio and Income Shares is to (1) oversee the Fund's accounting and financial reporting processes and the audits of the Fund's financial statements and (2) assist in Board oversight of the integrity of the Fund's financial statements, the Fund's compliance with legal and regulatory requirements, the independent auditors' qualifications, independence and performance. In addition, each Audit Committee may address questions arising with respect to the valuation of certain securities in the Fund's portfolio. The Audit Committees of High Income Portfolio and Income Shares each met three times in fiscal year 2007. The report of the Audit Committee of each of High Income Portfolio and Income Shares is included in Appendix D. A copy of the Audit Committee Charter of each of High Income Portfolio and Income Shares is available at [www.highlandfunds.com](http://www.highlandfunds.com). The members of each Audit Committee are Messrs. Hui, Kavanaugh, Leary, and Ward, and the Board of High Income Portfolio and Income Shares each has determined that Mr. Leary is an "audit committee financial expert," for purposes of the federal securities laws.

THE NOMINATING COMMITTEE. Each Nominating Committee of High Income Portfolio and Income Shares is responsible for selecting the Non-Interested Director nominees and recommending to the Board candidates for all other Director nominees for election by shareholders or appointment by the Board. A copy of the Nominating Committee Charter of each of High Income Portfolio and Income Shares is available at [www.highlandfunds.com](http://www.highlandfunds.com). Each Nominating Committee Charter describes the factors considered by the Nominating Committee in selecting nominees. In evaluating potential nominees, including any nominees recommended by shareholders, each Nominating Committee takes into consideration factors listed in the Nominating Committee Charter, including character and integrity, business and professional experience, whether the Nominating Committee believes the person has time availability in light of other commitments and the existence of any other relationships that might give rise to a conflict of interest.

Each Nominating Committee will consider recommendations for nominees from shareholders submitted to the Secretary of High Income Portfolio and Income Shares, Two Galleria Tower, Suite 800, 13455 Noel Road, Dallas, Texas 75240. Such shareholder recommendations must include information regarding the recommended nominee as specified in each Nominating Committee Charter. The Nominating Committees of High Income Portfolio and Income Shares each met once during fiscal year 2007. The members of each Nominating Committee are Messrs. Hui, Kavanaugh, Leary, and Ward.

High Income Portfolio and Income Shares have not received any recommendation from shareholders requesting consideration of a candidate for inclusion among the Directors' slate of nominees in this Proxy Statement/Prospectus.

THE LITIGATION COMMITTEE. High Income Portfolio and Income Shares each have established a Litigation Committee to seek to address any potential conflicts of interest between it and the Adviser in connection with any potential or existing litigation or other legal proceeding relating to securities held by both it and the Adviser or another client of the Adviser. The Litigation Committee met four times in fiscal year 2007 for High Income Portfolio and did not meet in fiscal

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year 2007 for Income Shares. The members of the Litigation Committees are Messrs. Hui, Kavanaugh, Leary and Ward.

THE QUALIFIED LEGAL COMPLIANCE COMMITTEE. The members of each Audit Committee of High Income Portfolio and Income Shares shall serve as the respective Qualified Legal Compliance Committee (the "QLCC") for High Income Portfolio and Income Shares for the purpose of establishing alternative reporting procedures for Fund counsel and Non-Interested Director Counsel to report evidence of material violations of the federal or state securities laws by High Income Portfolio and Income Shares or their officers, and to address the confidential receipt, retention and consideration of any reported evidence. The QLCC of each of High Income Portfolio and Income Shares each did not meet in fiscal year 2007.

High Income Portfolio and Income Shares do not have Compensation Committees.

### REMUNERATION OF DIRECTORS AND EXECUTIVE OFFICERS

The executive officers of High Income Portfolio and Income Shares and the Interested Directors receive no direct remuneration from High Income Portfolio and Income Shares. Currently, Non-Interested Directors of High Income Portfolio

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and Income Shares receive an annual fee of \$150,000 payable in quarterly installments in arrears and allocated among each portfolio in the Highland Fund Complex based on relative net assets. Prior to January 1, 2008, the Non-Interested Directors of High Income Portfolio and Income Shares were compensated at the rate of \$15,000 annually and \$5,000 annually, respectively, for serving as a Director, and also received compensation from the other portfolios in the Highland Fund Complex. Non-Interested Directors are also reimbursed for actual out-of-pocket expenses relating to attendance at meetings. The Directors do not have any pension or retirement plan.

The following tables summarize the compensation paid by High Income Portfolio and Income Shares to its Directors and the aggregate compensation paid by the Highland Fund Complex to the Directors.

NAME OF BOARD MEMBER -----	AGGREGATE COMPENSATION FROM HIGH INCOME PORTFOLIO FOR THE FISCAL YEAR ENDED OCTOBER 31, 2007 -----	AGGREGATE COMPENSATION FROM INCOME SHARES FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007 ----	AGGREGATE COMPENSATION FROM HIGHLAND FUND COMPLEX FOR THE CALENDAR YEAR ENDED DECEMBER 31, 2007 ----
INTERESTED DIRECTOR			
R. Joseph Dougherty.....	\$0	\$0	\$0
NON-INTERESTED DIRECTORS			
Timothy K. Hui.....	\$15,000	\$5,000	\$122,722
Scott F. Kavanaugh.....	\$15,000	\$5,000	\$122,722
James F. Leary.....	\$15,000	\$5,000	\$122,722
Bryan A. Ward.....	\$15,000	\$5,000	\$122,722

### SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

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Section 16(a) of the 1934 Act and Section 30(h) of the 1940 Act, and the rules thereunder, require that each Fund's Directors and officers, the Adviser, certain persons affiliated with the Adviser, and persons who own beneficially, directly or indirectly, more than 10% of each Fund's common shares, file reports of ownership and changes of ownership with the Securities and Exchange Commission ("SEC") and the NYSE. Directors, officers, the Adviser, certain affiliates of the Adviser and greater than 10% beneficial owners are required by SEC regulations to furnish to the applicable Fund copies of all Section 16(a) forms they file with respect to shares of the Fund. Based solely upon High Income Portfolio's and Income Shares' reviews of the copies of such forms they receive and written representations from such persons, High Income Portfolio and Income Shares believe that during the fiscal years ended October 31, 2007 for High Income Portfolio and December 31, 2007 for Income Shares, these persons complied with all such applicable filing requirements.

### SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Information regarding the selection of Deloitte & Touche LLP ("D&T") as High Income Portfolio's and Income Shares' independent registered public accounting firm for the fiscal year ending October 31, 2008 for High Income Portfolio and December 31, 2008 for Income Shares as well as the fees paid to D&T are found in Appendix D.

### REQUIRED VOTE

APPROVAL OF PROPOSAL 2(A) (HIGH INCOME PORTFOLIO). The election of Mr. Kavanaugh (Class II Director of High Income Portfolio) requires the affirmative vote of a majority of the common shares of High Income Portfolio, represented in person or by proxy at the Meeting and entitled to vote. The election of Mr. Hui (Class II Director of High Income Portfolio) requires the affirmative vote of a majority of the preferred shares of High Income Portfolio, represented in person or by proxy at the Meeting and entitled to vote.

APPROVAL OF PROPOSAL 2(B) (INCOME SHARES). The election of Mr. Dougherty (Class I Director of Income Shares) requires the affirmative vote of a majority of the outstanding common shares and preferred shares of Income Shares, voting together as a single class.

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THE DIRECTORS OF EACH ACQUIRED FUND, INCLUDING ALL OF THE  
NON-INTERESTED DIRECTORS, UNANIMOUSLY RECOMMEND THAT  
SHAREHOLDERS VOTE FOR THE PROPOSED NOMINEES FOR DIRECTOR.

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### ADDITIONAL INFORMATION RELATED TO THE REORGANIZATIONS OF THE ACQUIRED FUNDS COMPARISON OF THE FUNDS: INVESTMENT OBJECTIVES AND POLICIES

The following tables compare the investment objectives and policies of High Income Portfolio and Income Shares to Credit Strategies Fund and summarize the types of investments that each may engage in. For a more complete description of the types of investments, please refer to Appendix B.

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### COMPARISON OF HIGH INCOME PORTFOLIO TO CREDIT STRATEGIES FUND

	HIGH INCOME PORTFOLIO	CREDIT STRATEGIES FUND
Business	The Fund is a diversified, closed-end management investment company organized as a Maryland corporation.	The Fund is a non-diversified management investment company organized as a Delaware statutory corporation.
Net Assets (January 31, 2008)	\$89.6 million	\$721.3 million (this includes the offering of common shares in the Fund on January 28, 2008)
Listing (Common Shares)	NYSE under the ticker symbol "PHY"	NYSE under the ticker symbol "HCF"
Rating of Preferred Shares	Aaa/AAA	Not applicable
Fiscal Year End	10/31	12/31
Investment Adviser	Highland Capital Management, L.P.	Highland Capital Management, L.P.
Portfolio Managers	Brad Borud R. Joseph Dougherty	Mark Okada Kurtis Plumer Brad Borud
Investment Objective(s)	The Fund's investment objective is to provide high current income, while seeking to preserve shareholders' capital, through investment in a professionally managed, diversified portfolio of high-yield, high risk securities (commonly referred to as "junk" bonds or securities).	The Fund's investment objective is to provide high current income and capital appreciation through investment in both current income and growth securities.
Primary Investment Strategies	Under normal market conditions, the Fund invests at least 65% of its total assets in high-yield, fixed-income securities rated in the lower categories ("Ba"/"BB" or lower) by a nationally recognized rating agency or nonrated fixed-income securities deemed by the Adviser to be of comparable quality to the rated debt securities in which the Fund may invest. The Fund typically invests and currently intends to continue to invest a substantially higher percentage of its assets in such securities to the extent the Adviser believes market conditions favor such investments.  The Fund reserves the right, under normal market conditions, to invest up to 35% of its total assets in money market instruments and fixed income securities	The Fund pursues its objective by investing primarily in the following categories of securities: (i) securities of corporations and other entities; (ii) secured and floating rate debt securities; (iii) floating and fixed rate debt securities and other debt obligations of stressed issuers; (iv) distressed debt securities, including but not limited to mortgage-backed and other structured securities and collateralized debt obligations; and (v) equity securities. Additionally, within the categories of securities listed above, Highland may employ various investment strategies, including but not limited to arbitrage, pair trades, and other strategies. The Fund may also invest in these categories of securities.

	HIGH INCOME PORTFOLIO	CREDIT STRATEGIES FUND
	<p>rated higher than "Ba"/"BB" or the unrated equivalent as determined by the Adviser, although the percentage invested in such securities may increase under other than normal market conditions.</p> <p>Under current Moody's and S&amp;P guidelines relating to the receipt of ratings on the preferred shares, the Fund is limited in its use of certain types of securities in which it may otherwise invest, and certain strategies in which the Fund may otherwise engage, pursuant to the investment policies and strategies stated below. Such instruments consist of, among others: securities that are not readily marketable; private placements (other than Rule 144A securities); and securities not within the diversification guidelines of Moody's or S&amp;P. Accordingly, although the Fund reserves the right to invest in such securities and to engage in such strategies to the extent described in the Prospectus and this SAI, it is anticipated that they will not ordinarily constitute in total more than 20% of the Fund's total assets.</p> <p>The Fund seeks to achieve its objective of preserving shareholders' capital through careful selection of the Fund's high-yield, high risk investments, portfolio diversification, and portfolio monitoring and repositioning.</p>	<p>securities through the</p> <p>Highland will seek to a appreciation objective (iii) and (v) obligation lesser extent, in category obligations.</p> <p>Under normal market conditions the Fund's assets will of these principal investments only to this general goal broad discretion to all among these investment allocations as conditions has full discretion regarding from which it can access in accordance with the forth in this prospectus the Fund's assets may be rated below investment commonly referred to as</p>
Leverage and Borrowing	The Fund employs leverage through the issuance of preferred shares and, as of January 31, 2008, the Fund had 1,600 preferred shares outstanding with a liquidation preference of \$40 million.	The Fund employs leverage through a credit facility. As of January 31, 2008, the Fund had borrowed \$100 million.
Diversification	The Fund is a diversified investment company.	The Fund is a non-diversified investment company.
Concentration	The Fund may not invest 25% or more of its assets in the securities of issuers in one industry.	The Fund may not invest more than 25% of its assets in the securities of any one issuer.
Illiquid Securities	The Fund may invest up to 30% of its total assets in securities that are not readily marketable.	There is no limit on the amount of illiquid securities in the Fund's portfolio that can be invested.



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Portfolio Turnover	The Fund's portfolio turnover rate may exceed 100% per year.	The Adviser anticipates experience high portfolio
Senior Loans, Unsecured Loans, Second Lien Loans and Other Secured Loans	The Fund may invest up to 10% of its total assets in senior loans, unsecured loans, second lien loans and other secured loans.	There is no limit on the portfolio that can be included including bank loans, unsecured loans and other securities
Investment Grade Securities	The Fund may invest up to 35% of its total assets in investment grade securities, however, the Fund generally does not invest in investment grade securities.	There is no limit on the portfolio that can be included in securities, however, a portion of the Fund's assets may be included in securities below investment grade, referred to as "junk securities"

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	HIGH INCOME PORTFOLIO	CREDIT STRATEGIES FUND
Non-Investment Grade Securities	The Fund invests at least 65% of its total assets in high-yield, fixed-income securities rated in the lower categories ("Ba"/"BB" or lower) by a nationally recognized rating agency or nonrated fixed-income securities deemed by the Adviser to be of comparable quality to the rated debt securities in which the Fund may invest.	There is no limit on the portfolio that can be included in securities and a portion of the Fund's assets may be included in securities below investment grade, referred to as "junk securities"
Asset-Backed Securities and Mortgaged-Backed Securities	The Fund generally does not invest in asset-backed securities and mortgage-backed securities.	The Fund may invest in asset-backed securities and mortgage-backed securities
Collateralized Loan Obligations and Bond Obligations	The Fund may invest in collateralized loan obligations and bond obligations.	The Fund may invest in collateralized loan obligations and bond obligations. The Fund may invest in the lower tier of collateralized loan obligations.
Distressed Debt and Stressed Debt	The Fund may invest in the securities and other obligations of stressed, distressed and bankrupt issuers.	The Fund may invest in the securities and other obligations of stressed, distressed and bankrupt issuers, including debt securities with covenant or payment default risk
Equity Securities	The Fund may invest up to 20% of its total assets in equity securities, including common stocks, certain preferred stocks and depositary receipts, as well as warrants to purchase equity or other securities.	There is no limit on the portfolio that can be included in securities, including common stock, convertible securities, depositary receipts.
Money Market Instruments and U.S. Government Securities	The Fund may invest in money market instruments and U.S. government securities.	The Fund may invest in money market instruments and U.S. government securities.

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Other Investment Companies	The Fund generally does not invest in the securities of other investment companies.	The Fund may invest in investment companies (i funds ("ETFs")) to the investments are consist investment objectives a strategies and permissi Act.
Zero-Coupon Securities and Deferred Payment Obligations	The Fund may invest up to 20% of its total assets in zero coupon securities, including step-up bonds.	The Fund may invest in deferred payment obliga on the amount of the Fu invested in these secur
Derivatives	The Fund may use derivatives and other transactions and generally only uses options, financial futures and options on financial futures. The Fund has a policy to limit to 20% of the Fund's total assets the portion of the Fund's assets that may be subject to such transactions or invested in such instruments.	The Fund may purchase a instruments such as exc counter put and call op financial futures, equi interest rate indices, instruments, purchase a contracts and options t interest rate transacti or collars and enter in transactions such as cu

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	HIGH INCOME PORTFOLIO	CREDIT STRATEGIES FUND
		currency futures contra on currency or currency and credit default swap derivative instruments instruments. Apart from derivatives are not a s investments. However, t amount of its total ass derivative instruments.
Senior Loan Based Derivatives	The Fund generally does not invest in senior loan based derivatives.	The Fund may obtain exp loans and baskets of se the use of derivative i
Swaps	The Fund generally does not invest in swaps.	The Fund may invest in credit default swaps, i swaps, total return swa swaps. The Fund may us management purposes and investment.
Credit Linked Notes	The Fund generally does not invest in credit linked notes ("CLNs").	The Fund may invest in management purposes and portfolio. A CLN is a d instrument.
Options	The Fund may write (sell) call options	The Fund may purchase a

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	which are traded on national securities exchanges with respect to securities in its portfolio. The Fund may only write "covered" call options. However, the Fund generally does not use options.	options on securities a
Futures Contracts and Options on Futures Contracts	The Fund does not trade in futures contracts or related options on futures contracts. However, the Fund may do so, subject to the approval of the Board of Directors, for hedging purposes.	The Fund may enter into purchase or sale for fu contracts") of securiti or indices or prices th and U.S. government deb the above. The Fund wi transactions only for b and other portfolio man
Foreign Currency and Forward Foreign Currency Contracts	The Fund may buy or sell foreign currencies or deal in forward foreign currency contracts for hedging purposes.	The Fund may enter into transactions in an atte The Fund may enter into contracts to purchase o a fixed amount of U.S. currency.
Short Sales	The Fund may only sell a security short if it owns at least an equal amount of the security sold short or another security convertible or exchangeable for an equal amount of the security sold short without payment of further compensation (a short sale against-the-box).	The Fund may engage in box and not against the requirements of the 194 Fund will not make a sh effect to such sale, th securities sold short b the value of its total short sales against the limitations.
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	HIGH INCOME PORTFOLIO	CREDIT STRATEGIES FUND
Repurchase Agreements	The Fund may enter into repurchase agreements with respect to up to 25% of the value of its total assets. However, the Fund generally does not enter into repurchase agreements.	The Fund may invest up assets in repurchase ag
Reverse Repurchase Agreements	The Fund may enter into reverse repurchase agreements up to 5% of the value of its total assets. However, the Fund generally does not enter into reverse repurchase agreements.	The Fund may enter into agreements. Reverse rep be considered borrowing be subject to any restr
Inverse Floaters	The Fund generally does not invest in inverse floaters.	The Fund may invest in
Pay-in-kind Bonds	The Fund may invest in pay-in-kind ("PIK") bonds.	The Fund may invest in
When-Issued, Delayed-Delivery	The Fund may purchase securities on a when-issued or delayed-delivery basis.	The Fund may purchase s issued basis and may pu

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and Forward Commitment Purchases	The Fund does not purchase or sell securities on a "forward commitment" basis.	on a "forward commitment"
Securities Loans	The Fund may lend up to 33 1/3% of its assets.	The Fund may lend up to
Foreign Securities	The Fund may invest up to 10% of the value of its total assets in securities principally traded in foreign markets and Eurodollar certificates of deposit issued by branches of U.S. and foreign banks. The Fund will use currency transactions only for hedging and not speculation.	The Fund may invest up to 10% of the value of its total assets in non-U.S. credit or securities
Temporary Defensive Position	Under certain market conditions, the Fund may adopt a temporary defensive position to invest its assets in cash or cash equivalents.	Under certain market conditions, the Fund may adopt a temporary defensive position to invest its assets in cash or cash equivalents.

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COMPARISON OF INCOME SHARES TO CREDIT STRATEGIES FUND

	INCOME SHARES	CREDIT STRATEGIES FUND
Business	The Fund is a diversified, closed-end management investment company organized as a Maryland corporation.	The Fund is a non-diversified management investment company organized as a Delaware statutory trust
Net Assets (January 31, 2008)	\$57.4 million	\$721.3 million (this includes the offering of common shares in the Fund on January 28, 2008)
Listing (Common Shares)	NYSE under the ticker symbol "CNN"	NYSE under the ticker symbol "HCCF"
Rating of Preferred Shares	Aaa/AAA	Not applicable
Fiscal Year End	12/31	12/31
Investment Adviser	Highland Capital Management, L.P.	Highland Capital Management, L.P.
Portfolio Managers	Brad Borud R. Joseph Dougherty	Mark Okada Kurtis Plumer Brad Borud
Investment Objective(s)	The Fund's primary investment objective is to provide a high level of current income, with capital appreciation as a secondary objective.	The Fund's investment objective is to provide both current income and capital appreciation
Primary Investment	The Fund's policy is to invest at least 80% of its assets in	The Fund pursues its investment objective

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Strategies

50% of its total assets in debt securities rated in the four highest categories ("Baa"/"BBB" or higher) assigned by a nationally recognized rating agency, or other securities such as United States and Canadian government securities, obligations of or guaranteed by banks, commercial paper and cash equivalents, or nonrated debt securities deemed by the Adviser to be of comparable quality to the rated debt securities in which the Fund may invest. Securities rated "Baa" or "BBB" possess speculative characteristics. The Fund also may invest in other securities, including debt securities rated below the four highest rating categories, including the lowest rating category, which is reserved for securities in default and are commonly referred to as "junk bonds."

The Fund may invest up to 25% of the value of its total assets in other debt securities and securities which may be convertible into or exchangeable for, or carry warrants to purchase, common stock or other interests not included in the description above and preferred stock and common stock.

The Fund will invest at least 80% of the value of its total assets in income producing securities. The Fund will not

primarily in the following and instruments of corporate business entities: (i) floating and fixed rate debt obligations; (iii) distressed and bankrupt products, including but not limited to backed and other asset collateralized debt obligations.

Additionally, within the limits and securities in which the Fund invests, Highland may employ various strategies including but not limited to arbitrage, pair trades, and may also invest in these categories of securities through the use of

Highland will seek to achieve an appreciation objective in (iii) and (v) obligations to a lesser extent, in categories of obligations.

Under normal market conditions, the Fund's assets will be invested in only to this general guideline, with broad discretion to allocate among these investment allocations as conditions change. The Adviser has full discretion regarding which it can access investments.

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	INCOME SHARES	CREDIT STRATEGIES FUND
	invest more than 25% of the value of its total assets in restricted securities, which are securities acquired in private placement transactions.	accordance with the investment guidelines in this prospectus. A significant portion of the Fund's assets may be invested in securities below investment grade, including, but not limited to, as "junk securities."
Leverage and Borrowing	The Fund employs leverage through the issuance of preferred shares and, as of January 31, 2008, the Fund had 1,200 preferred shares outstanding with a liquidation preference of \$30 million.	The Fund employs leverage through a credit facility. As of January 31, 2008, the Fund had borrowed \$100 million.
Diversification	The Fund is a diversified investment company.	The Fund is a non-diversified investment company.
Concentration	The Fund may not invest 25% or more of	The Fund may not invest

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its assets in the securities of issuers in one industry except that at times when a significant portion of the market for corporate debt securities is composed of issues in the electric utility industry or the telephone utility industry, as the case may be, the Fund may invest up to 35% of its assets in the issues of such industry subject to certain conditions.

assets in the securities

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Illiquid Securities	The Fund will not invest more than 25% of the value of its total assets in restricted securities, which are securities acquired in private placement transactions.	There is no limit on the portfolio that can be i
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Portfolio Turnover	The Fund's portfolio turnover rate may exceed 100% per year.	The Adviser anticipates experience high portfol
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Senior Loans, Unsecured Loans, Second Lien Loans and Other Secured Loans	The Fund may invest up to 10% of its total assets in senior loans, unsecured loans, second lien loans and other secured loans.	There is no limit on the portfolio that can be i including bank loans, u lien loans and other se
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Investment Grade Securities	The Fund invests at least 50% of its total assets in debt securities rated in the four highest categories ("Baa"/"BBB" or higher) assigned by a nationally recognized rating agency, or other securities such as United States and Canadian government securities, obligations of or guaranteed by banks, commercial paper and cash equivalents, or nonrated debt securities deemed by the Adviser to be of comparable quality to the rated debt securities in which the Fund may invest.	There is no limit on the portfolio that can be i securities, however, a Fund's assets may be in below investment grade, referred to as "junk se
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INCOME SHARES

CREDIT STRATEGIES FUND

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Non-Investment Grade Securities	The Fund may invest up to 50% of its total assets in high-yield, fixed-income securities rated in the lower categories ("Ba"/"BB" or lower) by a nationally recognized rating agency or nonrated fixed-income securities deemed by the Adviser to be of comparable quality to the rated debt securities in which the Fund may invest.	There is no limit on the portfolio that can be i grade securities and a Fund's assets may be in below investment grade, referred to as "junk se
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Asset-Backed	The Fund generally does not invest in	The Fund may invest in
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Securities and Mortgaged-Backed Securities	asset-backed securities and mortgage-backed securities.	securities and mortgage
Collateralized Loan Obligations and Bond Obligations	The Fund generally does not invest in collateralized loan obligations and bond obligations.	The Fund may invest in obligations and bond ob invests in the lower tr bond obligations.
Distressed Debt and Stressed Debt	The Fund may invest in the securities and other obligations of stressed, distressed and bankrupt issuers, however, the Fund generally does not invest in securities that are in payment default.	The Fund may invest in obligations of stressed issuers, including debt covenant or payment def
Equity Securities	The Fund may invest up to 25% of its total assets in equity securities, including securities which may be convertible into or exchangeable for, or carry warrants to purchase, common stock, preferred stock and common stock.	There is no limit on th portfolio that can be i including common stock, convertible securities, receipts.
Money Market Instruments and U.S. Government Securities	The Fund may invest in money market instruments and U.S. government securities.	The Fund may invest in instruments and U.S. go
Other Investment Companies	The Fund generally does not invest in the securities of other investment companies.	The Fund may invest in investment companies (i extent that such invest the Fund's investment o investment strategies a 1940 Act.
Zero-Coupon Securities and Deferred Payment Obligations	The Fund generally does not invest in zero-coupon securities or deferred payment obligations.	The Fund may invest in deferred payment obliga on the amount of the Fu invested in these secur
Derivatives	The Fund may use interest rate futures contracts or fixed income options, subject to certain restrictions. However, the Fund generally does not enter into these transactions.	The Fund may purchase a instruments such as exc counter put and call op financial futures, equi interest rate indices, instruments, purchase a contracts and options t interest rate transacti or collars and enter in transactions such as cu currency futures contra on currency or currency and credit default swap

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INCOME SHARES

CREDIT STRATEGIES FUND

		derivative instruments instruments. Apart from derivatives are not a s investments. However, t amount of its total ass derivative instruments.
Senior Loan Based Derivatives	The Fund generally does not invest in senior loan based derivatives.	The Fund may obtain exp and baskets of senior l derivative instruments.
Swaps	The Fund generally does not invest in swaps.	The Fund may invest in default swaps, interest swaps and currency swap swaps for risk managem speculative investment.
Credit Linked Notes	The Fund generally does not invest in CLNs.	The Fund may invest in management purposes and CLN is a derivative ins
Options	The Fund may write fixed income options, subject to certain conditions. The Fund does not generally enter into these transactions.	The Fund may purchase a options on securities a
Futures Contracts and Options on Futures Contracts	The Fund may use interest rate futures contracts, subject to certain conditions. The Fund does not generally enter into these transactions.	The Fund may enter into purchase or sale for fu contracts") of securiti or indices or prices th and U.S. government deb above. The Fund will en for bona fide risk mana management purposes.
Foreign Currency and Forward Foreign Currency Contracts	The Fund generally does not purchase foreign currency or enter into forward foreign currency contracts.	The Fund may enter into transactions in an atte The Fund may enter into contracts to purchase o a fixed amount of U.S. currency.
Short Sales	The Fund may only sell a security short if it owns at least an equal amount of the security sold short or another security convertible or exchangeable for an equal amount of the security sold short without payment of further compensation (a short sale against-the-box). However, the Fund generally does not engage in short sales.	The Fund may engage in box and not against the requirements of the 194 Fund will not make a sh effect to such sale, th securities sold short b the value of its total short sales against the limitations.
Repurchase Agreements	The Fund generally does not enter into repurchase agreements.	The Fund may invest up in repurchase agreement
Reverse Repurchase Agreements	The Fund may enter into reverse repurchase agreements up to 5% of the value of its total assets. However, the Fund generally does not enter into	The Fund may enter into agreements. Reverse re be considered borrowing be subject to any restr



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reverse repurchase agreements.

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	INCOME SHARES	CREDIT STRATEGIES FUND
Inverse Floaters	The Fund may invest in inverse floaters. However, the Fund generally does not invest in inverse floaters.	The Fund may invest in
Pay-in-kind Bonds	The Fund may invest in PIK bonds.	The Fund may invest in
When-Issued, Delayed-Delivery and Forward Commitment Purchases	The Fund generally does not purchase securities on a when-issued or delayed-delivery basis and does not purchase or sell securities on a "forward commitment" basis.	The Fund may purchase s issued basis and may pu on a "forward commitmen
Securities Loans	The Fund may lend up to 25% of its net assets.	The Fund may lend up to
Foreign Securities	The Fund may invest up to 50% of its total assets in securities (payable in U.S. dollars) of, or guaranteed by, the Government of Canada or a Province of Canada or any instrumentality or political subdivision thereof.	The Fund may invest up non-U.S. credit or secu
Temporary Defensive Position	Under certain market conditions, the Fund may adopt a temporary defensive position to invest its assets in cash or cash equivalents.	Under certain market co adopt a temporary defen assets in cash or cash

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FEE, EXPENSE AND DISTRIBUTIONS ON PREFERRED SHARES TABLE FOR COMMON SHAREHOLDERS OF THE FUNDS

SUMMARY OF EXPENSE COMPARISON

As the tables below indicate, with the contractual fee waivers offered by Highland and the proceeds of a rights offering completed by Credit Strategies Fund on January 28, 2008, the PRO FORMA annual operating expenses of Credit Strategies Fund may be lower than the annual operating expenses of Income Shares, although they are expected to be higher than High Income Portfolio's annual operating expenses. In addition, a combined Fund offers the potential for economies of scale that may lead to a slight reduction in certain expenses.

THE FUNDS' EXPENSES

The tables below illustrate the change in operating expenses expected as a result of the Reorganization. The tables set forth (i) the fees, expenses and distributions to preferred shareholders paid by High Income Portfolio for the

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period ended October 31, 2007, (ii) the fees, expenses and distributions to preferred shareholders paid by Income Portfolio for the period ended December 31, 2007; (iii) the fees, expenses, and interest payments on borrowed funds paid by Credit Strategies Fund for the period ended December 31, 2007; and (iv) the PRO FORMA fees, expenses and interest payments on borrowed funds for the Acquiring Fund for the period ended December 31, 2007, assuming each of the Reorganizations had been completed at the beginning of such period. The following tables show each Fund's expenses as a percentage of net assets attributable to common shares and reflect the issuance of preferred shares in an amount equal to 29.33% of High Income Portfolio's total assets and 33.97% of Income Shares' total assets and borrowing in an amount equal to 28.54% of Credit Strategies Fund's total assets and 28.54% of the combined Fund's total assets after the Reorganizations are completed.

As described herein, an unfavorable vote by the shareholders of one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund's shareholders. It is anticipated that the most favorable expense ratio will be achieved for each Acquired Fund if both of the Reorganizations are approved and consummated and that a less favorable resulting expense ratio for each Acquired Fund will result if such Acquired Fund is the only Fund that participates in the Reorganization with the Acquiring Fund. As such, the following tables illustrate the anticipated change in operating expenses expected as a result of (i) both Acquired Funds approving and participating in the Reorganization, (ii) Reorganization of only High Income Portfolio into the Acquiring Fund, and (iii) Reorganization of only Income Shares into the Acquiring Fund.

### I. Both Acquired Funds Participating in the Reorganization:

	ACTUAL		PRO FORMA COMBINED (1)	
	HIGH INCOME PORTFOLIO (PHY)	INCOME SHARES (CNN)	CREDIT STRATEGIES FUND (HCF)	CREDIT STRATEGIES FUND (HCF)
COMMON SHAREHOLDER TRANSACTION EXPENSES (2)				
Sales Load (as a percentage of offering price)	None (3)	None (3)	None (3)	None (3)
Dividend Reinvestment Plan Fees	None (4)	None (4)	None (5)	None (5)

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(Unaudited)

	ACTUAL PERCENTAGE OF NET ASSETS ATTRIBUTABLE TO COMMON SHARES (ASSUMING LEVERAGE AS DESCRIBED ABOVE)		PRO FORMA COMBINED (1)	
	HIGH INCOME PORTFOLIO (PHY)	INCOME SHARES (CNN)	CREDIT STRATEGIES FUND (HCF)	CREDIT STRATEGIES FUND (HCF)

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ANNUAL EXPENSES (as a percentage of net assets attributable to common shares)

Management Fee	0.89%	0.73%	1.64%*	1.64%*
Interest Payments on Borrowed Funds	0.01%	0.07%	2.16%	2.16%
Other Expenses				
Dividend and Interest Expense For Short Positions	0.00%	0.00%	0.03%	0.03%
Other Expenses(6)	0.45%	0.71%	0.23%	0.20%
Total Other Expenses	0.45%	0.71%	0.26%	0.23%
 Total Annual Expenses	 1.35%	 1.51%	 4.06%	 4.03%
 Dividends on Preferred Shares	 1.99% (7) (8)	 2.48% (7) (9)	 0.00%	 0.00%
Total Annual Fund Operating Expenses and Dividends on Preferred Shares	3.34%	3.99%	4.06%	4.03%
Minus: Expense Waivers(10)	0.00%	0.00%	0.00%	0.15%
Net Annual Fund Operating Expenses and Dividends on Preferred Shares	3.34%	3.99%	4.06%	3.88%

\* Management fees include both the investment advisory and administrative services fees paid to Highland, which were 1.37% and 0.27% of annual average net assets, respectively.

(1) The PRO FORMA combined column shown assumes both Reorganizations are completed. As described herein, an unfavorable vote by one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund's shareholders. The PRO FORMA combined column also reflects the proceeds of the rights offering completed by the Acquiring Fund on January 28, 2008.

(2) No expense information is presented with respect to preferred shares because holders of preferred shares do not bear any transaction or operating expenses of any of the Funds and will not bear any transaction or operating expenses of the combined Fund.

(3) Shares of Funds purchased on the secondary market are not subject to sales charges but may be subject to brokerage commissions or other charges. The table does not include an underwriting commission paid by shareholders in the initial offering of each Fund.

(4) Each participant in the Fund's dividend reinvestment plan pays a proportionate share of the brokerage commissions incurred with respect to open market purchases in connection with such plan.

(5) Common shareholders will be charged a \$2.50 service charge and pay a brokerage commission of \$0.05 per share sold if they direct the Plan Agent (as defined below) to sell common shares held in a dividend reinvestment plan account. Each participant in the Credit Strategies Fund's Dividend Reinvestment Plan will pay a pro rata share of brokerage commissions incurred when dividend reinvestment occurs in open-market purchases because the NAV per common share is greater than the market value per common share.

(6) In connection with the Reorganizations, there are certain other transaction expenses not reflected in "Other Expenses" which include, but are not limited to: costs related to the preparation, printing and distributing of this Proxy

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Statement/Prospectus to shareholders; costs related to preparation and distribution of materials distributed to each Fund's Board; expenses incurred in

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connection with the preparation of each Agreement and the registration statement on Form N-14; SEC filing fees; legal and audit fees; portfolio transfer taxes (if any); and any similar expenses incurred in connection with the Reorganizations.

(7) Dividend rates on preferred shares are set in the auction process. Prevailing interest rate, yield curve and market circumstances at the time at which the dividend rate on preferred shares for the next dividend period are set substantially influence the rate determined in an auction. As these factors change over time, so too do the dividend rates set. In this regard, the dividend rates for each Fund's preferred shares were set on different dates and therefore do not provide a direct comparison of what these rates would be if established on the same date.

(8) Reflects a dividend rate of 5.31% based on the actual dividends paid on preferred shares during the period noted above.

(9) Reflects a dividend rate of 5.35% based on the actual dividends paid on preferred shares during the period noted above.

(10) If shareholders approve a Reorganization, the Adviser would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years. If Income Shares' shareholders approve its Reorganization, such combined waivers would be at an annual rate of 0.70% of the sum of Income Shares' net assets attributable to common shares as of the closing date of its Reorganization plus \$30 million (representing the value of its preferred shares that historically have been outstanding). If High Income Portfolio's shareholders approve its Reorganization, such combined waivers would be at an annual rate of 0.55% of the sum of High Income Portfolio's net assets attributable to common shares as of the closing date of its Reorganization plus \$40 million (representing the value of its preferred shares that historically have been outstanding). In each case, the amount of the waivers is intended to offset the additional revenue Highland would receive on each Acquired Fund's assets (including the value of its preferred shares that historically have been outstanding) due to the difference between the advisory fee rates of each Acquired Fund and Credit Strategies Fund and the fact that the Acquired Funds do not pay an administration fee to Highland. These waivers are not subject to recoupment by the Adviser. The calculations for the PRO FORMA combined numbers utilize the net assets of each Acquired Fund as of December 31, 2007. The net assets of each Acquired Fund may differ on the closing date of its Reorganization.

II. Reorganization of only High Income Portfolio into the Acquiring Fund:

	ACTUAL	PRO FORMA COMBINED (1)
	-----	-----
	HIGH INCOME PORTFOLIO (PHY)	CREDIT STRATEGIES FUND (HCF)
		CREDIT STRATEGIES FUND (HCF)

COMMON SHAREHOLDER TRANSACTION

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EXPENSES (2)			
Sales Load (as a percentage of offering price)	None (3)	None (3)	None (3)
Dividend Reinvestment Plan Fees	None (4)	None (5)	None (5)

(Unaudited)

	ACTUAL PERCENTAGE OF NET ASSETS ATTRIBUTABLE TO COMMON SHARES (ASSUMING LEVERAGE AS DESCRIBED ABOVE)	PRO FORMA COMBINED (1)	
	-----	-----	
	HIGH INCOME PORTFOLIO (PHY)	CREDIT STRATEGIES FUND (HCF)	CREDIT STRATEGIES FUND (HCF)
ANNUAL EXPENSES (as a percentage of net assets attributable to common shares)			
Management Fee	0.89%	1.64%*	1.64%*
Interest Payments on Borrowed Funds	0.01%	2.16%	2.16%
Other Expenses			
Dividend and Interest Expense For Short Positions	0.00%	0.03%	0.03%
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Other Expenses (6)	0.45%	0.23%	0.20%
Total Other Expenses	0.45%	0.26%	0.23%
Total Annual Expenses	1.35%	4.06%	4.03%
Dividends on Preferred Shares	1.99% (7) (8)	0.00%	0.00%
Total Annual Fund Operating Expenses and Dividends on Preferred Shares	3.34%	4.06%	4.03%
Minus: Expense Waivers (9)	0.00%	0.00%	0.09%
Net Annual Fund Operating Expenses and Dividends on Preferred Shares	3.34%	4.06%	3.94%

\* Management fees include both the investment advisory and administrative services fees paid to Highland, which were 1.37% and 0.27% of annual average net assets, respectively.

(1) The PRO FORMA combined column shown assumes that High Income Portfolio was the only Acquired Fund in the Reorganization completed. As described herein, an unfavorable vote by one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund's shareholders. The PRO FORMA combined column also reflects the proceeds of the rights offering completed by the Acquiring Fund on January 28, 2008.

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(2) No expense information is presented with respect to preferred shares because holders of preferred shares do not bear any transaction or operating expenses of any of the Funds and will not bear any transaction or operating expenses of the combined Fund.

(3) Shares of Funds purchased on the secondary market are not subject to sales charges but may be subject to brokerage commissions or other charges. The table does not include an underwriting commission paid by shareholders in the initial offering of each Fund.

(4) Each participant in the Fund's dividend reinvestment plan pays a proportionate share of the brokerage commissions incurred with respect to open market purchases in connection with such plan.

(5) Common shareholders will be charged a \$2.50 service charge and pay a brokerage commission of \$0.05 per share sold if they direct the Plan Agent (as defined below) to sell common shares held in a dividend reinvestment plan account. Each participant in the Credit Strategies Fund's Dividend Reinvestment Plan will pay a pro rata share of brokerage commissions incurred when dividend reinvestment occurs in open-market purchases because the NAV per common share is greater than the market value per common share.

(6) In connection with the Reorganizations, there are certain other transaction expenses not reflected in "Other Expenses" which include, but are not limited to: costs related to the preparation, printing and distributing of this Proxy Statement/Prospectus to shareholders; costs related to preparation and distribution of materials distributed to each Fund's Board; expenses incurred in connection with the preparation of each Agreement and the registration statement on Form N-14; SEC filing fees; legal and audit fees; portfolio transfer taxes (if any); and any similar expenses incurred in connection with the Reorganizations.

(7) Dividend rates on preferred shares are set in the auction process. Prevailing interest rate, yield curve and market circumstances at the time at which the dividend rate on preferred shares for the next dividend period are set substantially influence the rate determined in an auction. As these factors change over time, so too do the dividend rates set. In this regard, the dividend rates for each Fund's preferred shares were set on different dates and therefore do not provide a direct comparison of what these rates would be if established on the same date.

(8) Reflects a dividend rate of 5.31% based on the actual dividends paid on preferred shares during the period noted above.

(9) If High Income Portfolio's shareholders approve its Reorganization, the Adviser would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years so that such combined waivers would be at an annual rate of 0.55% of the sum of High Income Portfolio's net assets attributable to common shares as of the closing date of its Reorganization plus \$40 million (representing the value of its preferred shares that historically have been outstanding). The amount of the waivers is intended to offset the additional revenue Highland would receive on High Income Portfolio's assets (including the value of its preferred shares that historically have been outstanding) due to the difference between the advisory fee rates of High Income Portfolio and Credit Strategies Fund and the fact that High Income Portfolio does not pay an administration fee to Highland. These waivers are not subject to recoupment by the Adviser. The calculations for the PRO FORMA combined numbers utilize the net assets of High Income Portfolio as of

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December 31, 2007. The net assets of High Income Portfolio may differ on the closing date of its Reorganization.

### III. Reorganization of only Income Shares into the Acquiring Fund:

	ACTUAL	PRO FORMA COMBINED (1)	
	INCOME SHARES (CNN)	CREDIT STRATEGIES FUND (HCF)	CREDIT STRATEGIES FUND (HCF)
COMMON SHAREHOLDER TRANSACTION			
EXPENSES (2)			
Sales Load (as a percentage of offering price)	None (3)	None (3)	None (3)
Dividend Reinvestment Plan Fees	None (4)	None (5)	None (5)

(Unaudited)

	ACTUAL PERCENTAGE OF NET ASSETS ATTRIBUTABLE TO COMMON SHARES (ASSUMING LEVERAGE AS DESCRIBED ABOVE)	PRO FORMA COMBINED (1)	
	INCOME SHARES (CNN)	CREDIT STRATEGIES FUND (HCF)	CREDIT STRATEGIES FUND (HCF)
ANNUAL EXPENSES (as a percentage of net assets attributable to common shares)			
Management Fee	0.73%	1.64%*	1.64%*
Interest Payments on Borrowed Funds	0.07%	2.16%	2.16%
Other Expenses			
Dividend and Interest Expense For Short Positions	0.00%	0.03%	0.03%
Other Expenses (6)	0.71%	0.23%	0.21%
Total Other Expenses	0.71%	0.26%	0.24%
Total Annual Expenses	1.51%	4.06%	4.04%
Dividends on Preferred Shares	2.48% (7) (8)	0.00%	0.00%
Total Annual Fund	3.99%	4.06%	4.04%
Operating Expenses and Dividends on Preferred Shares			
Minus: Expense Waivers (9)	0.00%	0.00%	0.08%
Net Annual Fund Operating Expenses and Dividends on Preferred Shares	3.99%	4.06%	3.96%

\* Management fees include both the investment advisory and administrative

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services fees paid to Highland, which were 1.37% and 0.27% of annual average net assets, respectively.

(1) The PRO FORMA combined column shown assumes that Income Shares was the only Acquired Fund in the Reorganization completed. As described herein, an unfavorable vote by one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund's shareholders. The PRO FORMA combined column also reflects the proceeds of the rights offering completed by the Acquiring Fund on January 28, 2008.

(2) No expense information is presented with respect to preferred shares because holders of preferred shares do not bear any transaction or operating expenses of any of the Funds and will not bear any transaction or operating expenses of the combined Fund.

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(3) Shares of Funds purchased on the secondary market are not subject to sales charges but may be subject to brokerage commissions or other charges. The table does not include an underwriting commission paid by shareholders in the initial offering of each Fund.

(4) Each participant in the Fund's dividend reinvestment plan pays a proportionate share of the brokerage commissions incurred with respect to open market purchases in connection with such plan.

(5) Common shareholders will be charged a \$2.50 service charge and pay a brokerage commission of \$0.05 per share sold if they direct the Plan Agent (as defined below) to sell common shares held in a dividend reinvestment plan account. Each participant in the Credit Strategies Fund's Dividend Reinvestment Plan will pay a pro rata share of brokerage commissions incurred when dividend reinvestment occurs in open-market purchases because the NAV per common share is greater than the market value per common share.

(6) In connection with the Reorganizations, there are certain other transaction expenses not reflected in "Other Expenses" which include, but are not limited to: costs related to the preparation, printing and distributing of this Proxy Statement/Prospectus to shareholders; costs related to preparation and distribution of materials distributed to each Fund's Board; expenses incurred in connection with the preparation of each Agreement and the registration statement on Form N-14; SEC filing fees; legal and audit fees; portfolio transfer taxes (if any); and any similar expenses incurred in connection with the Reorganizations.

(7) Dividend rates on preferred shares are set in the auction process. Prevailing interest rate, yield curve and market circumstances at the time at which the dividend rate on preferred shares for the next dividend period are set substantially influence the rate determined in an auction. As these factors change over time, so too do the dividend rates set. In this regard, the dividend rates for each Fund's preferred shares were set on different dates and therefore do not provide a direct comparison of what these rates would be if established on the same date.

(8) Reflects a dividend rate of 5.35% based on the actual dividends paid on preferred shares during the period noted above.

(9) If Income Shares' shareholders approve its Reorganization, the Adviser would contractually agree to waive a portion of Credit Strategies Fund's advisory fee and administration fee for two years so that such combined waivers would be at an annual rate of 0.70% of the sum of Income Shares' net assets attributable to common shares as of the closing date of its Reorganization plus \$30 million



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(representing the value of its preferred shares that historically have been outstanding). The amount of the waivers is intended to offset the additional revenue Highland would receive on Income Shares' assets (including the value of its preferred shares that historically have been outstanding) due to the difference between the advisory fee rates of Income Shares and Credit Strategies Fund and the fact that Income Shares does not pay an administration fee to Highland. These waivers are not subject to recoupment by the Adviser. The calculations for the PRO FORMA combined numbers utilize the net assets of Income Shares as of December 31, 2007. The net assets of Income Shares may differ on the closing date of its Reorganization.

The purpose of the tables in this section is to assist you in understanding the various costs and expenses that a shareholder will bear directly or indirectly by investing in a Fund's common shares and the Acquiring Fund's costs and expenses that are expected to be incurred in the first year following the Reorganizations.

### EXAMPLE

The following example is intended to help you compare the costs of investing in the Acquiring Fund PRO FORMA after the Reorganizations with the costs of investing in the Acquired Funds and the Acquiring Fund without the Reorganizations. An investor would pay the following expenses on a \$1,000 investment in common shares, assuming (i) the operating expense ratio for each Fund (as a percentage of net assets attributable to common shares) set forth in the table above for years 1 through 10, (ii) dividends on preferred shares as set forth in the table above (iii) average borrowings under Credit Strategies Fund's credit facility of \$253.2 million prior to the Reorganizations, (iv) borrowings under Credit Strategies Fund's credit facility of \$310.4 million after the Reorganizations, (v) a 5% annual return throughout the period (vi) and the contractual fee waivers noted above after the Reorganizations.

### ASSUMING LEVERAGE

(Unaudited)

	1 Year	3 Years	5 Years	10 Years
High Income Portfolio (PHY)	\$34	\$103	\$174	\$363
Income Shares (CNN)	\$40	\$122	\$205	\$420
Credit Strategies Fund (HCF)	\$41	\$124	\$208	\$426

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	1 Year	3 Years	5 Years	10 Years
Pro Forma Combined - Credit Strategies Fund (HCF) (1)	\$39	\$120	\$204	\$423
Pro Forma Combined - Credit Strategies Fund (HCF) (2)	\$40	\$121	\$205	\$423
Pro Forma Combined - Credit Strategies Fund (HCF) (3)	\$40	\$121	\$206	\$424

(1) The PRO FORMA combined row shown assumes each of the Reorganizations is completed. As described herein, an unfavorable vote by one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund.

(2) The PRO FORMA combined row shown assumes that High Income Portfolio was the only Acquired Fund in the Reorganization completed. As described herein, an

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unfavorable vote by one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund.

(3) The PRO FORMA combined row shown assumes that Income Shares was the only Acquired Fund in the Reorganization completed. As described herein, an unfavorable vote by one Acquired Fund will not affect the consummation of the Reorganization by the other Acquired Fund if approved by such other Acquired Fund.

The example set forth above assumes the reinvestment of all dividends and other distributions at NAV. The example should not be considered a representation of past or future expenses or annual rates of return. Actual expenses or annual rates of return may be more or less than those assumed for purposes of the example.

### INFORMATION ABOUT THE FUNDS

#### OUTSTANDING SECURITIES

Set forth below is information about each Fund's common shares as of December 31, 2007.

#### CREDIT STRATEGIES FUND

TITLE OF CLASS	AMOUNT AUTHORIZED	AMOUNT HELD BY FUND	AMOUNT OUTSTANDING
Common Shares	Unlimited	-	46,056,165*

\* This includes shares issued by Credit Strategies Fund pursuant to a rights offering completed on January 28, 2008. Excluding shares of the rights offering, Credit Strategies Fund had 34,520,550 shares outstanding on December 31, 2007.

#### HIGH INCOME PORTFOLIO

TITLE OF CLASS	AMOUNT AUTHORIZED	AMOUNT HELD BY FUND	AMOUNT OUTSTANDING
Common Shares	100,000,000	-	30,874,699

#### INCOME SHARES

TITLE OF CLASS	AMOUNT AUTHORIZED	AMOUNT HELD BY FUND	AMOUNT OUTSTANDING
Common Shares	15,000,000	-	9,947,104

Set forth below is information about High Income Portfolio's and Income Shares' preferred shares as of December 31, 2007.

#### HIGH INCOME PORTFOLIO

TITLE OF CLASS	AMOUNT AUTHORIZED	AMOUNT HELD BY FUND	AMOUNT OUTSTANDING
Series W	1,000,000	-	1,600

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### INCOME SHARES

TITLE OF CLASS	AMOUNT AUTHORIZED	AMOUNT HELD BY FUND	AMOUNT OUTSTANDING
Series T	1,000,000	-	1,200

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### COMMON SHARE PRICE DATA

The following table sets forth the high and low sales prices for common shares of each Fund on the NYSE for each full quarterly period within the two most recent fiscal years or since inception and each full quarter since the beginning of the current fiscal year, along with the NAV and discount or premium to NAV for each quotation.

The Funds only make public their net asset values on a weekly basis. Accordingly, the net asset value and the premium and discount from net asset value in the table below are based on the publicly available net asset values for the week in which the high and low sales price occurred. Since the net asset value and the premium and discount from net asset value is based on the publicly available net asset values for the week, which may not fall on the same date as the high and low sales prices, the range of net asset values and the premium and discount from net asset value for the common shares during the periods shown may be broader or more narrow than what is shown in this table.

#### CREDIT STRATEGIES FUND

QUARTERLY PERIOD ENDING	HIGH PRICE	NET ASSET VALUE	PREMIUM (DISCOUNT)	LOW PRICE	NET ASSET VALUE	PREMIUM (DISCOUNT)
March 31, 2008	\$15.54	\$17.85	-12.92%	\$13.13	\$14.97	-12.28%
December 31, 2007	\$18.80	\$19.32	-2.69%	\$15.67	\$17.99	-12.89%
September 30, 2007	\$20.17	\$20.60	-2.09%	\$16.25	\$19.33	-15.93%
June 30, 2007	\$21.14	\$20.51	3.07%	\$19.80	\$20.45	-3.18%
March 31, 2007	\$21.69	\$20.29	6.90%	\$20.37	\$20.30	0.34%
December 31, 2006	\$21.48	\$19.97	7.56%	\$20.10	\$19.36	3.82%
September 30, 2006	\$21.30	\$19.09	11.58%	\$19.82	\$19.13	3.61%
June 30, 2006	\$20.60	\$19.07	8.02%	\$20.18	\$19.06	5.88%

#### HIGH INCOME PORTFOLIO

QUARTERLY PERIOD ENDING	HIGH PRICE	NET ASSET VALUE	PREMIUM (DISCOUNT)	LOW PRICE	NET ASSET VALUE	PREMIUM (DISCOUNT)
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January 31, 2008	\$3.02	\$3.38	-10.65%	\$2.59	\$2.91	-11.00%
October 31, 2007	\$3.09	\$3.48	-11.29%	\$2.59	\$3.30	-21.52%
July 31, 2007	\$3.35	\$3.64	-7.97%	\$2.98	\$3.43	-13.12%
April 30, 2007	\$3.32	\$3.64	-8.79%	\$3.09	\$3.43	-9.91%
January 31, 2007	\$3.27	\$3.48	-6.03%	\$3.19	\$3.45	-7.54%
October 31, 2006	\$3.27	\$3.40	-3.82%	\$3.14	\$3.40	-7.65%
July 31, 2006	\$3.37	\$3.64	-7.42%	\$3.10	\$3.51	-11.68%
April 30, 2006	\$3.40	\$3.63	-6.34%	\$2.97	\$3.47	-14.41%
January 31, 2006	\$3.11	\$3.53	-11.90%	\$2.71	\$3.20	-15.31%

INCOME SHARES

QUARTERLY PERIOD ENDING	HIGH PRICE	NET ASSET VALUE	PREMIUM (DISCOUNT)	LOW PRICE	NET ASSET VALUE	PREMIUM (DISCOUNT)
March 31, 2008	\$5.22	\$5.84	-10.64%	\$4.75	\$5.60	-15.24%
December 31, 2007	\$5.61	\$6.27	-10.50%	\$5.02	\$6.04	-16.95%
September 30, 2007	\$6.10	\$6.62	-7.85%	\$5.10	\$6.22	-18.01%
June 30, 2007	\$6.14	\$6.77	-9.31%	\$6.03	\$6.79	-11.19%
March 31, 2007	\$6.34	\$6.82	-7.04%	\$6.02	\$6.59	-8.65%
December 31, 2006	\$6.08	\$6.70	-9.25%	\$5.82	\$6.39	-8.92%
September 30, 2006	\$5.96	\$6.42	-7.17%	\$5.58	\$6.32	-11.71%
June 30, 2006	\$5.94	\$6.40	-7.19%	\$5.57	\$6.36	-12.42%
March 31, 2006	\$5.98	\$6.50	-8.00%	\$5.55	\$6.40	-13.28%

As of March 31, 2008, (i) the net value per share for common shares of the Acquiring Fund was \$14.50 and the market price per share was \$13.02, representing a discount to NAV of -10.21%, (ii) the NAV per share for common

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shares of High Income Portfolio was \$2.79 and the market price per share was \$2.45, representing a discount to NAV of -12.19%, and (iii) the NAV per share for common shares of Income Shares was \$5.50 and the market price per share was \$4.78, representing a discount to NAV of -13.07%.

The NAV per share and market price per share of the common shares of each Fund may fluctuate prior to the closing date of its Reorganization. Depending on market conditions immediately prior to the closing date of a Reorganization, Acquiring Fund Common Shares may trade at a larger or smaller discount to NAV

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than an Acquired Fund's common shares. This could result in the Acquiring Fund Common Shares having a market value that is greater or less than the market value of an Acquired Fund's common shares on the closing date of a Reorganization.

### SHARE REPURCHASES

Common shares of Credit Strategies Fund have traded at a premium to NAV at certain times and at a discount to NAV at certain times. Common shares of both the Acquired Funds have traded at a premium to NAV at certain times and at a discount to NAV at certain times.

Each Fund may from time to time take action to attempt to reduce or eliminate a market value discount from NAV by repurchasing their common shares in the open market or by tendering for their common shares at NAV.

So long as any preferred shares are outstanding, High Income Portfolio and Income Shares may not purchase, redeem or otherwise acquire any common shares unless (1) all accumulated dividends on the preferred shares or any other preferred shares have been paid or set aside for payment through the date of such purchase, redemption or other acquisition and (2) at the time of such purchase, redemption or acquisition certain asset coverage requirements (determined after deducting the acquisition price of the common shares) are met. Repurchases of common shares may result in High Income Portfolio and Income Shares being required to redeem preferred shares to satisfy asset coverage requirements.

Subject to its investment restrictions, a 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 a Fund in anticipation of share repurchases or tenders will reduce the Fund's net income. The Fund will comply with the Securities Exchange Act of 1934, as amended (the "1934 Act"), the 1940 Act and the rules and regulations thereunder in connection with any share repurchase, tender offer or borrowing that might be approved by the Fund's Board. Any such borrowings will be subject to the limitations imposed by the 1940 Act and the Rating Agency Guidelines.

The repurchase by a Fund of its common shares at prices below NAV will result in an increase in the NAV of those common shares that remain outstanding. However, there can be no assurance that common share repurchases or tender offers at or below NAV will result in the Fund's common shares trading at a price equal to their NAV. Nevertheless, the fact that a Fund's common shares may be the subject of repurchase or tender offers from time to time, or that the Fund may be converted to an open-end investment company, may reduce any spread between market price and NAV that might otherwise exist.

In addition, a purchase by the Fund of its common shares will decrease the Fund's total assets which 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 preferred shares are outstanding will increase the leverage applicable to the outstanding common shares then remaining.

Before deciding whether to take any action if the common shares trade below NAV, a Fund's Board would likely 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 a Fund's shares should trade at a discount, the Fund's Board may determine that, in the interest of the Fund and its shareholders, no action should be taken.

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### DIVIDENDS AND OTHER DISTRIBUTIONS

#### ALL FUNDS.

Distributions on each Fund's common shares are declared based on annual projections of net investment income (defined as dividends and interest income, net of Fund expenses). High Income Portfolio and Credit Strategies Fund pay monthly distributions to common shareholders. Income Shares pays quarterly distributions to common shareholders. As a result of market conditions or investment decisions, the amount of distributions may exceed net investment income earned at certain times throughout the period. It is anticipated that, on an annual basis, the amount of distributions to common shareholders will not exceed net investment income (as defined above) allocated to common shareholders for income tax purposes. Each Fund intends to pay any capital gain distributions annually.

Various factors will affect the level of each Fund's current income and current gains, such as its asset mix, and each Fund's use of options. To permit each Fund to maintain more stable monthly dividends and annual distributions, each Fund may from time to time distribute less than the entire amount of income and gains earned in the relevant month or year, respectively. The undistributed income and gains would be available to supplement future distributions. As a result, the distributions paid by each Fund for any particular period may be more or less than the amount of income and gains actually earned by each Fund during the applicable period. Undistributed income and gains will add to each Fund's NAV and, correspondingly, distributions from undistributed income and gains and from capital, if any, will be deducted from each Fund's NAV. Shareholders will automatically have all dividends and other distributions reinvested in common shares of each Fund issued by each Fund or purchased in the open market in accordance with each Fund's Dividend Reinvestment Plan unless an election is made to receive cash. Each participant in each Fund's Dividend Reinvestment Plan will pay a pro rata portion of brokerage commissions incurred in connection with open market purchases, and participants requesting a sale of securities through the plan agent of the Dividend Reinvestment Plan of the Acquiring Fund are subject to a sales fee and a brokerage commission. See "Dividend Reinvestment Plan."

#### HIGH INCOME PORTFOLIO AND INCOME SHARES.

So long as any preferred shares of High Income Portfolio or Income Shares are outstanding, common shareholders of each Fund will not be entitled to receive any dividends or other distributions from each Fund, unless at the time of such declaration, (1) all accrued dividends on preferred shares or accrued interest on borrowings have been paid and (2) the value of each Fund's total assets (determined after deducting the amount of such dividend or other distribution), less all liabilities and indebtedness of each Fund not represented by senior securities, is at least 300% of the aggregate amount of such securities representing indebtedness and at least 200% of the aggregate amount of 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 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, each Fund is required to comply with other asset coverage requirements as a condition of each Fund obtaining a rating of the preferred shares from a rating agency. These requirements include an asset coverage test more stringent than under the 1940 Act.

#### DIVIDEND REINVESTMENT PLAN

Each Fund offers its shareholders a Dividend Reinvestment Plan (the "Plan"),

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which offers the opportunity to earn compounded yields. The terms of each Plan is set forth below.

HIGH INCOME PORTFOLIO AND INCOME SHARES. If your common shares are registered directly with the Fund or if you hold your common shares with a brokerage firm that participates in the Fund's Plan, unless you elect by written notice to the Fund to receive cash distributions, all dividends, including any capital gain distributions, on your common shares will be automatically reinvested by PFPC Inc. (the "Plan Agent"), in additional common shares under the Plan. If you elect to receive cash distributions, you will receive all distributions in cash paid by check mailed directly to you by PFPC Inc., as dividend paying agent.

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If you decide to participate in the Plan, the number of common shares you will receive will be determined as follows:

(1) If the common shares are trading at or above NAV at the time of valuation, the Fund will issue new shares of common shares at a price equal to the greater of (i) NAV per share of common shares on that date or (ii) 95% of the market price on that date.

(2) If common shares are trading below NAV at the time of valuation, the Plan Agent will receive the dividend or distribution in cash and will purchase common shares in the open market, on the American Stock Exchange or elsewhere, for the participants' accounts. It is possible that the market price for the common shares may increase before the Plan Agent has completed its purchases. Therefore, the average purchase price per share of common shares paid by the Plan Agent may exceed the market price at the time of valuation, resulting in the purchase of fewer shares of common shares than if the dividend or distribution had been paid in common shares issued by the Fund. The Plan Agent will use all dividends and other distributions received in cash to purchase common shares in the open market within 30 days of the valuation date except where temporary curtailment or suspension of purchases is necessary to comply with federal securities laws. Interest will not be paid on any uninvested cash payments.

You may elect to opt out of or withdraw from the Plan at any time by giving written notice to the Plan Agent, or by telephone at (800) 331-1710, in accordance with such reasonable requirements as the Plan Agent and Fund may agree upon. If you withdraw or the Plan is terminated, you or your broker (on your behalf) will receive (a) your whole shares in non-certificated form and (b) a cash payment for any fraction of a share in your account. If you wish, the Plan Agent will sell your shares and send you the proceeds, minus brokerage commissions.

The Plan Agent maintains all common shareholders' accounts in the Plan and gives written confirmation of all transactions in the accounts, including information you may need for tax records. Common shares in your account will be held by the Plan Agent in non-certificated form. The Plan Agent will forward to each participant any proxy solicitation material and will vote any common shares so held only in accordance with proxies returned to the Fund. Any proxy you receive will include all common shares you have received under the Plan.

There is no brokerage charge for reinvestment of your dividends or distributions in common shares. However, all participants will pay a pro rata share of brokerage commissions incurred by the Plan Agent when it makes open market purchases.

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Automatically reinvesting dividends and other distributions does not mean that you do not have income tax liability thereon. Income from distributions is realized even if you do not receive cash. Consult your financial advisor for more information.

If you hold your common shares with a brokerage firm that does not participate in the Plan, you will not be able to participate in the Plan and any dividend reinvestment may be effected on different terms than those described above.

The Fund reserves the right to amend or terminate the Plan if in the judgment of the Board of Directors the change is warranted. There is no direct service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants. Additional information about the Plan may be obtained by writing PFPC Inc., 301 Bellevue Parkway, Wilmington, Delaware 19809.

CREDIT STRATEGIES FUND. Unless the registered owner of common shares elects to receive cash by contacting the Plan Agent, all dividends declared for the common shares of Credit Strategies Fund will be automatically paid in the form of, or reinvested by the Plan Agent (agent for shareholders in administering Credit Strategies Fund's Plan) in, additional common shares of Credit Strategies Fund. If you are a registered owner of common shares and elect not to participate in the Plan, you will receive all dividends in cash paid by check mailed directly to you (or, if the shares are held in street or other nominee name, then to such nominee) by PFPC Inc., as dividend disbursing agent. You may elect not to participate in the Plan and to receive all dividends in cash by sending written instructions or by contacting PFPC Inc., as dividend disbursing agent, at the address set forth below. Participation in the Plan is completely voluntary and may be terminated or resumed at any time without penalty by contacting the Plan Agent before the dividend record date; otherwise such termination or resumption

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will be effective with respect to any subsequently declared dividend or other distribution. Some brokers may automatically elect to receive cash on your behalf and may re-invest that cash in additional shares of Credit Strategies Fund for you.

The Plan Agent will open an account for each shareholder under the Plan in the same name in which such shareholder's shares are registered. Whenever Credit Strategies Fund declares a dividend or other distribution (together, a "dividend") payable in cash, non-participants in the Plan will receive cash and participants in the Plan will receive the equivalent in common shares. The common shares will be acquired by the Plan Agent for the participants' accounts, depending upon the circumstances described below, either (i) through receipt of additional unissued but authorized shares from Credit Strategies Fund ("newly issued shares") or (ii) by purchase of outstanding common shares on the open market ("open-market purchases") on the NYSE or elsewhere.

If, on the payment date for any dividend, the market price per common share plus estimated brokerage commissions is greater than the NAV per common share (such condition being referred to herein as "market premium"), the Fund will issue common shares, including fractions, to the participants in the amount of the dividend. The number of newly issued common shares to be credited to each participant's account will be determined by dividing the dollar amount of the dividend by the NAV per common share on the payment date; provided that, if the NAV per common share is less than 95% of the market price per common share on the payment date, the dollar amount of the dividend will be divided by 95% of the market price per common share on the payment date.

If, on the payment date for any dividend, the NAV per common share is greater



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than the market value per common share plus estimated brokerage commissions (such condition being referred to herein as "market discount"), the Plan Agent will invest the dividend amount in common shares acquired on behalf of the participants in open-market purchases.

In the event of a market discount on the payment date for any dividend, the Plan Agent will have until the last business day before the next date on which the common shares trade on an "ex-dividend" basis or 120 days after the payment date for such dividend, whichever is sooner (the "last purchase date"), to invest the dividend amount in common shares acquired in open-market purchases. It is contemplated that Credit Strategies Fund will pay monthly dividends. Therefore, the period during which open-market purchases can be made will exist only from the payment date of each dividend through the date before the "ex-dividend" date of the third month of the quarter. If, before the Plan Agent has completed its open-market purchases, the market price of a common share exceeds the NAV per common share, the average per common share purchase price paid by the Plan Agent may exceed the NAV of the common shares, resulting in the acquisition of fewer common shares than if the dividend had been paid in newly issued common shares on the dividend payment date. Because of the foregoing difficulty with respect to open market purchases, if the Plan Agent is unable to invest the full dividend amount in open market purchases during the purchase period or if the market discount shifts to a market premium during the purchase period, the Plan Agent may cease making open-market purchases and may invest the uninvested portion of the dividend amount in newly issued common shares at the NAV per common share at the close of business on the last purchase date; provided that, if the NAV per common share is less than 95% of the market price per common share on the payment date, the dollar amount of the dividend will be divided by 95% of the market price per common share on the payment date.

The Plan Agent maintains all shareholders' accounts in the Plan and furnishes written confirmation of all transactions in the accounts, including information needed by shareholders for tax records. Common shares in the account of each Plan participant will be held by the Plan Agent on behalf of the Plan participant, and each shareholder proxy will include those shares purchased or received pursuant to the Plan. The Plan Agent will forward all proxy solicitation materials to participants and vote proxies for shares held under the Plan in accordance with the instructions of the participants.

In the case of shareholders such as banks, brokers or nominees which hold shares for others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of common shares certified from time to time by the record shareholder's name and held for the account of beneficial owners who participate in the Plan.

There will be no brokerage charges with respect to common shares issued directly by Credit Strategies Fund. However, each participant will pay a pro rata share of brokerage commissions incurred in connection with open-market purchases. The automatic reinvestment of dividends will not relieve participants of any federal, state or local income tax that may be payable (or required to be

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withheld) on such dividends. Accordingly, any taxable dividend received by a participant that is reinvested in additional common shares will be subject to federal (and possibly state and local) income tax even though such participant will not receive a corresponding amount of cash with which to pay such taxes. See "Tax Matters." Participants who request a sale of shares through the Plan Agent are subject to a \$2.50 sales fee and pay a brokerage commission of \$0.05 per share sold.

Credit Strategies Fund reserves the right to amend or terminate the Plan. There

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is no direct service charge to participants in the Plan; however, Credit Strategies Fund reserves the right to amend the Plan to include a service charge payable by the participants.

All correspondence concerning the Plan should be directed to the Plan Agent at PFPC Inc., 301 Bellevue Parkway, Wilmington, Delaware 19809; telephone (877) 665-1287.

### DESCRIPTION OF CAPITAL STRUCTURE

#### HIGH INCOME PORTFOLIO AND INCOME SHARES

##### COMMON SHARES

High Income Portfolio was incorporated in Maryland on May 13, 1988. High Income Portfolio's Articles of Incorporation, as amended and supplemented ("Charter") authorize the issuance of up to 100,000,000 common shares, \$0.03 par value per share. Income Shares was incorporated in Maryland on March 19, 1973. Income Shares' Charter authorizes the issuance of up to 15,000,000 common shares, \$1.00 par value per share. Each Acquired Fund's common shares have equal rights as to voting, dividends and liquidation. All common shares issued and outstanding are fully paid and nonassessable. Shares of common shares have no preemptive, conversion or redemption rights and are freely transferable. The voting rights of the common shares are noncumulative, which means that the holders of more than 50% of the common shares voting for the election of Directors can elect all of those Directors that are subject to election by the holders of the common shares if they choose to do so, and, in that event, the holders of the remaining common shares voting for the election of Directors will not be able to elect any Directors. The holders of the common shares vote as a single class with the holders of the preferred shares on all matters except as described below under "Voting Rights." Each Acquired Fund's Charter may generally be amended by the affirmative vote of holders of common shares and preferred shares entitled to cast a majority of all votes entitled to be cast on the matter.

So long as any preferred shares of an Acquired Fund are outstanding, holders of the Acquired Fund's common shares will not be entitled to receive any dividends of or other distributions from the Acquired Fund, unless at the time of such declaration (1) all accrued dividends on preferred shares or accrued interest on borrowings have been paid and (2) the value of the Acquired Fund's total assets (determined after deducting the amount of such dividend or other distribution), less all of its liabilities and indebtedness not represented by senior securities, is at least 300% of the aggregate amount of such securities representing indebtedness and at least 200% of the aggregate amount of 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 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 Acquired Funds are required to comply with other asset coverage requirements as a condition of each Acquired Fund obtaining a rating of the preferred shares from a rating agency. These requirements include an asset coverage test more stringent than that under the 1940 Act.

##### PREFERRED SHARES

Under the 1940 Act, each Acquired Fund is permitted to have outstanding more than one series of preferred shares as long as neither a single series has priority over another series nor holders of preferred shares have pre-emptive rights to purchase any other preferred shares that might be issued. Each Acquired Fund's Charter authorizes the issuance of a class of preferred shares (which class may be divided into more than one series) as the Directors may, without shareholder approval, authorize. The preferred shares has such

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preferences, voting powers, terms of redemption, if any, and special or relative rights or privileges (including conversion rights, if any) as the Directors may

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determine and as are set forth in the respective Acquired Fund's Charter establishing the terms of the preferred shares. Any decision to offer preferred shares is subject to market conditions and to the Board of Directors' and the Adviser's continuing belief that leveraging the respective Acquired Fund's capital structure through the issuance of preferred shares is likely to benefit the holders of common shares. Each Acquired Fund is authorized to issue a maximum of 1,000,000 preferred shares. To date, High Income Portfolio's Directors have authorized the creation of, and High Income Portfolio has issued, 3,000 Auction Rate Cumulative Preferred Shares, having a par value of \$0.001 per share, with a liquidation preference of \$25,000 per share, classified as Series W Auction Rate Cumulative Preferred Shares. As of January 31, 2007, High Income Portfolio had redeemed 1,400 preferred shares and had a total of \$40 million preferred shares outstanding. To date, Income Shares' Directors have authorized the creation of, and Income Shares has issued, 1,200 Auction Rate Cumulative Preferred Shares, having a par value of \$0.01 per share, with a liquidation preference of \$25,000 per share, classified as Series T Auction Rate Cumulative Preferred Shares, all of which were outstanding as of January 31, 2007.

The preferred shares have complete priority over common shares as to distribution of assets. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of either Acquired Fund, holders of preferred shares will be entitled to receive a preferential liquidating distribution (expected to equal the original purchase price per share plus accumulated and unpaid dividends thereon, whether or not earned or declared) before any distribution of assets is made to holders of common shares. After the payment to the holders of preferred shares of the full preferential amounts, the holders of preferred shares as such will have no right or claim to any of the remaining assets of the relevant Acquired Fund. Neither the consolidation nor merger of either Acquired Fund with or into any other corporation or corporations, nor the sale, lease, exchange or transfer by either Acquired Fund of all or substantially all of its property and assets, will be deemed to be a liquidation, dissolution or winding up of that Acquired Fund.

### VOTING RIGHTS

Except as noted below, each Acquired Fund's common shares and preferred shares have equal voting rights of one vote per share and vote together as a single class. In elections of Directors, the holders of preferred shares, as a separate class, vote to elect two Directors, the holders of the common shares, as a separate class, vote to elect two Directors and the holders of the preferred shares and the common shares, voting together as a single class, elect the remaining Directors. In addition, during any period ("Voting Period") in which either Acquired Fund has not paid dividends on the preferred shares in an amount equal to two full years' dividends, the holders of preferred shares, voting as a single class, are entitled to elect (in addition to the two Directors set forth above) the smallest number of additional Directors as is necessary to assure that a majority of the Directors have been elected by the holders of preferred shares.

In an instance when an Acquired Fund has not paid dividends as set forth in the immediately preceding paragraph, the terms of office of all persons who are Directors of the Acquired Fund at the time of the commencement of a Voting Period will continue, notwithstanding the election by the holders of the preferred shares of the number of Directors that such holders are entitled to elect. The persons elected by the holders of the preferred shares, together with the incumbent Directors elected by the holders of the common shares, will

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constitute the duly elected Directors of the Acquired Fund. When all dividends in arrears on the preferred shares have been paid or provided for, the terms of office of the additional Directors elected by the holders of the preferred shares will terminate.

The common shares and preferred shares of each Acquired Fund vote as separate classes on amendments to the Charter that would adversely affect their respective interests.

In addition, so long as any High Income Portfolio preferred shares are outstanding:

(1) High Income Portfolio may not be voluntarily liquidated, dissolved, wound up, merged or consolidated and may not sell all or substantially all of its assets, without the approval of at least a majority of the preferred shares, voting as a separate class;

(2) the adoption of any plan of reorganization adversely affecting the preferred shares requires the approval of holders of a majority of the preferred shares, voting as a separate class;

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(3) High Income Portfolio may not, without the affirmative vote of at least a majority of the preferred shares outstanding, voting as a separate class, file a voluntary application for relief under federal bankruptcy law or any similar application under state law for so long as High Income Portfolio is solvent and does not foresee becoming insolvent;

(4) the approval of a majority of the outstanding preferred shares, voting as a separate class, is required to approve any action requiring a vote of security holders under Section 13(a) of the 1940 Act including, among other things, changes in High Income Portfolio's investment objective, changes in certain investment restrictions described under "Investment Restrictions" in the SAI and changes in High Income Portfolio's subclassification as a closed-end investment company; and

(5) the approval of a majority of the outstanding preferred shares, voting as a separate class, is required to amend, alter or repeal any of the authorized preferences, rights or powers of the holders of preferred shares.

In addition, so long as any Income Shares' preferred shares are outstanding:

(1) Income Shares may not be voluntarily liquidated, dissolved, wound up, merged or consolidated and may not sell all or substantially all of its assets, without the approval of at least a majority of the preferred shares, voting as a separate class;

(2) the adoption of any plan of reorganization adversely affecting the preferred shares requires the approval of holders of a majority of the preferred shares, voting as a separate class;

(3) Income Shares may not, without the affirmative vote of at least a majority of the preferred shares outstanding, voting as a separate class, file a voluntary application for relief under federal bankruptcy law or any similar application under state law for so long as Income Shares is solvent and does not foresee becoming insolvent; and

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(4) the approval of a majority of the outstanding preferred shares, voting as a separate class, is required to approve any action requiring a vote of security holders under Section 13(a) of the 1940 Act including, among other things, changes in Income Shares' investment objectives, changes in certain investment restrictions described under "Investment Restrictions" in the SAI and changes in Income Shares' subclassification as a closed-end investment company.

The required vote for certain of the items listed above for each of the Acquired Funds, such as items 1, 2 and 4, may be subject to the supermajority voting requirements referred to under "Anti-Takeover Provisions" below, if they have not been approved, authorized or adopted by the affirmative vote of at least 80% of the total number of Continuing Directors. "Continuing Directors" are those Directors who have been directors of Income Shares since May 2002 or are those Directors who have been directors of High Income Portfolio since March 2001 or who have subsequently become directors and whose election is approved by a majority of the Continuing Directors then on the Board. The common shares and preferred shares for each Acquired Fund also will vote separately to the extent otherwise required under Maryland law or the 1940 Act, as in effect from time to time. To the extent required under the 1940 Act, certain actions by shareholders of each Acquired Fund require a vote of a majority of that Fund's outstanding voting securities. If applicable, the class vote of holders of preferred shares described above will in each case be in addition to a separate vote of the requisite percentage of common shares and preferred shares, voting together as a single class, necessary to authorize the action in question.

### CREDIT STRATEGIES FUND

#### COMMON SHARES

Credit Strategies Fund is a statutory trust organized under the laws of Delaware pursuant to an Agreement and Declaration of Trust dated as of March 10, 2006 ("Declaration of Trust"). Credit Strategies Fund is authorized to issue an unlimited number of common shares of beneficial interest, par value \$0.001 per share. Each common share has one vote and, when issued and paid for is fully

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paid and non-assessable, except that the trustees shall have the power to cause shareholders to pay expenses of Credit Strategies Fund by setting off charges due from shareholders from declared but unpaid dividends or distributions owed the shareholders and/or by reducing the number of common shares owned by each respective shareholder. Credit Strategies Fund currently is not aware of any expenses that will be paid pursuant to this provision, except to the extent fees payable under its Dividend Reinvestment Plan are deemed to be paid pursuant to this provision.

Credit Strategies 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. All common shares are equal as to dividends, assets and voting privileges and have no conversion, preemptive or other subscription rights. Credit Strategies Fund will send annual and semi-annual reports, including financial statements, to all holders of its shares.

While Credit Strategies Fund has filed a registration statement to permit it to offer additional shares from time to time, such registration statement has not been declared effective and Credit Strategies Fund has no present intention of offering any additional shares on that registration statement. Any additional offerings of shares will require approval by Credit Strategies Fund's Board. Any additional offering of common shares will be subject to the requirements of the

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1940 Act, which provides that shares may not be issued at a price below the then current NAV, exclusive of sales load, except in connection with an offering to existing holders of common shares or with the consent of a majority of Credit Strategies Fund's common shareholders. Credit Strategies Fund currently issues additional shares under its Dividend Reinvestment Plan and, if approved, Credit Strategies Fund will issue additional shares pursuant to the Reorganizations.

Any additional offerings of common shares would result in current shareholders owning a smaller proportionate interest in Credit Strategies Fund than they owned prior to such offering to the extent that shareholders do not purchase sufficient shares in such offering to maintain their percentage interest. Credit Strategies Fund's net asset value would be reduced immediately following an offering of the shares due to the costs of such offering, which will be borne entirely by Credit Strategies Fund. The sale of shares by Credit Strategies Fund (or the perception that such sales may occur) may have an adverse effect on prices of shares in the secondary market. An increase in the number of shares available may put downward pressure on the market price for shares. If Credit Strategies Fund were unable to invest the proceeds of an additional offering of shares as intended, Credit Strategies Fund's per share distribution may decrease and the Trust may not participate in market advances to the same extent as if such proceeds were fully invested as planned.

Unlike open-end funds, closed-end funds like Credit Strategies Fund do not continuously offer shares and do not provide daily redemptions. Rather, if a shareholder determines to buy additional common shares or sell shares already held, the shareholder may do so by trading through a broker on the NYSE or otherwise. Shares of closed-end investment companies frequently trade on an exchange at prices lower than NAV. Because the market value of the common shares may be influenced by such factors as dividend levels (which are in turn affected by expenses), dividend stability, NAV, relative demand for and supply of such shares in the market, general market and economic conditions and other factors beyond the control of Credit Strategies Fund, Credit Strategies Fund cannot assure you that common shares will trade at a price equal to or higher than NAV in the future. The common shares are designed primarily for long-term investors and you should not purchase the common shares if you intend to sell them soon after purchase. See the Statement of Additional Information under "Repurchase of Common Shares."

### PREFERRED SHARES

The Declaration of Trust provides that Credit Strategies Fund's Board may authorize and issue preferred shares with rights as determined by the Board, by action of the Board without the approval of the holders of the common shares. Holders of common shares have no preemptive right to purchase any preferred shares that might be issued. Whenever preferred shares are outstanding, the holders of common shares will not be entitled to receive any distributions from Credit Strategies Fund unless all accrued dividends on preferred shares have been paid, unless asset coverage (as defined in the 1940 Act) with respect to preferred shares would be at least 200% after giving effect to the distributions and unless certain other requirements imposed by any rating agencies rating the preferred shares have been met.

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Credit Strategies Fund may issue preferred shares as part of its leverage strategy. We cannot assure you, however, that any preferred shares will be issued. Although the terms of any preferred shares, including dividend rate, liquidation preference and redemption provisions, will be determined by the Board, subject to applicable law and the Declaration of Trust, it is likely that the preferred shares will be structured to carry a relatively short-term dividend rate reflecting interest rates on short-term bonds, by providing for

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the periodic redetermination of the dividend rate at relatively short intervals through an auction, remarketing or other procedure. Credit Strategies Fund also believes that it is likely that the liquidation preference, voting rights and redemption provisions of the preferred shares will be similar to those stated below.

**LIQUIDATION PREFERENCE.** In the event of any voluntary or involuntary liquidation, dissolution or winding up of Credit Strategies Fund, the holders of preferred shares will be entitled to receive a preferential liquidating distribution, which is expected to equal the original purchase price per preferred share plus accrued and unpaid dividends, whether or not declared, before any distribution of assets is made to holders of common shares. After payment of the full amount of the liquidating distribution to which they are entitled, the holders of preferred shares will not be entitled to any further participation in any distribution of assets by Credit Strategies Fund.

**VOTING RIGHTS.** The 1940 Act requires that the holders of any preferred shares, voting separately as a single class, have the right to elect at least two trustees at all times. The remaining trustees will be elected by holders of common shares and preferred shares, voting together as a single class. In addition, subject to the prior rights, if any, of the holders of any other class of senior securities outstanding, the holders of any preferred shares have the right to elect a majority of the trustees of Credit Strategies Fund at any time two years' dividends on any preferred shares are unpaid. The 1940 Act also requires that, in addition to any approval by shareholders that might otherwise be required, the approval of the holders of a majority of any outstanding preferred shares, voting separately as a class, would be required to (i) adopt any plan of reorganization that would adversely affect the preferred shares, and (ii) take any action requiring a vote of security holders under Section 13(a) of the 1940 Act, including, among other things, changes in Credit Strategies Fund's subclassification as a closed-end investment company or changes in its fundamental investment restrictions. As a result of these voting rights, Credit Strategies Fund's ability to take any such actions may be impeded to the extent that there are any preferred shares outstanding. The board of trustees presently intends that, except as otherwise indicated in this prospectus and except as otherwise required by applicable law, holders of preferred shares will have equal voting rights with holders of common shares (one vote per share, unless otherwise required by the 1940 Act) and will vote together with holders of common shares as a single class.

The affirmative vote of the holders of a majority of the outstanding preferred shares, voting as a separate class, will be required to amend, alter or repeal any of the preferences, rights or powers of holders of preferred shares so as to affect materially and adversely such preferences, rights or powers, or to increase or decrease the authorized number of preferred shares. The class vote of holders of preferred shares described above will in each case be in addition to any other vote required to authorize the action in question.

**REDEMPTION, PURCHASE AND SALE OF PREFERRED SHARES BY CREDIT STRATEGIES FUND.** The terms of the preferred shares are expected to provide that (i) they are redeemable by Credit Strategies Fund in whole or in part at the original purchase price per share plus accrued dividends per share, (ii) Credit Strategies Fund may tender for or purchase preferred shares and (iii) Credit Strategies Fund may subsequently resell any shares so tendered for or purchased. Any redemption or purchase of preferred shares by Credit Strategies Fund will reduce the leverage applicable to the common shares, while any resale of shares by Credit Strategies Fund will increase that leverage.

THE DISCUSSION ABOVE DESCRIBES THE POSSIBLE OFFERING OF PREFERRED SHARES BY CREDIT STRATEGIES FUND. If the Board determines to proceed with such an offering, the terms of the preferred shares may be the same as, or different from, the terms described above, subject to applicable law and the Declaration

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of Trust. The board of trustees, without the approval of the holders of common shares, may authorize an offering of preferred shares or may determine not to authorize such an offering and may fix the terms of the preferred shares to be offered.

While Credit Strategies Fund has filed a registration statement to permit it to offer preferred shares, this registration statement has not been declared effective and Credit Strategies Fund has no present intention of offering any preferred shares in the next twelve months.

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### OTHER SHARES

The Board (subject to applicable law and the Declaration of Trust) may authorize an offering, without the approval of the holders of common shares, of other classes of shares, or other classes or series of shares, as they determine to be necessary, desirable or appropriate, having such terms, rights, preferences, privileges, limitations and restrictions as the board of trustees see fit. Credit Strategies Fund currently does not expect to issue any other classes of shares, or series of shares, except for the common shares.

### CREDIT FACILITY

Credit Strategies Fund currently leverages through borrowings from a credit facility. Credit Strategies Fund has entered into a revolving credit agreement with The Bank of Nova Scotia ("Scotia") to borrow up to \$380,000,000 (the "Loan Agreement"). Such borrowings constitute financial leverage. The Loan Agreement contains covenants that limit Credit Strategies Fund's ability to, without the prior consent of Scotia: (i) pay dividends in certain circumstances, (ii) incur additional debt, or (iii) adopt or carry out any plan of liquidation, reorganization, incorporation, recapitalization, merger or consolidation or sell, transfer or otherwise dispose of all or a substantial part of its assets. For instance, Credit Strategies Fund agreed not to purchase assets not contemplated by the investment policies and restrictions in effect when the Loan Agreement became effective. Furthermore, Credit Strategies Fund may not incur additional debt from any other party, except for in limited circumstances (E.G., in the ordinary course of business). In addition, the Loan Agreement contains a covenant requiring asset coverage ratios that may be more stringent than those required by the 1940 Act. Such restrictions shall apply only so long as the Loan Agreement remains in effect. Any senior security representing indebtedness, as defined in Section 18(g) of the 1940 Act, must have asset coverage of at least 300%. Debt incurred under the Loan Agreement will be considered a senior security for this purpose.

### FEDERAL INCOME TAX MATTERS

The following discussion summarizes certain federal income tax considerations affecting the Funds and their shareholders that are "United States persons" (as defined in the Code). For more information, please see the Statement of Additional Information, under "Federal Income Tax Matters." Because each shareholder's tax situation is unique, ask your tax professional about the tax consequences to you of an investment in a Fund.

Each Fund intends to qualify annually as a regulated investment company under the Code. Accordingly, each Fund generally will not be subject to federal income tax on income and gains that it distributes to its shareholders.

Distributions a Fund makes from its net capital gain (I.E., the excess of net long-term capital gain over net short-term capital loss), if any, that it designates as capital gain dividends, are taxable as long-term capital gain,



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regardless of how long you have held your common shares. All dividends a Fund pays from its investment company taxable income (consisting generally of net investment income, the excess, if any, of net short-term capital gain over net long-term capital loss, and net gains and losses from certain foreign currency transactions, if any, all determined without regard to any deduction for dividends paid) ("ordinary income dividends") are generally subject to tax as ordinary income.

In general, the Funds do not expect that a significant portion of its ordinary income dividends will be treated as "qualified dividend income," which is eligible for taxation at the rates applicable to net capital gain in the case of individual shareholders (a maximum of 15%), or that a corporate shareholder will be able to claim a dividends-received reduction with respect to any significant portion of Fund distributions.

Dividends and other taxable distributions are taxable to you even if they are reinvested in additional common shares of a Fund. Dividends and other distributions generally are treated as received by you at the time the distribution is made. If, however, an Acquired Fund pays you a distribution in January that was declared in the previous October, November or December to shareholders of record on a date in one of those months, then that distribution will be treated for tax purposes as being paid by the Fund and received by you on December 31 of the year in which the distribution was declared.

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The price of common shares purchased at any time may reflect the amount of a forthcoming distribution. Accordingly, if you purchase common shares just before a distribution, that distribution will be taxable to you even though it represents in part a return of your invested capital.

Each Fund sends in shareholders information after the end of each calendar year setting forth the amount and tax status of any distributions it made during that year. Distributions also may be subject to state and local taxes.

If you sell or otherwise dispose of common shares, you generally will recognize a gain or loss in an amount equal to the difference between your tax basis in those shares and the amount you receive on the disposition. If you hold your common shares as a capital asset, any such gain or loss generally will be long-term capital gain or loss if you have held the shares for more than one year at the time of sale or exchange thereof.

A Fund will be required to withhold, for federal backup withholding tax purposes, 28% of the distributions (and redemption proceeds, if any) payable to a noncorporate shareholder who fails to provide the Fund (or its agent) with the shareholder's correct taxpayer identification number (in the case of an individual, generally, the individual's social security number) or to make required certifications or who has been notified by the Internal Revenue Service ("IRS") that the shareholder is subject to backup withholding. Certain shareholders are exempt from backup withholding. Backup withholding is not an additional tax, and any amount withheld may be refunded or credited against your federal income tax liability, if any, provided that you furnish the required information to the IRS.

THE DISCUSSIONS SET FORTH HEREIN AND IN THE STATEMENT OF ADDITIONAL INFORMATION DO NOT CONSTITUTE TAX ADVICE, AND YOU ARE URGED TO CONSULT YOUR OWN TAX ADVISOR TO DETERMINE THE SPECIFIC FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES TO YOU OF INVESTING IN A FUND.

ANTI-TAKEOVER PROVISIONS

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### HIGH INCOME PORTFOLIO AND INCOME SHARES

Each Acquired Fund's Charter includes certain "supermajority" voting provisions that could have the effect of limiting the ability of other entities or persons to acquire control of either Acquired Fund or cause either Acquired Fund to engage in certain transactions. These provisions could have the effect of depriving holders of common shares of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of either Acquired Fund. In addition, holders of a minority of the total shares outstanding and entitled to vote may have a veto power over matters which management and/or a majority of the shareholders may believe is desirable and beneficial. However, by discouraging attempts to acquire control of either Acquired Fund, these provisions may enable the relevant Acquired Fund to avoid adverse effects of such attempts such as increasing the expenses of the relevant Acquired Fund and interfering with the normal operation of the relevant Acquired Fund. They also promote continuity and stability, and they enhance each Acquired Fund's ability to continue to pursue long-term strategies that are consistent with its investment objective.

Specifically, each Charter provides for a "supermajority" voting requirement to effect any of the following actions: (1) any amendment to the Charter to make the Fund's shares "redeemable securities" or to convert the Fund from a "closed-end company" to an "open-end company" (as such terms are defined in the 1940 Act), (2) any shareholder proposal regarding the Fund's investment objective or specific investment restrictions, policies or decisions made or to be made with respect to the Fund's assets, (3) any shareholder proposal as to the voluntary liquidation or dissolution of the Fund or any amendment to the Charter to terminate the existence of the Fund, (4) business combinations such as a merger, consolidation, share exchange or the sale of all or substantially all of the Fund's assets, and, (5) any amendment to Article VI of the Charter of High Income, and any amendment to article Eighth of the Charter of Income Shares.

The Charter of each Acquired Fund requires the affirmative vote of the holders of at least 80% of the votes then entitled to be cast by the holders of the common shares and the preferred shares, voting as a single class, and an affirmative vote of the holders of at least 80% of the preferred shares, voting as a separate class, and at least 80% of the entire Board of Directors to authorize any of the foregoing items, unless such action had been approved, adopted or authorized by the affirmative vote of at least 80% of the total number of Continuing Directors (as defined below), in which case (A) for items

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(1) and (2) above, approval would require the affirmative vote of the lesser of (a) 67% or more of the voting securities present or represented by proxy, if the holders of more than 50% of outstanding voting securities are present or represented by proxy, or (b) more than 50% of the outstanding voting securities, and (B) for items (3) and (4) above, the affirmative vote of at least a majority of the Fund's securities entitled to vote on the matter, subject, in the case of both (A) and (B), to the preferred shares voting both with the common shares as a single class and separately, as described below.

Each Acquired Fund's Board of Directors has determined that the voting requirements described above, which are greater than the minimum requirements under Maryland law or the 1940 Act and which can only be changed by a favorable vote of the holders of at least 80% of the holders of the common shares and preferred shares, voting as a single class, and a favorable vote of at least 80% of the preferred shares, voting separately, and at least 80% of the entire Board of Directors or a majority of the Continuing Directors, are in the best interests of shareholders generally.

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The Fund's by-laws currently contain other provisions permitted by Maryland law to deter attempts to obtain control of the Fund as follows: (1) the Fund's Secretary may call a special meeting of shareholders only on the request of the shareholders entitled to cast at least a majority of all the votes entitled to be cast at the meeting and only if the request states the matters proposed to be acted upon at it and the requesting shareholders bear the costs of the Fund's notification of each shareholder entitled to notice of the meeting, (2) the number of Directors and the positions on the Board to be filled by vote of the holders of particular classes of shares to, if applicable, the exclusion of other classes of shares, shall be fixed from time to time only by resolution of the Board of Directors adopted by a majority of the Directors then in office and (3) the shareholders of the Fund may remove any Director only by the affirmative vote of at least two-thirds (2/3) of all the votes entitled to be cast by the shareholders generally in the election of such Director, and if the Directors have been divided into classes, a Director may not be removed without cause. The Fund has also established a classified or "staggered" Board of Directors. The effect of this structure may make it more difficult for shareholders to change a majority of Directors because it would take two annual meetings to replace the majority of the Directors.

The Fund's Board of Directors may elect to submit to the Fund's shareholders at any time a proposal to convert the Fund to an open-end investment company and in connection therewith to redeem any outstanding preferred shares, as would be required upon such conversion by the 1940 Act. In determining whether to exercise its discretion to submit this issue to shareholders, the Board of Directors would consider all factors then relevant, including the relationship of the market price of the common shares to NAV, the extent to which the Fund's capital structure is leveraged and the possibility of re-leveraging, the spread, if any, between yields on high-yield securities in the Fund's portfolio as compared to interest and dividend charges on senior securities and general market and economic conditions. In addition to any vote required by Maryland law, conversion of the Fund to an open-end investment company would require the affirmative vote of the holders of a majority (as defined in the 1940 Act) of each class of shares entitled to be voted on the matter, including the preferred shares, voting as a separate class. 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 NAV, less such redemption charges, if any, as might be in effect at the time of redemption. Conversion of the Fund to an open-end investment company would require the redemption of any outstanding preferred shares. The Board of Directors believes, however, that the closed-end structure is desirable in light of the Fund's investment objective and policies. Therefore, it is currently not likely that the Board of Directors would vote to convert the Fund to an open-end fund. The Fund's Charter requires (except under certain circumstances) the affirmative vote of the holders of at least 80% of the votes then entitled to be cast by shareholders and the affirmative vote of at least 80% of the preferred shares, voting as a separate class and at least 80% of the entire Board of Directors to authorize, among other things, any amendment to the Fund's Charter to make the Fund's shares "redeemable securities" or to convert the Fund from a closed-end company to an open-end company.

### CREDIT STRATEGIES FUND

Credit Strategies Fund's Declaration of Trust 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. This could have the effect of depriving shareholders of an opportunity to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control over the Fund. Such attempts could have the

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effect of increasing the expenses of the Fund and disrupting the normal operation of the Fund. The board of trustees is divided into three classes, with the terms of one class expiring at each annual meeting of shareholders. At each annual meeting, one class of trustees is elected to a three-year term. This provision could delay for up to two years the replacement of a majority of the board of trustees. A trustee may be removed from office (for cause, and not without cause) by the action of a majority of the remaining trustees followed by a vote of the holders of at least 75% of the shares then entitled to vote for the election of the respective trustee.

In addition, the Declaration of Trust requires the favorable vote of a majority of the Fund's board of trustees followed by the favorable vote of the holders of at least 75% of the outstanding shares of each affected class or series of the Fund, voting separately as a class or series, to approve, adopt or authorize certain transactions with 5% or greater holders of a class or series of shares and their associates, unless the transaction has been approved by at least 80% of the trustees, in which case "a majority of the outstanding voting securities" (as defined in the 1940 Act) of the Fund shall be required. For purposes of these provisions, a 5% or greater holder of a class or series of shares (a "Principal Shareholder") refers to any person who, whether directly or indirectly and whether alone or together with its affiliates and associates, beneficially owns 5% or more of the outstanding shares of all outstanding classes or series of shares of beneficial interest of the Fund.

The 5% holder transactions subject to these special approval requirements are: the merger or consolidation of the Fund or any subsidiary of the Fund with or into any Principal Shareholder; the issuance of any securities of the Fund to any Principal Shareholder for cash, except pursuant to any automatic dividend reinvestment plan; the sale, lease or exchange of all or any substantial part of the assets of the Fund to any Principal Shareholder, except assets having an aggregate fair market value of less than 2% of the total assets of the Fund, aggregating for the purpose of such computation all assets sold, leased or exchanged in any series of similar transactions within a twelve-month period; or the sale, lease or exchange to the Fund or any subsidiary of the Fund, in exchange for securities of the Fund, of any assets of any Principal Shareholder, except assets having an aggregate fair market value of less than 2% of the total assets of the Fund, aggregating for purposes of such computation all assets sold, leased or exchanged in any series of similar transactions within a twelve-month period.

To convert the Fund to an open-end investment company, the Declaration of Trust requires the favorable vote of a majority of the board of the trustees followed by the favorable vote of the holders of at least 75% of the outstanding shares of each affected class or series of shares of the Fund, voting separately as a class or series, unless such amendment has been approved by at least 80% of the trustees, in which case "a majority of the outstanding voting securities" (as defined in the 1940 Act) of the Fund shall be required. The foregoing vote would satisfy a separate requirement in the 1940 Act that any conversion of the Fund to an open-end investment company be approved by the shareholders. If approved in the foregoing manner, conversion of the Fund to an open-end investment company could not occur until 90 days after the shareholders' meeting at which such conversion was approved and would also require at least 30 days' prior notice to all shareholders. Following any such conversion, it is possible that certain of the Fund's investment policies and strategies would have to be modified to assure sufficient portfolio liquidity. In the event of conversion, the common shares would cease to be listed on the NYSE or other national securities exchanges or market systems. 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 NAV, less such redemption charge, if any, as might be in effect at the time of a

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redemption. The Fund expects to pay all such redemption requests in cash, but reserves the right to pay redemption requests in a combination of cash or securities. If such partial payment in securities were made, investors may incur brokerage costs in converting such securities to cash. If the Fund were converted to an open-end fund, it is likely that new shares would be sold at NAV plus a sales load. The board of trustees believes, however, that the closed-end structure is desirable in light of the Fund's investment objectives and policies. Therefore, you should assume that it is not likely that the board of trustees would vote to convert the Fund to an open-end fund.

For the purposes of calculating "a majority of the outstanding voting securities" under the Declaration of Trust, each class and series of the Fund shall vote together as a single class, except to the extent required by the 1940 Act or the Declaration of Trust, with respect to any class or series of shares. If a separate class vote is required, the applicable proportion of shares of the class or series, voting as a separate class or series, also will be required.

The Declaration of Trust also provides that the Fund may be liquidated upon the approval of 80% of the trustees.

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The board of trustees has determined that provisions with respect to the board of trustees and the shareholder voting requirements described above, which voting requirements are greater than the minimum requirements under Delaware law or the 1940 Act, are in the best interest of shareholders generally. Reference should be made to the Declaration of Trust, on file with the SEC for the full text of these provisions.

### PAST PERFORMANCE OF EACH FUND

As shown in the table below, the performance of Credit Strategies Fund on a net asset value basis has exceeded that of Income Shares for the one-year period ended December 31, 2007. However, there is no guarantee or assurance as to the future performance of Credit Strategies Fund. Each Fund's performance at market price may differ from its results at NAV. Although market price performance generally reflects investment results, it may also be influenced by several factors, including changes in investor perceptions of each Fund or its investment adviser, market conditions, fluctuations in supply and demand for each Fund's shares and changes in each Fund's distributions.

TOTAL RETURNS AS OF DECEMBER 31, 2007

	HIGH INCOME PORTFOLIO*		INCOME SHARES**		CREDIT STRATEGIES FUND***	
	NAV	Market Price	NAV	Market Price	NAV	Market Price
1 year	-1.51%	-6.58%	-4.26%	-10.10%	-0.35%	-17.05%
3 years	2.63%	-0.21%	2.28%	0.85%	N/A	N/A
5 years	20.05%	15.51%	8.13%	7.31%	N/A	N/A
10 years	1.13%	-0.13%	3.19%	1.04%	N/A	N/A

\* Prior to January 21, 2000, High Income Portfolio was managed by a different investment adviser.

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\*\* Prior to July 31, 2001, Income Shares was managed by a different investment adviser.

\*\*\* Credit Strategies Fund commenced investment operations on June 29, 2006.

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### FINANCIAL HIGHLIGHTS

#### HIGH INCOME PORTFOLIO

For the Year Ended October 31,	2007 (audited)	2006 (audited)	2005 (audited)	2004 (audited)	2003 (audited)
NAV, beginning of period	\$3.39	\$3.25	\$3.08	\$2.61	\$1.91
Net investment income(a)	\$0.37	\$0.35	\$0.36	\$0.35	\$0.35
Net realized and unrealized gain/(loss) on investments(a)	- (b)	\$0.11	\$0.14	\$0.47	\$0.47
Distributions to preferred stockholders	\$(0.07)	\$(0.06)	\$(0.04)	\$(0.02)	\$(0.02)
Total from investment operations	\$0.30	\$0.40	\$0.46	\$0.80	\$1.00
Distributions:					
Distributions from accumulated net investment income to common shareholders	\$(0.28)	\$(0.26)	\$(0.29)	\$(0.33)	\$(0.33)
Total distributions to common shareholders	\$(0.28)	\$(0.26)	\$(0.29)	\$(0.33)	\$(0.33)
NAV, end of year	\$3.41	\$3.39	\$3.25	\$3.08	\$2.61
Market price per share, end of year	\$3.01	\$3.23	\$2.77	\$3.24	\$2.77
Total investment return based on market value(c)	1.63%	26.86%	(6.90)%	21.61%	66.67%
Net Assets - end of year(d)	105,411	104,535	100,443	93,894	74,000
Preferred shares outstanding, end of year(d)	40,000	40,000	40,000	40,000	40,000
Asset Coverage:					
Per indebtedness	N/A	N/A	N/A	N/A	N/A
Per preferred share(e)	382%	372%	351%	334%	200%
Ratio of total expenses to average net assets, applicable to common stock(f)	1.35% (g)	1.67%	1.85%	2.18%	4.17%
Ratio of net investment income to average net assets, applicable to common stock(f)	10.80%	10.15%	10.08%	11.88%	16.28%
Portfolio turnover	216.17%	150.28%	72.84%	81.25%	111.11%

(a) Calculation is based on average shares outstanding during the indicated period due to the per share effect of the Fund's rights offerings.

(b) Represents less than \$0.005 per share.

(c) Total investment return based on market value may result in substantially different returns than investment return based on net asset value, because market value can be significantly greater or less than the net asset value. Total investment return calculation assumes reinvestment of dividends, and does not contemplate any over-distribution.

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(d) Dollars in thousands

(e) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the principal amount of the debt outstanding and aggregate liquidation preference of the outstanding shares of Series W Auction Rate Cumulative Preferred Shares.

(f) Ratios do not reflect the effect of dividend payments to preferred stockholders.

(g) Ratio of total expenses to average net assets include interest expense of 0.01% for the year ended October 31, 2007.

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For the Year Ended October 31,	2002 (b) (unaudited)	2001 (b) (unaudited)	2000 (b) (i) (unaudited)	1999 (b) (i) (unaudited)	1998 (unaudited)
NAV, beginning of period	\$3.12	\$5.30	\$6.98	\$7.97	\$11.00
Net investment income (a)	\$0.46	\$0.74	\$1.12	\$1.08	\$1.00
Net realized and unrealized gain/(loss) on investments (a)	\$ (0.95)	\$ (1.96)	\$ (1.77)	\$ (1.00)	\$ (3.00)
Distributions to preferred stockholders	\$ (0.05)	\$ (0.07)	-	-	\$ (0.00)
Total from investment operations	\$ (0.54)	\$ (1.29)	\$ (0.65)	\$0.08	\$ (2.00)
Distributions:					
Distributions from accumulated net investment income	\$ (0.42)	\$ (0.76)	\$ (1.03)	\$ (1.26)	\$ (1.00)
Distributions from return of capital (c)	\$ (0.39)	\$ (0.14)	-	-	\$ (0.00)
Total distributions to common shareholders	\$ (0.81)	\$ (0.90)	\$ (1.03)	\$ (1.26)	\$ (1.00)
Effect of sale of common stock and related expenses from rights offering	-	\$0.01	-	\$0.19	\$ (0.00)
NAV, end of year	\$1.77	\$3.12	\$5.30	\$6.98	\$7.97
Market price per share, end of year	\$2.02	\$4.24	\$5.69	\$7.94	\$10.00
Total investment return based on market value (d)	(42.19)%	(9.82)%	(8.31)%	(11.78)%	(7.60)%
Net Assets - end of year (e)	49,182	86,048	142,924	186,167	157,000
Preferred shares outstanding, end of year (e)	40,000	40,000	-	-	40,000
Indebtedness, end of year (e)	-	-	71,000	50,000	40,000
Asset Coverage:					
Per indebtedness (f)	N/A	N/A	330%	472%	400%
Per preferred stock share (g)	187%	215%	N/A	N/A	N/A
Ratio of total expenses to average net assets, applicable to common stock (h)	3.22%	3.75%	4.46%	2.67%	2.00%
Ratio of net investment income to average net assets, applicable to common stock (h)	15.99%	20.06%	17.59%	13.72%	11.00%
Portfolio turnover	96.89%	73.63%	104.99%	126.45%	156.00%

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(a) Calculation is based on average shares outstanding during the indicated period due to the per share effect of the Fund's rights offerings.

(b) Presentation of distributions paid to preferred shareholders has been changed from prior financial reports filed by the Fund due to the reclassification from total distributions to total from investment operations presented above.

(c) Taxes are calculated on a calendar year, whereas this data is calculated on a fiscal year ended 10/31.

(d) Total investment return based on market value may result in substantially different returns than investment return based on net asset value, because market value can be significantly greater or less than the net asset value. Total investment return calculation assumes reinvestment of dividends, and does not contemplate any over-distribution.

(e) Dollars in thousands

(f) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the principal amount of the debt outstanding.

(g) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the principal amount of the debt outstanding and aggregate liquidation preference of the outstanding shares of Series W Auction Rate Cumulative Preferred Shares.

(h) Ratios do not reflect the effect of dividend payments to preferred stockholders.

(i) As of January 21, 2000, the Fund entered into a new advisory agreement with Highland. For periods prior to that date, the Fund was advised by a different investment adviser.

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### INCOME SHARES

For the Year Ended December 31,	2007 (audited)	2006 (audited)	2005 (audited)	2004 (audited)	2003 (audited)
NAV, beginning of period	\$6.59	\$6.40	\$6.75	\$6.49	\$5.95
Net investment income(a)	\$0.66	\$0.63	\$0.58	\$0.59	\$0.58
Net realized and unrealized gain/(loss) on investments	\$(0.78)	\$0.16	\$(0.37)	\$0.29	\$0.11
Distributions to preferred shareholders	\$(0.16)	\$(0.15)	\$(0.10)	\$(0.05)	\$(0.05)
Total from investment operations	\$(0.28)	\$0.64	\$0.11	\$0.83	\$1.11
<b>Distributions:</b>					
Distributions from accumulated net investment income to common shareholders	\$(0.45)	\$(0.45)	\$(0.46)	\$(0.55)	\$(0.55)
Distributions from tax return of capital to common shareholders	-	-	-	\$(0.02)	-



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Total distributions	\$ (0.45)	\$ (0.45)	\$ (0.46)	\$ (0.57)	\$ (0.57)
NAV, end of year	\$5.86	\$6.59	\$6.40	\$6.75	\$6.75
Market price per share, end of year	\$5.05	\$6.08	\$5.45	\$6.21	\$6.21
Total investment return based on market value (b)	(10.27%)	20.23%	(5.28)%	7.63%	27.63%
Net Assets - end of year (c)	\$58,301	\$65,552	\$63,689	\$66,183	\$63,689
Preferred shares outstanding, end of year (c)	\$30,000	\$30,000	\$30,000	\$30,000	\$30,000
Asset Coverage:					
Per indebtedness (d)	N/A	N/A	N/A	N/A	N/A
Per preferred stock share (e)	294%	319%	312%	321%	321%
Ratio of total expenses to average net assets, applicable to common stock excluding interest expense (f)	1.44%	1.52%	1.40%	1.36%	1.36%
Ratio of total expenses to average net assets, applicable to common stock including interest expense (f)	1.51%	1.52%	1.40%	1.36%	1.36%
Ratio of net investment income to average net assets, applicable to common stock (f)	10.08%	9.81%	8.79%	9.06%	9.06%
Portfolio turnover rate	222.25%	146.23%	60.23%	41.32%	51.32%

(a) Per share net investment income or loss is calculated by dividing net investment income by the average number of shares outstanding during the year.

(b) Total investment return based on market value may result in substantially different returns than investment return based on net asset value, because market value can be significantly greater or less than the net asset value. Total investment return assumes reinvestment of dividends.

(c) Dollars in thousands.

(d) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the principal amount of the debt outstanding.

(e) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the liquidation preference of the outstanding shares of Series T preferred stock.

(f) Ratios do not reflect the effect of dividend payments to preferred shareholders.

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For the Year Ended December 31,	2002 (unaudited)	2001 (b) (unaudited)	2000 (b) (unaudited)	1999 (b) (unaudited)	1998 (b) (unaudited)
NAV, beginning of period	\$6.77	\$7.21	\$8.49	\$9.70	\$10.00
Net investment income (a)	\$0.75	\$0.80	\$0.90	\$0.96	\$0.96
Net realized and unrealized gain/(loss) on investments	\$ (0.74)	\$ (0.55)	\$ (1.28)	\$ (1.21)	\$ (1.21)

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Distributions to preferred shareholders	\$ (0.05)	\$ (0.04)	-	-	
Total from investment operations	\$ (0.04)	\$ 0.21	\$ (0.38)	\$ (0.25)	\$ (0.04)
-----					
Distributions:					
Distributions from accumulated net investment income to common shareholders	\$ (0.83)	\$ (0.60)	\$ (0.90)	\$ (0.96)	\$ (0.83)
Total distributions	\$ (0.83)	\$ (0.60)	\$ (0.90)	\$ (0.96)	\$ (0.83)
-----					
Effect of related preferred shares offering cost	-	\$ (0.05)	-	-	
NAV, end of year	\$5.90	\$6.77	\$7.21	\$8.49	\$9.00
Market price per share, end of year	\$5.45	\$6.44	\$6.81	\$7.13	\$7.50
-----					
Total Investment Return(c):					
Based on market price per share	(2.48)%	3.34%	8.25%	(20.63)%	(7.50)%
Based on net asset value per share	(0.59)%	2.27%	(4.48)%	(2.58)%	(0.59)%
-----					
Net Assets - end of year(e)	57,160	63,846	66,959	77,968	87,000
Preferred shares outstanding, end of year(e)	\$30,000	\$30,000	\$0	\$0	\$0
Credit facility indebtedness, end of year(e)	\$0	\$0	\$30,000	\$30,000	\$30,000
Asset Coverage:					
Per indebtedness(f)	N/A	N/A	323%	360%	
Per preferred stock share(g)	291%	313%	N/A	N/A	
-----					
Ratio of operating expenses to average net assets, applicable to common stock	1.63%	1.29%	1.03%	0.97%	0.97%
Ratio of total expenses to average net assets, applicable to common stock(d)	1.63%	3.06%	4.03%	3.66%	3.66%
Ratio of net investment income to average net assets, applicable to common stock(d)	11.93%	11.31%	11.38%	10.45%	9.99%
-----					
Portfolio turnover	26.71%	35.77%	33.04%	36.16%	26.71%
-----					

(a) Per share net investment income or loss is calculated by dividing net investment income by the average number of shares outstanding during the year.

(b) As of July 30, 2001, the Fund entered into a new advisory agreement with Highland Capital Management, L.P. For periods prior to that date, a different investment adviser advised the Fund.

(c) Total investment return based on market value may result in substantially different returns than investment return based on net asset value, because market value can be significantly greater or less than the net asset value. Investment return assumes reinvestment of dividends.

(d) For the year ended December 31, 2001 and prior, this ratio included interest paid on the Bank Credit Facility. In 2001 the Bank Credit Facility was replaced with preferred stock. Dividends paid on the preferred stock are classified as a financing activity, and are not included in this ratio.

(e) Dollars in thousands.

(f) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the principal amount of the debt outstanding.

(g) Calculated by subtracting the Fund's total liabilities (not including bank loans and senior securities) from the Fund's total assets and dividing such amount by the liquidation preference of the outstanding shares of Series T preferred stock.

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CREDIT STRATEGIES FUND

	For the year ended 12/31/2007 (audited)	For the period 12/31/2006 (audited)
NAV, beginning of period	\$20.08	\$19.00
Income from Investment Operations:		
Net investment income	\$1.71	\$0.00
Net realized and unrealized gain/(loss) on investments	\$(1.85)	\$0.00
Total from investment operations	\$(0.14)	\$1.00
Less Distributions Declared to Common Shareholders:		
From net investment income	\$(1.65)	\$(0.00)
From net realized gains	\$(0.30)	-
Total distributions declared to common shareholders	\$(1.95)	\$(0.00)
NAV, end of period	\$17.99	\$20.00
Market Value, end of period	\$15.82	\$21.00
Market Value Total Return(c)	(17.05)%	9.00%
Ratios and Supplemental Data:		
Net Assets - end of period (in 000s)	621,078	692,900
Common Share Information at End of Period:		
Ratios based on average net assets of common shares:		
Net operating expenses	1.87%	1.00%
Interest expenses	2.16%	1.00%
Dividend income from short positions	0.03%	N/A
Net expenses	4.06%	2.00%
Net investment income	8.64%	7.00%
Ratios based on managed net assets of common shares:		
Net operating expenses	1.36%	1.00%
Interest expenses	1.58%	0.00%
Dividend income from short positions	0.02%	N/A
Net expenses	2.96%	2.00%
Net investment income	6.31%	6.00%
Portfolio turnover rate	66.49%	45.00%

(a) The Fund commenced investment operations on June 29, 2006.

(b) Not annualized.

(c) Based on market value per share. Dividends and distributions, if any, are assumed for purposes of this calculation to be reinvested at prices obtained under the Fund's Dividend reinvestment plan

FURTHER INFORMATION ON THE REORGANIZATIONS

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### FEDERAL INCOME TAX CONSEQUENCES OF THE REORGANIZATIONS

Each Reorganization is intended to be a tax-free reorganization for federal income tax purposes. As a condition (which cannot be waived) to consummation of each Reorganization, Kirkpatrick & Lockhart Preston Gates Ellis LLP ("Tax Counsel") will deliver an opinion ("Tax Opinion") to the Acquired Fund participating therein and to the Acquiring Fund, dated as of that Reorganization's closing date, substantially to the effect that, based on the facts and assumptions stated therein (as well as certain representations of each Fund) and the existing federal income tax law, and conditioned on that Reorganization's being consummated in accordance with the applicable Agreement, for federal income tax purposes, with respect to that Reorganization and the Funds participating therein:

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- o The Reorganization will qualify as a "reorganization" (as defined in section 368(a)(1) of the Code, and each Fund will be a "party to a reorganization" (within the meaning of section 368(b) of the Code);
- o Neither Fund will recognize any gain or loss on the Reorganization;
- o The Acquiring Fund's tax basis in each asset the Acquired Fund transfers to it will be the same as the Acquired Fund's tax basis therein immediately before the Reorganization, and the Acquiring Fund's holding period for each such asset will include the Acquired Fund's holding period therefor (except where the Acquiring Fund's investment activities have the effect of reducing or eliminating an asset's holding period);
- o The Acquired Fund's shareholders will not recognize any gain or loss on the receipt of Acquiring Fund Common Shares pursuant to the Reorganization, except to the extent such shareholders are paid cash in lieu of fractional shares of Acquiring Fund Common Shares in the Reorganization; and
- o The tax basis in the Acquiring Fund Common Shares that an Acquired Fund shareholder receives pursuant to the Reorganization will be the same as the aggregate tax basis in the Acquired Fund common shares the shareholder holds immediately before the Reorganization, and the shareholder's holding period for those Acquiring Fund Common Shares will include the holding period for that Acquired Fund common shares (provided the shareholder holds those shares as a capital asset at the closing date of the Reorganization).

Notwithstanding the second and third bullet points above, the Tax Opinion may state that no opinion is expressed as to the effect of a Reorganization on the Funds or the Acquired Fund's shareholders with respect to any transferred asset as to which any unrealized gain or loss is required to be recognized for federal income tax purposes at the end of a taxable year (or on the termination or transfer thereof) under a mark-to-market system of accounting.

The Tax Opinion is not binding on the IRS or the courts and is not a guarantee that the tax consequences of the Reorganizations will be as described above.

Prior to the closing of a Reorganization, the Acquired Fund participating therein will distribute to its shareholders all of its investment company taxable income and net realized capital gain (after reduction by any available capital loss carryforwards), if any, that have not previously been distributed to them.

The Acquiring Fund's ability to use pre-Reorganization capital losses of each

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Acquired Fund to offset post-Reorganization capital gains of the combined Fund will be limited due to the application of loss limitation rules under the federal tax law. Those rules, as applied to the Funds, generally

(1) permit each Fund, as a regulated investment company, to use CLCs (that is, capital losses sustained in a taxable year) in each of the eight succeeding taxable years,

(2) permit the Acquiring Fund to succeed to each Acquired Fund's CLCs,

(3) prevent the Acquiring Fund, as a "gain corporation" (i.e., a corporation the fair market value of the assets of which on the closing date of a reorganization exceeds its adjusted basis therein on that date by more than \$10 million), from offsetting any amount of an Acquired Fund's CLCs against any part of the net unrealized gains the Acquiring Fund has on the respective closing date of a Reorganization and recognizes during the five-year period beginning on that date, but will not prevent the Acquiring Fund from offsetting those CLCs against any gains the Acquiring Fund realizes after the five-year period or due to appreciation that occurs after the closing date, subject to the limitation in clause (4), and

(4) limit the Acquiring Fund's use of an Acquired Fund's CLCs that are not prevented by clause (3) to (a) an annual amount equal to the product of the Acquired Fund's value at the time of the Reorganization multiplied by a specified rate that varies each month (currently 4.55%).

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At the date hereof, Income Shares had CLCs from prior taxable years aggregating almost \$28.8 million, most of which will expire, in the absence of its Reorganization, by the end of its 2009 taxable year; based on Income Shares' (unaudited) net asset value of approximately \$57.4 million at January 31, 2008, the Acquiring Fund would only be able to use less than \$2.5 million of those CLCs each year pursuant to clause (4) above, and only against recognized gains attributable to appreciation after the Reorganizations, with the result that a large part of those CLCs will expire unused. Similarly, at the date hereof, High Income Portfolio had CLCs from prior taxable years aggregating almost \$133.5 million, a majority of which will expire, in the absence of its Reorganization, by the end of its 2009 taxable year; based on High Income Portfolio's (unaudited) value of approximately \$89.5 million at January 31, 2008, the Acquiring Fund would be able to use only about \$3.9 million of High Income Portfolio's CLCs each year pursuant to clause (4) above, and only against recognized gains attributable to appreciation after the Reorganizations, with the result that a very large part of those CLCs also will expire unused. But if the Acquiring Fund recognizes sufficient gains attributable to post-Reorganization appreciation, it nevertheless would be able to use approximately [\$34] million of the Acquired Funds' combined CLCs through its taxable year ending December 31, [2013]. As a consequence, if the Acquiring Fund recognizes significant net capital gains in the future, it can be expected that an Acquired Fund's shareholders would receive taxable distributions from the Acquiring Fund earlier than they would have received from that Acquired Fund if its Reorganization had not occurred and it had generated comparable gains.

### ADDITIONAL TERMS OF THE AGREEMENTS AND PLANS OF REORGANIZATION

Certain terms of each Agreement are described above. The following is a summary of certain additional terms of each Agreement. This summary and any other description of the terms of each Agreement contained in this Proxy Statement/Prospectus are qualified in their entirety by Appendix A hereto, which is the form of each Agreement.

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**SURRENDER OF SHARE CERTIFICATES.** If your shares are represented by one or more share certificates before the closing date of the applicable Reorganization, you must either surrender the certificate to your Fund(s) or deliver to your Fund(s) a lost certificate affidavit, in the form of and accompanied by the surety bonds that your Fund(s) may require (collectively, an "Affidavit"). On the closing date of a Reorganization, all share certificates of the participating Acquired Fund that have not been surrendered will be canceled, will no longer evidence ownership of that Fund's shares and will evidence ownership of the Acquiring Fund's Common Shares. Until such share certificates have been so surrendered, no dividends payable after a Reorganization to the holders of record as of the closing date of Acquired Fund common shares represented by these certificates will be reinvested pursuant to the Acquiring Fund's Dividend Reinvestment Plan, but will instead be paid in cash. Once such certificates have been surrendered, a holder of shares of an Acquired Fund who currently elects to receive dividends in cash will continue to receive dividends from the Acquiring Fund in cash; all holders who currently elect to participate in the Dividend Reinvestment Plan of a Fund will have their dividends automatically reinvested in shares of the Acquiring Fund. Shareholders may not redeem or transfer Acquiring Fund shares received in the Reorganization until they have surrendered their Fund share certificates or delivered an Affidavit. The Acquiring Fund will not issue share certificates in the Reorganizations. Upon consummation of each Reorganization, holders of Acquired Fund common shares will be entitled to receive cash in lieu of any fractional Acquiring Fund Common Shares held other than in a Dividend Reinvestment Plan Account.

**CONDITIONS TO CLOSING A REORGANIZATION.** The obligation of each Fund to consummate its Reorganization is subject to the satisfaction of certain conditions, including the performance by the other participating Fund of all of its obligations under the Agreement and the receipt of all consents, orders and permits necessary to consummate the Reorganization.

The obligations of the Funds that are parties to an Agreement are subject to approval of that Agreement by the necessary vote of the outstanding shares of the participating Acquired Fund, in accordance with the provisions of that Acquired Fund's Charter and By-Laws. Those Funds' obligations are also subject to the receipt of a favorable opinion of Tax Counsel as to the federal income tax consequences of their Reorganization.

**TERMINATION OF AN AGREEMENT.** The Boards of the Funds that are parties to an Agreement may terminate the Agreement by mutual consent (even if shareholders of the applicable Acquired Fund have already approved it) at any time before the closing date of the Reorganization, if the Boards believe that proceeding with that Reorganization would no longer be advisable.

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**EXPENSES OF A REORGANIZATION.** The costs associated with the Reorganizations will be borne by each of the Acquired Funds and the Acquiring Fund in proportion to their respective net assets determined at the close of regular trading on the NYSE on the date of the Reorganizations' closing, provided that if they close at different times, that determination will be made as of the date that the first Reorganization closes. Neither the Funds nor the Adviser will pay any expenses of shareholders arising out of or in connection with the Reorganizations.

### **PAYMENT OF UNDISTRIBUTED INCOME IN ADVANCE OF REORGANIZATIONS**

Each Acquired Fund generally retains an amount of earned net income that is not distributed in regular dividend payments in order to provide a reserve to regularize dividend payments over time. Each Acquired Fund intends to declare and pay a special dividend on its common shares in advance of the Reorganization

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of that Fund, distributing such reserved income. The record date for such special dividends will be a date following the approval of the Reorganization. If a Reorganization is not approved, no such special dividend will be declared or paid for the Acquired Fund for which the Reorganization has not been approved.

### CAPITALIZATION

With respect to each Proposal, the following tables set forth the capitalization of each Fund as of December 31, 2007, and the PRO FORMA combined capitalization of the Acquiring Fund as if all proposed Reorganizations had occurred on that date, as well as the PRO FORMA combined capitalization of the Acquiring Fund as if each Reorganization had occurred on that date absent any of the other Reorganizations. The tables also assume the outstanding preferred shares of each Acquired Fund were redeemed prior to its respective Reorganization and reflect the proceeds received from the Acquiring Fund's rights offering completed on January 28, 2008. The tables should not be relied upon to determine the amount of Acquiring Fund shares that will actually be received and distributed.

IF THE REORGANIZATION OF YOUR FUND(S) HAD TAKEN PLACE ON DECEMBER 31, 2007:

(Unaudited)	ACTUAL			ADJUSTMENT FOR RIGHTS OFFERING	ADJUSTED	ADJ REORG
	High Income Portfolio	Income Shares	Credit Strategies Fund		Credit Strategies Fund	
<b>SHARES OUTSTANDING</b>						
Common shares	30,874,699	9,947,104	34,520,550	11,535,615*	46,056,165	
Preferred shares	1,600	1,200	-	-	-	(
<b>NET ASSETS</b>						
Common shares	96,357,317	58,300,946	621,078,161	143,563,457**	764,641,618	(561
Preferred shares and accrued dividends	40,000,000	30,000,000	-	-	-	(70,
<b>NET ASSETS INCLUDING PREFERRED SHARES</b>	136,357,317	88,300,946	621,078,161	143,563,457	764,641,618	(70,
<b>NET ASSET VALUE PER COMMON SHARE</b>	3.12	5.86	17.99		16.59	

\* Shares issued by Credit Strategies Fund pursuant to a rights offering completed on January 28, 2008.

\*\* Reflects the proceeds received from the rights offering completed on January 28, 2008.

\*\*\* Reflects the estimated Reorganization expenses.

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IF THE REORGANIZATION OF YOUR FUND(S) HAD TAKEN PLACE ON DECEMBER 31, 2007:

(Unaudited)	ACTUAL		ADJUSTMENT FOR RIGHTS OFFERING	ADJUSTED	ADJUSTMENT FOR REORGANIZATION	C
	High Income Portfolio	Credit Strategies Fund		Credit Strategies Fund		St
SHARES OUTSTANDING						
Common shares	30,874,699	34,520,550	11,535,615*	46,056,165	-	51
Preferred shares	1,600	-	-	-	(1,600)	
NET ASSETS						
Common shares	96,357,317	621,078,161	143,563,457**	764,641,618	(561,950)***	860
Preferred shares and accrued dividends	40,000,000	-	-	-	(40,000,000)	
NET ASSETS INCLUDING PREFERRED SHARES	136,357,317	621,078,161	143,563,457	764,641,618	(40,561,950)	860
NET ASSET VALUE PER COMMON SHARE	3.12	17.99		16.59		

\* Shares issued by Credit Strategies Fund pursuant to a rights offering completed on January 28, 2008.

\*\* Reflects the proceeds received from the rights offering completed on January 28, 2008.

\*\*\* Reflects the estimated Reorganization expenses.

IF THE REORGANIZATION OF YOUR FUND(S) HAD TAKEN PLACE ON DECEMBER 31, 2007:

(Unaudited)	ACTUAL		ADJUSTMENT FOR RIGHTS OFFERING	ADJUSTED	ADJUSTMENT FOR REORGANIZATION	C
	Income Shares	Credit Strategies Fund		Credit Strategies Fund		St
SHARES OUTSTANDING						



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Common shares	9,947,104	34,520,550	11,535,615*	46,056,165	-	49
Preferred shares	1,200	-	-	-	(1,200)	
NET ASSETS						
Common shares	58,300,946	621,078,161	143,563,457**	764,641,618	(561,950)***	822
Preferred shares and accrued dividends	30,000,000	-	-	-	(30,000,000)	
NET ASSETS INCLUDING PREFERRED SHARES	88,300,946	621,078,161	143,563,457	764,641,618	(30,561,950)	822
NET ASSET VALUE PER COMMON SHARE	5.86	17.99		16.59		

\* Shares issued by Credit Strategies Fund pursuant to a rights offering completed on January 28, 2008.

\*\* Reflects the proceeds received from the rights offering completed on January 28, 2008.

\*\*\* Reflects the estimated Reorganization expenses.

MANAGEMENT OF THE FUNDS

TRUSTEES/DIRECTORS AND OFFICERS

The Directors of each Acquired Fund are the same individuals as the Trustees of the Acquiring Fund. Each Fund's Board provides broad supervision over the affairs of each Fund. The officers of each Fund are responsible for the Fund's operations. The Trustees/Directors and officers of the Funds, together with their principal occupations during the past five years, are listed in the Statement of Additional Information. Each of the Trustees/Directors serves as a Trustee/Director for other closed-end investment companies for which the Adviser serves as investment adviser.

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INVESTMENT ADVISER

Highland acts as each Fund's investment adviser. Highland is located at Two Galleria Tower, 13455 Noel Road, Suite 800, Dallas, Texas 75240. As of December 31, 2007, the Adviser managed approximately \$37.4 billion in assets on behalf of investors around the world. Highland is controlled by James Dondero and Mark Okada, by virtue of their respective share ownership, and its general partner, Strand Advisors, Inc., of which Mr. Dondero is the sole stockholder. Messrs. Dondero and Okada have managed portfolios together since 1990.

Since each Fund employs leverage, the Adviser benefits because each Fund's assets subject to an advisory fee increase with leverage. Furthermore, the Adviser also benefits to the extent that each Fund's assets subject to an advisory fee are derived from the reinvested collateral received on portfolio securities loaned.

The Adviser has built a professional working environment, a firm-wide compliance

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culture and compliance procedures and systems designed to protect against potential incentives that may favor one account over another. The Adviser has adopted policies and procedures that address the allocation of investment opportunities, execution of portfolio transactions, personal trading by employees and other potential conflicts of interest that are designed to ensure that all client accounts are treated equitably over time. Nevertheless, the Adviser furnishes advisory services to numerous clients in addition to each Fund, and the Adviser may, consistent with applicable law, make investment recommendations to other clients or accounts (including accounts which are hedge funds or have performance or higher fees paid to the Adviser, or in which portfolio managers have a personal interest in the receipt of such fees), which may be the same as or different from those made to each Fund. In addition, the Adviser, its affiliates and any officer, director, stockholder or employee may or may not have an interest in the securities whose purchase and sale the Adviser recommends to each Fund. Actions with respect to securities of the same kind may be the same as or different from the action which the Adviser, or any of its affiliates, or any officer, director, stockholder, employee or any member of their families may take with respect to the same securities. Moreover, the Adviser may refrain from rendering any advice or services concerning securities of companies of which any of the Adviser's (or its affiliates') officers, directors or employees are directors or officers, or companies as to which the Adviser or any of its affiliates or the officers, directors and employees of any of them has any substantial economic interest or possesses material non-public information. In addition to its various policies and procedures designed to address these issues, the Adviser includes disclosure regarding these matters to its clients in both its Form ADV and investment advisory agreements.

The Adviser may also have clients that invest in different levels of the capital structure of a company, such as equity versus senior loans, or that take contrary provisions in multiple levels of the capital structure. This may create situations where a client could be disadvantaged because of the investment activities conducted by the Adviser for other client accounts.

The Adviser, its affiliates or their officers and employees serve or may serve as officers, directors or principals of entities that operate in the same or related lines of business or of investment funds managed by affiliates of the Adviser. Accordingly, these individuals may have obligations to investors in those entities or funds or to other clients, the fulfillment of which might not be in the best interests of each Fund. As a result, the Adviser will face conflicts in the allocation of investment opportunities to each Fund and other funds and clients. In order to enable such affiliates to fulfill their fiduciary duties to each of the clients for which they have responsibility, the Adviser will endeavor to allocate investment opportunities in a fair and equitable manner which may, subject to applicable regulatory constraints, involve pro rata co-investment by each Fund and such other clients or may involve a rotation of opportunities among each Fund and such other clients.

While the Adviser does not believe there will be frequent conflicts of interest, if any, the Adviser and its affiliates have both subjective and objective procedures and policies in place designed to manage the potential conflicts of interest between the Adviser's fiduciary obligations to each Fund and their similar fiduciary obligations to other clients so that, for example, investment opportunities are allocated in a fair and equitable manner among each Fund and such other clients. An investment opportunity that is suitable for multiple clients of the Adviser and its affiliates may not be capable of being shared among some or all of such clients due to the limited scale of the opportunity or other factors, including regulatory restrictions imposed by the 1940 Act. There can be no assurance that the Adviser's or its affiliates' efforts to allocate any particular investment opportunity fairly among all clients for whom such

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opportunity is appropriate will result in an allocation of all or part of such opportunity to each Fund. Not all conflicts of interest can be expected to be resolved in favor of each Fund.

Under current SEC regulations, each Fund may be prohibited from co-investing with any unregistered fund managed now or in the future by the Adviser in certain private placements in which the Adviser negotiates non-pricing terms.

### HIGH INCOME PORTFOLIO

The Adviser has overall responsibility for the management of High Income Portfolio's portfolio. High Income Portfolio and the Adviser have entered into an Advisory Agreement, dated as of January 21, 2000, that requires the Adviser to provide all investment advisory and portfolio management services for High Income Portfolio. It also requires the Adviser to assist in managing and supervising all aspects of the general day-to-day business activities and operations of High Income Portfolio, including custodial, transfer agency, dividend disbursing, accounting, auditing, compliance and related services. The Adviser provides High Income Portfolio with the personnel necessary to administer High Income Portfolio. The agreement with the Adviser can be canceled by the Board of Directors and the Adviser upon not less than 30 nor more than 60 days' written notice.

The Adviser bears its expenses of providing the services described above. High Income Portfolio pays all operating and other expenses of High Income Portfolio not borne by the Adviser including, but not limited to, audit and legal fees, transfer agent, registrar and custodian fees, expenses in preparing tender offers, shareholder reports and proxy solicitation materials and other miscellaneous business expenses. High Income Portfolio also pays all taxes imposed on it and all brokerage commissions and loan-related fees.

The Adviser earned \$967,015, \$961,707 and \$953,801 in management fees for the fiscal years ended October 31, 2005, 2006 and 2007, respectively. Management fees paid by High Income Portfolio to the Adviser were calculated at 0.65% (on an annual basis) of High Income Portfolio's average weekly net asset value defined as total assets of the Fund less accrued liabilities (excluding the principal amount of any bank any loan, notes and the liquidation preference of preferred shares and including accrued and unpaid dividends on the preferred shares), up to and including \$175 million of net assets, 0.55% on the next \$50 million of net assets and 0.50% of the excess of net assets over \$225 million. A discussion regarding the basis for the approval of the investment advisory agreement by High Income Portfolio's board is available in High Income Portfolio's report to shareholders for the period ended April 30, 2007.

### INCOME SHARES

The Adviser has overall responsibility for the management of Income Shares. Income Shares and the Adviser have entered into an Investment Advisory Agreement, dated as of July 30, 2001, pursuant to which the Adviser is responsible for the selection and ongoing monitoring of Income Shares' investment portfolio. The Adviser provides Income Shares with the personnel necessary to administer Income Shares. The agreement with the Adviser can be terminated on 60 days' written notice.

The Adviser bears its expenses of providing the services described above. The Adviser currently receives from Income Shares a management fee calculated at an annual rate of 0.50% of the average weekly net assets of Income Shares. The definition of net assets includes the assets acquired through the Fund's use of leverage. The Adviser earned \$325,838, \$470,503 and \$473,658 in management fees for the fiscal years ended December 31, 2005, 2006 and 2007, respectively. A discussion regarding the basis for the approval of the investment advisory

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agreement by Income Shares' board is available in Income Shares' report to shareholders for the period ended June 30, 2007.

Income Shares pays all operating and other expenses of Income Shares not borne by the Adviser including, but not limited to, directors' fees not borne by the Adviser, custodian expenses, legal fees, costs of keeping Income Shares' books and records, fees and expenses of independent accountants, costs of acquiring and disposing of portfolio securities, interest, taxes, stock exchange listing expenses and fees, costs and fees of registration with and reporting to the SEC, costs of Income Shares' Automatic Dividend Reinvestment Plan, and fees and expenses of Income Shares' transfer agent, registrar, custodian and dividend disbursing agent. However, if such costs and expenses (excluding interest, taxes, brokerage charges and expenses, extraordinary costs and expenses and expenses incident to the public offering of shares other than those offered

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through the Automatic Dividend Reinvestment Plan) borne by Income Shares in any fiscal year exceed 1.5% of average net assets up to \$30,000,000 plus 1.0% of average net assets over \$30,000,000, the Adviser is obligated to reimburse Income Shares for any excess pursuant to the Investment Advisory Agreement. The determination of whether such reimbursement is due is made monthly, on an accrual basis, and to the extent that such reimbursement is due it serves as an offset against the investment advisory fee payable monthly by Income Shares to the Adviser. To the extent permitted under the 1940 Act, if, at the end of Income Shares' fiscal year, full reimbursement has not been accomplished by such monthly offsetting, the balance due must be paid by the Adviser to Income Shares.

### CREDIT STRATEGIES FUND

The Adviser provides the following services to Credit Strategies Fund: (i) furnishes an investment program for Credit Strategies Fund; (ii) determines, subject to the overall supervision and review of the board of trustees, the investments to be purchased, held, sold or exchanged by Credit Strategies Fund and the portion, if any, of the assets of Credit Strategies Fund to be held uninvested; (iii) makes changes in the investments of Credit Strategies Fund; and (iv) votes, exercises consents and exercises all other rights pertaining to such investments. Subject to the foregoing, the Adviser, at its own expense, will have the authority to engage one or more sub-advisers in connection with the portfolio management of Credit Strategies Fund, which sub-advisers may be affiliates of the Adviser; provided, however, that the Adviser shall remain responsible to Credit Strategies Fund with respect to its duties and obligations set forth in the investment advisory agreement.

In return for its advisory services, the Adviser will receive an annual fee, payable monthly, in an amount equal to 1.00% of the average weekly value of Credit Strategies Fund's Managed Assets (the "Advisory Fee"). The Adviser earned \$3,879,925 and \$9,368,976 in management fees for the fiscal periods ended December 31, 2006 and 2007, respectively. (The Fund commenced investment operations on June 29, 2006). "Managed Assets" means the total assets of Credit Strategies Fund, including any form of investment leverage, minus all accrued expenses incurred in the normal course of operations, but not excluding any liabilities or obligations attributable to investment leverage obtained through (i) indebtedness of any type (including, without limitation, borrowing through a credit facility or the issuance of debt securities), (ii) the issuance of preferred shares or other similar preference securities, (iii) the reinvestment of collateral received for securities loaned in accordance with Credit Strategies Fund's investment objectives and policies, and/or (iv) any other means. The accrued fees will be payable monthly as promptly as possible after the end of each month during which the investment advisory agreement is in

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effect. The Adviser may waive a portion of its fees. A discussion regarding the basis for the approval of the investment advisory agreement by Credit Strategies Fund's board is available in Credit Strategies Fund's report to shareholders for the period ending June 30, 2006.

In addition to the advisory fee of Highland, Credit Strategies Fund pays all other costs and expenses of its operations, including, but not limited to, compensation of its trustees (other than those affiliated with Highland), custodian, transfer and dividend disbursing agent expenses, legal fees, listing fees and expenses, expenses of independent auditors, expenses of preparing, printing and distributing shareholder reports, notices, proxy statements and reports to governmental agencies, and reimbursement of actual expenses of the Adviser or others for registration and maintenance of Credit Strategies Fund's registrations with the SEC and other jurisdictions and taxes, if any.

### ADMINISTRATOR/SUB-ADMINISTRATOR/ACCOUNTING SERVICES AGENT

Under an administration agreement dated June 29, 2006, Highland provides administration services to Credit Strategies Fund, provides executive and other personnel necessary to administer Credit Strategies Fund and furnishes office space. Highland will receive an annual fee, payable monthly, in an amount equal to 0.20% of the average weekly value of Credit Strategies Fund's Managed Assets. Highland earned for administration services \$775,985 and \$1,873,796 in fees for the fiscal periods ended December 31, 2006 and 2007, respectively. The accrued fees are payable monthly as promptly as possible after the end of each month during which this Agreement is in effect. Highland may waive a portion of its fees. Under a separate sub-administration agreement, dated June 29, 2006, Highland has delegated certain administrative functions to PFPC Inc., at an annual rate, payable by Highland, of 0.01% of the average weekly value of Credit Strategies Fund's Managed Assets.

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Each Acquired Fund is a party to an administration and accounting services agreement with PFPC Inc. dated April 10, 2006 pursuant to which PFPC Inc. provides administrative and accounting services to each Acquired Fund. PFPC Inc. will receive an annual fee, payable monthly, in an amount equal to 0.026%, subject to a minimum fee, of the average weekly value of each Acquired Fund's Managed Assets plus certain other fees. For the fiscal periods ended December 31, 2006 and 2007, Income Shares paid \$44,334 and \$69,562, respectively, to PFPC Inc. in fees for such services. For the fiscal periods ended October 31, 2006 and 2007, High Income Portfolio paid \$41,130 and \$65,876, respectively, to PFPC Inc. in fees for such services.

### PORTFOLIO MANAGEMENT

Each Acquired Fund is managed by Brad Borud and R. Joseph Dougherty. Mark Okada, Kurtis Plumer and Brad Borud manage the Acquiring Fund. The investment decisions are not subject to the oversight, approval or ratification of a committee.

Mark Okada, CFA. Mr. Okada is Executive Vice President of Strand and the funds in the Highland Fund Complex. Mr. Okada is a founder and Chief Investment Officer of Highland and has served as Chief Investment Officer since 2000. From 1993 to 2000, Mr. Okada served as Executive Vice President of Highland. He is responsible for overseeing Highland's investment activities for its various funds and has over 19 years of experience in the leveraged finance market. Formerly, Mr. Okada served as Manager of Fixed Income for Protective Life's GIC

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subsidiary from 1990 to 1993. He was primarily responsible for the bank loan portfolio and other risk assets. Protective was one of the first non-bank entrants into the syndicated loan market. From 1986 to 1990, he served as Vice President for Hibernia National Bank, managing over \$1 billion of high-yield bank loans. Mr. Okada is an honors graduate of the University of California Los Angeles with degrees in Economics and Psychology. He completed his credit training at Mitsui and is a Chartered Financial Analyst. Mr. Okada is also Chairman of the Board of Directors of Common Grace Ministries Inc.

Kurtis Plumer, CFA. Mr. Plumer is a Senior Portfolio Manager and head of the Multi-Strategies group at Highland where he is responsible for managing the sourcing, investing and monitoring process. He has over 15 years of experience in distressed, high yield bond and leveraged loan products. Prior to joining Highland in 1999, Mr. Plumer was a distressed high yield bond trader at Lehman Brothers in New York, where he managed a \$250 million portfolio invested in global distressed securities. While at Lehman, he also traded emerging market sovereign bonds. Prior to joining Lehman Brothers, Mr. Plumer was a corporate finance banker at NationsBanc Capital Markets, Inc. (now Bank of America Capital Markets, Inc.) where he focused on M&A and financing transactions for the bank's clients. Mr. Plumer earned a BBA in Economics and Finance from Baylor University and an MBA in Strategy and Finance from the Kellogg School at Northwestern University. Mr. Plumer is a Chartered Financial Analyst.

Brad Borud. Mr. Borud is a Partner, Senior Trader and Chief Investment Officer--Retail Products at Highland. Prior to his current duties, Mr. Borud served as a Senior Trader and Co-Director of Portfolio Management for Highland from 2003 to 2008, as a Portfolio Manager and Team Leader from 2001 to 2003, as a Portfolio Manager from 1998 to 2001, and as a Portfolio Analyst from 1996 to 1998. As a Portfolio Manager, Mr. Borud covered a wide range of industries, including wireline telecommunications, wireless telecommunications, telecommunication equipment manufacturers, multi-channel video and media. Prior to joining Highland in November 1996, Mr. Borud worked as a Global Finance Analyst in the Corporate Finance Group at NationsBank from 1995 to 1996 where he was involved in the originating, structuring, modeling and credit analysis of leveraged transactions for large corporate accounts in the Southwest region of the United States. In 1994, Mr. Borud served at Conesco Capital Management as an Analyst Intern in the Fixed Income Research Department, following the transportation and energy sectors. Mr. Borud has a BS in Business Finance from Indiana University.

R. Joseph Dougherty. Mr. Dougherty is a Partner and Senior Portfolio Manager at Highland and heads its Retail Products business unit. He serves as Portfolio Manager, Senior Vice President, Trustee and/or Director of Highland's NYSE-listed funds and 1940 Act registered funds. He also serves as Portfolio Manager for Highland's sub-advised closed-end funds. In this capacity, Mr. Dougherty oversees investment decisions for the retail funds, alongside several other Portfolio Managers, and manages the team dedicated to the day-to-day operations of the retail funds. Prior to his current duties, Mr. Dougherty served as Portfolio Analyst for Highland from 1998 to 1999. As a Portfolio Analyst, Mr. Dougherty followed companies within the chemical, retail, supermarket, wireless and restaurant sectors. Prior to joining Highland in March 1998, Mr. Dougherty served as an Investment Analyst with Sandera Capital

Management from 1997 to 1998. Formerly, he was a Business Development Manager at Akzo Nobel from 1994 to 1996 and a Senior Accountant at Deloitte & Touche, LLP from 1992 to 1994. He received an MBA from Southern Methodist University, and a BS in Accounting from Villanova University. Mr. Dougherty is a Certified Public Accountant, and has earned the right to use the Chartered Financial Analyst designation.

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The Statement of Additional Information provides additional information about the portfolio managers' compensation, other accounts managed by the portfolio managers and the portfolio managers' ownership of securities issued by Credit Strategies Fund.

### PORTFOLIO TRANSACTIONS WITH AFFILIATES

In placing portfolio transactions for the Funds, the Adviser will give primary consideration to securing the most favorable price and efficient execution. Consistent with this policy, the Adviser may consider the financial responsibility, research and investment information and other services provided by brokers or dealers who may effect or be a party to any such transaction or other transactions to which other clients of the Adviser may be a party. Neither the Funds nor the Adviser has adopted a formula for allocation of the Funds' investment transaction business. The Adviser has access to supplemental investment and market research and security and economic analysis provided by brokers who may execute brokerage transactions at a higher cost to the Funds than would otherwise result when allocating brokerage transactions to other brokers on the basis of seeking the most favorable price and efficient execution. The Adviser, therefore, is authorized to place orders for the purchase and sale of securities for the Funds with such brokers, subject to review by the Funds' Boards from time to time with respect to the extent and continuation of this practice. The services provided by such brokers may be useful or beneficial to the Adviser in connection with its services to other clients.

On occasions when the Adviser deems the purchase or sale of a security to be in the best interest of the Funds as well as other clients, the Adviser, to the extent permitted by applicable laws and regulations, may, but shall be under no obligation to, aggregate the securities to be so sold or purchased in order to obtain the most favorable price or lower brokerage commissions and efficient execution. In such event, allocation of the securities so purchased or sold, as well as the expenses incurred in the transaction, will be made by the Adviser in the manner it considers to be the most equitable and consistent with its fiduciary obligations to the Funds and to such other clients.

### OTHER SERVICE PROVIDERS

The custodian of the assets of the Funds is PFPC Trust Company (8800 Tinicum Blvd., 4th Floor, Philadelphia, PA 19153; telephone (877) 665-1287). The custodian will perform custodial, fund accounting and portfolio accounting services. PFPC Inc. (301 Bellevue Parkway, Wilmington, Delaware 19809; telephone (877) 665-1287) serves as the transfer agent for the Funds with respect to their common shares.

### VOTING INFORMATION AND REQUIRED VOTE

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Each Acquired Fund common and preferred share is entitled to one vote.

APPROVAL OF PROPOSAL 1(A) AND 1(B). With respect to the applicable Acquired Fund, approval of the proposal requires the vote of: (1) the holders of at least a majority of the common and preferred shares entitled to vote, voting as a single class; and (2) the holders of at least a majority of the preferred shares entitled to vote, voting as a separate class.

APPROVAL OF PROPOSAL 2(A) (HIGH INCOME PORTFOLIO). The election of Mr. Kavanaugh (Class II Director of High Income Portfolio) requires the affirmative vote of a majority of the common shares of High Income Portfolio, represented in person or by proxy at the Meeting and entitled to vote. The election of Mr. Hui (Class II

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Director of High Income Portfolio) requires the affirmative vote of a majority of the preferred shares of High Income Portfolio, represented in person or by proxy at the Meeting and entitled to vote.

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APPROVAL OF PROPOSAL 2(B) (INCOME SHARES). The election of Mr. Dougherty (Class I Director of Income Shares) requires the affirmative vote of a majority of the outstanding common shares and preferred shares of Income Shares, voting together as a single class.

If the accompanying form of proxy card is properly executed and returned in time to be voted at the Meeting, the shares covered thereby will be voted in accordance with the instructions marked thereon. Executed and returned proxy cards that are unmarked will be voted FOR the applicable proposal and in the discretion of the persons named as proxies in connection with any other matter which may properly come before the Meeting or any adjournment thereof. The Boards of the Acquired Funds do not know of any matter to be considered at the Meeting other than the proposals referred to in this Proxy Statement/Prospectus. Voting on a proposal does not limit the transferability of common shares and common shareholders can sell their shares at any time before the Meeting or before a Reorganization.

The presence in person or by proxy of shareholders of an Acquired Fund entitled to cast at least a majority of the votes entitled to be cast shall constitute a quorum ("Quorum") for that Fund's Meeting. If a Quorum is not present at the Meeting, or if a Quorum is present but sufficient votes to approve a proposal are not received, the persons named as proxies may propose one or more adjournments of the Meeting to permit further solicitation of proxies. Any adjournment will require the affirmative vote of a majority of those shares affected by the adjournment that are represented at the meeting in person or by proxy.

For Proposal 1, shares represented by properly executed proxies which are either votes to abstain or broker non-votes will be treated as shares that are present and entitled to vote for purposes of determining a Quorum and has the same effect as a vote "against" Proposal 1.

For Proposal 2, shares represented by properly executed proxies which are either votes to withhold or broker non-votes will be treated as shares that are present and entitled to vote for purposes of determining a Quorum and has the same effect as a vote "against" Proposal 2.

The following table summarizes how the quorum and voting requirements for each Proposal are determined:

SHARES	QUORUM	VOTING FOR PROPOSAL 1	VOTING FOR PROPOSAL 2
In General	All shares "present" in person or by proxy are counted towards a quorum.	Shares "present" in person will be voted in person at the Meeting. Shares present by proxy will be voted in accordance with instructions.	Shares "present" in person will be voted in person at the Meeting. Shares present by proxy will be voted in accordance with instructions.



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Proxy with no Voting Instruction (other than Broker Non-Vote)	Considered "present" at Meeting.	Voted "for" Proposal 1.	Voted "for" Proposal 2.
Broker Non-Vote*	Considered "present" at Meeting.	Not voted. Same effect as a vote "against" Proposal 1.	Not voted. Same effect as a vote "against" Proposal 2.
Vote to Abstain or Withhold	Considered "present" at Meeting.	Not voted. Same effect as a vote "against" Proposal 1.	Not voted. Same effect as a vote "against" Proposal 2.
Proportionately Voted Preferred Shares with No Voting Instruction	Considered "present" at Meeting.	Voted in proportion to preferred shares for which the broker received instructions.	Voted in proportion to preferred shares for which the broker received instructions.

\* Broker Non-Votes shall not include preferred shares which the broker is permitted to proportionately vote in accordance with applicable law or rules of a national securities exchange.

An unfavorable vote on a proposed Reorganization by the shareholders of one Acquired Fund will not affect the consummation of a Reorganization by the other Acquired Fund, if such Reorganization is approved by the shareholders of such other Acquired Fund. If the required approval of shareholders is not obtained with respect to a proposal, the Acquired Fund subject to the proposal will

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continue to engage in business and the respective Board will consider what further action may be appropriate.

Income Shares' common and preferred shareholders and High Income Portfolio's common shareholders who object to the proposed Reorganization(s) are not entitled under Maryland law or the relevant Charter to demand payment for, or an appraisal of, their shares. Under Maryland law, High Income Portfolio's preferred shareholders who object to its proposed Reorganization are entitled to demand payment for, or an appraisal of, their shares. However, before the final stockholder vote thereon, the High Income Portfolio will commence, and irrevocably commit to complete as expeditiously as possible, the process for redeeming its preferred stock. This redemption, which will be completed before a Reorganization, will extinguish any appraisal rights.

However, shareholders should be aware that the Reorganizations as proposed are not expected to result in recognition of gain or loss to shareholders for federal income tax purposes (except to the extent such shareholders are paid cash in lieu of fractional Acquiring Fund Common Shares in the Reorganization) and that shares of each Fund may be sold at any time prior to the consummation of the proposed Reorganizations.

**CERTAIN VOTING INFORMATION REGARDING PREFERRED SHARES.** Pursuant to the rules of the NYSE, preferred shares of each Fund held in "street name" may be voted under certain conditions by broker-dealer firms and counted for purposes of establishing a quorum of that Fund if no instructions are received one business day before the Meeting or, if adjourned, one business day before the day to which the Meeting is adjourned. These conditions include, among others, that (i) at least 30% of a Fund's preferred shares outstanding have voted on the proposal, and (ii) less than 10% of a Fund's preferred shares outstanding have voted against such proposal. In such instance, the broker-dealer firm will vote

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such uninstructed Fund's preferred shares on the proposal in the same proportion as the votes cast by all Fund preferred shareholders who voted on such proposal. Each Fund will include shares held of record by broker-dealers as to which such authority has been granted in its tabulation of the total number of shares present for purposes of determining whether the necessary quorum of shareholders of such Fund exists.

### INFORMATION CONCERNING THE MEETING

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#### EXPENSES AND METHODS OF SOLICITATION

In addition to the mailing of these proxy materials, proxies may be solicited by telephone, by fax or in person by the Trustees/Directors, officers and employees of each Fund; by personnel of the Adviser and its transfer agent, PFPC Inc.; or by broker-dealer firms. Persons holding shares as nominees will be reimbursed by the relevant Fund, upon request, for their reasonable expenses in sending soliciting material to the principals of the accounts. The costs associated with the Reorganizations, including the proxy solicitation expenses, will be borne by each of the Acquired Funds and the Acquiring Fund in proportion to their respective net assets determined at the close of regular trading on the NYSE on the date of the Reorganizations' closing, provided that if they close at different times, that determination will be made as of the date that the first Reorganization closes. The costs associated with the election or directors will be borne by each of the Acquired Funds.

The Altman Group has been retained to assist in the solicitation of proxies at an estimated cost of approximately \$30,000 for Income Shares and \$20,000 for High Income Portfolio plus reasonable expenses.

#### REVOKING PROXIES

A shareholder may revoke his or her proxy by appearing at the Meeting and voting in person, or by giving written notice of such revocation to the Acquired Fund Secretary or by returning a later-dated proxy before the Meeting.

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#### OUTSTANDING SHARES

As of April 14, 2008 (the "record date"), the number of shares of beneficial interest of each Acquired Fund outstanding was as follows:

FUND	SHARES OUTSTANDING
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HIGH INCOME PORTFOLIO	
Common Shares	30,874,699
Preferred Shares, Series W	1,600
INCOME SHARES	
Common Shares	9,947,104
Preferred Shares, Series T	1,200

#### OTHER BUSINESS

Directors do not intend to present any other business at the Meeting nor are they aware that any shareholder intends to do so. If, however, any other matters are properly brought before the Meeting, the persons named in the accompanying proxy will vote thereon in accordance with their judgment.

#### SHAREHOLDERS' PROPOSALS AND COMMUNICATIONS

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Any proposals of shareholders that are intended for inclusion in an Acquired Fund's proxy statement and form of proxy for the Acquired Fund's 2009 annual meeting of shareholders must be received at the Acquired Fund's principal executive office no later than December 27, 2008 and must comply with all other legal requirements. The date after which notice of a shareholder proposal submitted is considered untimely and persons holding proxies will have discretionary voting authority over such proposals, except as otherwise provided under applicable law, is March 12, 2009.

Shareholders of the Acquired Funds who wish to communicate with Directors should send communications to the attention of the Secretary of the Acquired Funds, Two Galleria Tower, Suite 800, 13455 Noel Road, Dallas, Texas 75240, and communications will be directed to the Director or Directors indicated in the communication or, if no Director or Directors are indicated, to the Chairman of the Board.

### PROXY STATEMENT/PROSPECTUS DELIVERY

"Householding" is the term used to describe the practice of delivering one copy of a document to a household of shareholders instead of delivering one copy of a document to each shareholder in the household. Shareholders of each Fund who share a common address and who have not opted out of the householding process should receive a single copy of this Proxy Statement/Prospectus together with one proxy card for each account. If you received more than one copy of this Proxy Statement/Prospectus, you may elect to household in the future; if you received a single copy of this Proxy Statement/Prospectus, you may opt out of householding in the future; and you may, in any event, obtain an additional copy of this Proxy Statement/Prospectus by writing to each Fund at the following address: 13455 Noel Road, Suite 800, Dallas, Texas 75240, or by calling each Fund at the following number: (877) 665-1287.

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### OWNERSHIP OF SHARES OF THE FUNDS

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Please see Appendix C to the Proxy Statement/Prospectus for information regarding the holdings of each Trustee/Director in each Fund and for information regarding the persons who owned of record or beneficially 5% or more of the outstanding common shares or preferred shares of each Fund.

### EXPERTS

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The independent registered public accounting firm for each Acquired Fund is Deloitte & Touche LLP, JP Morgan Chase Tower, 2200 Ross Avenue, Suite 1600, Dallas, TX 75201-6778. The independent registered public accounting firm for the Acquiring Fund is PricewaterhouseCoopers LLP, 2001 Ross Avenue, Suite 1800, Dallas, TX 75201. The financial highlights and financial statements, including the reports of the respective independent registered public accounting firm, of (i) High Income Portfolio, for the period ended October 31, 2007, (ii) Income Shares, for the period ended December 31, 2007, and (iii) Credit Strategies Fund, for the period ended December 31, 2007, are incorporated by reference into this Proxy Statement/Prospectus. The financial statements for each Fund's fiscal year ended 2007 and financial highlights have been independently audited by the independent registered public accounting firm for each Fund, as stated in their reports appearing in the statement of additional information. These financial

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statements and financial highlights have been included in reliance on their reports given on their authority as experts in accounting and auditing.

### AVAILABLE INFORMATION

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Each Fund is subject to the informational requirements of the 1934 Act and the 1940 Act and files reports, proxy statements and other information with the SEC. These reports, proxy statements and other information filed by the Funds can be inspected and copied (for a duplication fee) at the public reference facilities of the SEC at 100 F Street, N.E., Washington, D.C., and at the Central Regional Office (1801 California Street, Suite 4800, Denver, CO 80202). Copies of these materials can also be obtained by mail from the Public Reference Section of the SEC at 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. In addition, copies of these documents may be viewed on-screen or downloaded from the SEC's Internet site at <http://www.sec.gov>.

In addition, reports, proxy statements and other information concerning the Funds may be inspected at the offices of the NYSE, 20 Broad Street, New York, New York 10005.

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### APPENDIX A

The Form of Agreement and Plan of Reorganization has been included to provide investors with information regarding its terms. It is not intended to provide any factual information about the Funds. Accordingly, shareholders should not rely on the representations and warranties in the Form of Agreement and Plan of Reorganization as characterizations of the actual state of facts at the time they were made or otherwise. In addition, the Form of Agreement and Plan of Reorganization may be revised from that shown here prior to its execution, and may be amended after its execution. Should material changes be made to the Form of Agreement and Plan of Reorganization, the Funds will take such steps as may be required by applicable law.

### FORM OF AGREEMENT AND PLAN OF REORGANIZATION

THIS AGREEMENT AND PLAN OF REORGANIZATION ("AGREEMENT") is made as of \_\_\_\_\_, 2008, between [PROSPECT STREET HIGH INCOME PORTFOLIO INC.] [PROSPECT STREET INCOME SHARES INC.][1], a Maryland corporation ("ACQUIRED FUND"), and HIGHLAND CREDIT STRATEGIES FUND, a Delaware statutory trust ("ACQUIRING FUND") (each, a "FUND").

The Funds wish to effect a reorganization described in section 368(a)(1)(C) of the Internal Revenue Code of 1986, as amended ("CODE"), and intend this Agreement to be, and adopt it as, a "plan of reorganization" within the meaning of the regulations under the Code ("REGULATIONS").(2) The reorganization will consist of (1) the transfer of Acquired Fund's assets to Acquiring Fund in exchange solely for the issuance to Acquired Fund of shares of beneficial interest in Acquiring Fund (and, if necessary or desirable, Acquiring Fund's delivery to Acquired Fund of cash in lieu of fractional shares) and Acquiring Fund's assumption of Acquired Fund's liabilities, (2) the distribution of such shares (and cash, if applicable) to Acquired Fund's stockholders in liquidation thereof, and (3) Acquired Fund's dissolution, all on the terms and conditions set forth in this Agreement (collectively, "REORGANIZATION").

Each of Acquired Fund's Board of Directors and Acquiring Fund's Board of Trustees (each, a "BOARD"), including a majority of the members thereof who are not "interested persons" (as such term is defined in the Investment Company Act of 1940, as amended ("1940 ACT")) thereof, (1) has duly adopted and approved

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this Agreement and the transactions contemplated hereby and (2) has determined that participation in those transactions is in the best interests of its Fund and that the interests of the existing stockholders/shareholders thereof will not be diluted as a result thereof.

Acquired Fund is authorized to issue [101,000,000] [16,000,000] shares of capital stock, of which (1) [100,000,000] [15,000,000] shares are classified as common stock, par value \$0.03 per share ("ACQUIRED FUND COMMON STOCK") and (2) 1,000,000 shares are classified as Auction Rate Cumulative Preferred Shares, par value [\$0.001] [\$0.01] per share, with a liquidation preference of \$25,000 per share plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared) ("ACQUIRED FUND PREFERRED STOCK"). Acquired Fund intends to redeem the Acquired Fund Preferred Stock before the EFFECTIVE TIME (as defined in paragraph 3.1). Acquiring Fund is authorized to issue an unlimited number of shares of beneficial interest, par value \$0.001 per share ("ACQUIRING FUND SHARES"). All outstanding shares of each Fund are fully paid, non-assessable, and have full voting rights.

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[(1) In this "Form" of Agreement, wherever text is surrounded by consecutive pairs of brackets, the text in the first pair of brackets is included in the Agreement involving Prospect Street High Income Portfolio Inc. and the text in the second pair of brackets is included in the Agreement involving Prospect Street Income Shares Inc.]

(2) On or about the date hereof, Acquiring Fund also is entering into an Agreement and Plan of Reorganization with [Prospect Street Income Shares Inc.] [Prospect Street High Income Portfolio Inc.], a Maryland corporation ("OTHER ACQUIRED FUND"), containing substantially the same terms as herein, regarding the reorganization of those entities ("OTHER REORGANIZATION"). The consummation of the Reorganization is not contingent on the consummation of the Other Reorganization.

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Based on its review of the Funds' respective investment portfolios, each Fund has determined that those portfolios generally are compatible and, as a result, believes that all or substantially all of the ASSETS (as defined in paragraph 1.1) can be transferred to and held by Acquiring Fund pursuant to the Reorganization.

In consideration of the mutual promises contained herein, the parties agree as follows:

### 1. PLAN OF REORGANIZATION

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1.1. Subject to the requisite approval of Acquired Fund's stockholders and the terms and conditions hereof, Acquired Fund shall assign, sell, convey, transfer, and deliver all of its assets described in paragraph 1.2 ("ASSETS") to Acquiring Fund. In exchange therefor, Acquiring Fund shall -

(a) issue and deliver to Acquired Fund the number of Acquiring Fund Shares determined by dividing Acquired Fund's net value (computed as set forth in paragraph 2.1) by the net asset value ("NAV") of an Acquiring Fund Share (computed as set forth in paragraph 2.2) (and, if necessary or desirable, deliver to Acquired Fund cash in lieu of fractional Acquiring Fund Shares); and

(b) assume all of Acquired Fund's liabilities described in paragraph 1.3 ("LIABILITIES").

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Such transactions shall take place at the CLOSING (as defined in paragraph 3.1).

1.2. The Assets shall consist of all assets and property -- including all cash, cash equivalents, securities, commodities, futures interests, receivables (including interest and dividends receivable), claims and rights of action, rights to register stock under applicable securities laws, books and records, and deferred and prepaid expenses (other than unamortized organizational expenses) shown as assets on Acquired Fund's books -- Acquired Fund owns at the VALUATION TIME (as defined in paragraph 2.1).

1.3. The Liabilities shall consist of all of Acquired Fund's liabilities, debts, obligations, and duties of whatever kind or nature existing at the Valuation Time, whether absolute, accrued, contingent, or otherwise, whether known or unknown, whether or not arising in the ordinary course of business, whether or not determinable at the Valuation Time, and whether or not specifically referred to in this Agreement, excluding REORGANIZATION EXPENSES (as defined in paragraph 4.3.9) borne by Acquiring Fund and/or the Other Acquired Fund pursuant to paragraph 7.2. Notwithstanding the foregoing, Acquired Fund agrees to use its best efforts to discharge all its known Liabilities before the Effective Time.

1.4. At the Effective Time (or as soon thereafter as is reasonably practicable), Acquired Fund shall distribute the Acquiring Fund Shares (and, if applicable, the cash) it receives pursuant to paragraph 1.1(a) to the holders of record at the Effective Time of Acquired Fund Common Stock (each, a "STOCKHOLDER"), in exchange for their Acquired Fund Common Stock, and shall completely liquidate. The distribution of such shares shall be accomplished by Acquiring Fund's transfer agent's opening accounts on Acquiring Fund's shareholder records in the names of the Stockholders (except Stockholders in whose names accounts thereon already exist) and crediting each Stockholder's newly opened or pre-existing account with the respective PRO RATA number of Acquiring Fund Shares due such Stockholder. All outstanding Acquired Fund Common Stock, including any represented by certificates, shall simultaneously be canceled on Acquired Fund's stockholder records. Acquiring Fund shall not issue certificates representing the Acquiring Fund Shares issued in connection with the Reorganization.

1.5. If it is necessary or desirable to distribute cash in lieu of fractional Acquiring Fund Shares, then fractional Acquiring Fund Shares that the Stockholders (except the agent for Acquired Fund's dividend reinvestment plan) would otherwise be entitled to receive pursuant to paragraph 1.4 shall not be distributed to them. In that event, each such Stockholder instead shall receive an amount of cash equal to the fraction of an Acquiring Fund Share it otherwise would have received multiplied by the NAV per Acquiring Fund Share at the Valuation Time.

1.6. Acquired Fund shall declare and, immediately before the Valuation Time, shall pay (a) to the holders of the Acquired Fund Common Stock one or more dividends and/or other distributions in an amount large enough so that, together with the dividends described in (b) below, it will have distributed substantially all (and in any event not less than 98%) of its (i) "investment

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company taxable income" (within the meaning of section 852(b)(2) of the Code), computed without regard to any deduction for dividends paid, and (ii) "net capital gain" (as defined in section 1222(11) of the Code), after reduction by any capital loss carryforward, for the current taxable year through the Effective Time and (b) to the holders of the Acquired Fund Preferred Stock, if any is then outstanding, all accumulated unpaid dividends.

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1.7. As soon as reasonably practicable after the distribution of the Acquiring Fund Shares (and, if applicable, cash) pursuant to paragraph 1.4, (a) Acquired Fund shall be dissolved and any further actions shall be taken in connection therewith as required by applicable law and (b) the Acquired Fund Common Stock shall be delisted from the New York Stock Exchange ("NYSE") and Acquired Fund's registration under the 1940 Act shall be terminated.

1.8. Any reporting responsibility of Acquired Fund to a public authority, including the responsibility for filing regulatory reports, tax returns, and other documents with the Securities and Exchange Commission ("COMMISSION"), any state securities commission, any federal, state, and local tax authorities, and any other relevant regulatory authority, is and shall remain its responsibility up to and including the date on which it is dissolved.

1.9. Any transfer taxes payable on issuance of Acquiring Fund Shares in a name other than that of the registered holder on Acquired Fund's stockholder records of the Acquired Fund Common Stock actually or constructively exchanged therefor shall be paid by the person to whom such Acquiring Fund Shares are to be issued, as a condition of such transfer.

1.10. After Acquired Fund's stockholders approve this Agreement, Acquired Fund shall file articles of transfer complying with section 3-109 of the Maryland General Corporation Law (Titles 1-3 of the Corporations and Associations Article of the Maryland Code) ("ARTICLES OF TRANSFER") with the Department of Assessments and Taxation of the State of Maryland ("DEPARTMENT").

### 2. VALUATION -----

2.1. For purposes of paragraph 1.1(a), Acquired Fund's net value shall be (a) the value of the Assets computed at the close of regular trading on the NYSE on the date of the Closing ("VALUATION TIME"), using the valuation procedures adopted by its Board.

2.2. For purposes of paragraph 1.1(a), the NAV per Acquiring Fund Share shall be computed at the Valuation Time, using the valuation procedures adopted by Acquiring Fund's Board.

2.3. All computations pursuant to paragraphs 2.1 and 2.2 shall be made by or under the direction of Highland Capital Management, L.P. ("ADVISER").

### 3. CLOSING AND EFFECTIVE TIME -----

3.1. Unless the Funds agree otherwise, (a) the Reorganization, together with related acts necessary to consummate it ("CLOSING"), shall occur at Acquiring Fund's offices on the later of (i) the date the Articles of Transfer are accepted for record by the Department or (ii) a later date specified in the Articles of Transfer not more than 30 days after they are so accepted (which later date must be a day on which the NYSE is open for regular trading ("BUSINESS DAY")), and (b) all acts taking place at the Closing shall be deemed to take place simultaneously at the close of business (4:00 p.m., Eastern Time) on that date ("EFFECTIVE TIME"). If, immediately before the Valuation Time, (i) the NYSE or another primary trading market for portfolio securities of either Fund (each, an "EXCHANGE") is closed to trading or trading thereon is restricted or (ii) trading or the reporting of trading on an Exchange or elsewhere is disrupted, so that, in either Board's judgment, accurate appraisal of Acquired Fund's net value and/or the NAV on an Acquiring Fund Share is impracticable, the Effective Time shall be postponed until the first day on which the NYSE is open for regular trading after the day when such trading has been fully resumed and such reporting has been restored.

3.2. Acquired Fund shall direct its fund accounting and pricing agent to deliver at the Closing a certificate of an authorized officer verifying that the information (including adjusted basis and holding period, by lot) concerning the Assets, including all portfolio securities, transferred by Acquired Fund to Acquiring Fund, as reflected on Acquiring Fund's books immediately after the Closing, does or will conform to such information on Acquired Fund's books immediately before the Closing. Acquired Fund shall direct its custodian to deliver at the Closing a certificate of an authorized officer stating that (a) the Assets it holds will be transferred to Acquiring Fund at the Effective Time and (b) all necessary taxes in conjunction with the delivery of the Assets, including all applicable federal and state stock transfer stamps, if any, have been paid or provision for payment has been made.

3.3. Acquired Fund shall deliver to Acquiring Fund at the Closing a list of the Stockholders' names and addresses, and the number of full and fractional (rounded to the third decimal place) outstanding shares of Acquired Fund Common Stock each Stockholder owns, at the Effective Time, certified by Acquired Fund's Secretary or Assistant Secretary. Acquiring Fund shall direct its transfer agent to deliver at the Closing a certificate as to the opening of accounts on Acquiring Fund's shareholder records in the names of the Stockholders (except Stockholders in whose names accounts thereon already exist). Acquiring Fund shall issue and deliver to Acquired Fund a confirmation, or other evidence satisfactory to Acquired Fund, that the Acquiring Fund Shares to be credited to Acquired Fund at the Effective Time have been credited to its account on such records. At the Closing, each Fund shall deliver to the other bills of sale, checks, assignments, stock certificates, receipts, or other documents the other Fund or its counsel reasonably requests.

3.4. Each Fund shall deliver to the other at the Closing a certificate executed in its name by its President or a Vice President in form and substance satisfactory to the recipient and dated the date of the Closing, to the effect that the representations and warranties it made in this Agreement are true and correct at the Effective Time except as they may be affected by the transactions contemplated hereby.

4. REPRESENTATIONS AND WARRANTIES

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4.1. Acquired Fund represents and warrants to Acquiring Fund as follows:

4.1.1. Acquired Fund (a) is a corporation that is duly organized, validly existing, and in good standing under the laws of the State of Maryland and (b) has the power to own all its properties and assets and to carry on its business as described in documents filed with the Commission; and its Articles of Incorporation ("CHARTER") are on file with the Department;

4.1.2. Acquired Fund is duly registered as a closed-end management investment company under the 1940 Act, such registration is in full force and effect, and no proceeding has been instituted to suspend such registration;

4.1.3. At the Effective Time, Acquired Fund will have good and marketable title to the Assets and full right, power, and authority to sell, assign, transfer, and deliver the Assets free of any liens or other encumbrances (except securities that are subject to "securities loans," as referred to in section 851(b)(2) of the Code, or that are restricted to resale by their terms), and on delivery and payment for



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the Assets, Acquiring Fund will acquire good and marketable title thereto, subject to no restrictions on the full transfer thereof, including restrictions that might arise under the Securities Act of 1933, as amended ("1933 ACT"), except as previously disclosed in writing to and accepted by Acquiring Fund;

4.1.4. Acquired Fund is not currently engaged in, and Acquired Fund's execution, delivery, and performance of this Agreement and consummation of the Reorganization will not result in, (1) a material violation of any provision of Maryland law, the Charter or Acquired Fund's By-Laws, or any agreement, indenture, instrument, contract, lease, or other undertaking (each, an "UNDERTAKING") to which Acquired Fund is a party or by which it is bound or (2) the acceleration of any obligation, or the imposition of any penalty, under any Undertaking, judgment, or decree to which Acquired Fund is a party or by which it is bound;

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4.1.5. All material contracts and other commitments of or applicable to Acquired Fund (other than this Agreement and certain investment contracts, including options, futures, and forward contracts) will terminate, or provision for discharge of any liabilities of Acquired Fund thereunder will be made, at or before the Effective Time, without either Fund's incurring any liability or penalty with respect thereto and without diminishing or releasing any rights Acquired Fund may have had with respect to actions taken or omitted or to be taken by any other party thereto before the Closing;

4.1.6. Except as previously disclosed in writing to and accepted by Acquiring Fund, (a) no litigation, administrative proceeding, action, or investigation of or before any court, governmental body, or arbitrator is presently pending or, to Acquired Fund's knowledge, threatened against Acquired Fund or any of its properties or assets that, if adversely determined, would materially and adversely affect Acquired Fund's financial condition or the conduct of its business, and (b) Acquired Fund knows of no facts that might form the basis for the institution of any such litigation, proceeding, or investigation and is not a party to or subject to the provisions of any order, decree, or judgment of any court or governmental body that materially or adversely affects Acquired Fund's business or its ability to consummate the transactions contemplated hereby;

4.1.7. The execution, delivery, and performance of this Agreement have been duly authorized at the date hereof by all necessary action on the part of Acquired Fund's Board, which has made the determinations required by Rule 17a-8(a) under the 1940 Act; and this Agreement constitutes a valid and legally binding obligation of Acquired Fund, enforceable in accordance with its terms, subject to the effect of bankruptcy, insolvency, fraudulent transfer, reorganization, receivership, moratorium, and other laws affecting the rights and remedies of creditors generally and general principles of equity;

4.1.8. No governmental consents, approvals, authorizations, or filings are required under the 1933 Act, the Securities Exchange Act of 1934, as amended, or the 1940 Act (collectively, "FEDERAL SECURITIES LAWS") or state securities laws, and no authorizations, consents, or orders of any court are required, for Acquired Fund's execution or performance of this Agreement, except for (a) Acquiring Fund's filing with the Commission of a registration statement on Form N-14 relating to the Acquiring Fund Shares issuable hereunder, and any supplement or

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amendment thereto ("REGISTRATION STATEMENT"), including therein a prospectus and proxy statement ("PROSPECTUS/STATEMENT"), and (b) consents, approvals, authorizations, and filings that have been made or received or may be required after the Effective Time;

4.1.9. On the effective date of the Registration Statement, at the time of the STOCKHOLDERS MEETING (as defined in paragraph 6.1), and at the Effective Time, the Prospectus/Statement will (a) comply in all material respects with the applicable provisions of the Federal Securities Laws and the rules and regulations thereunder and (b) not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which such statements were made, not misleading; provided that the foregoing shall not apply to statements in or omissions from the Prospectus/Statement made in reliance on and in conformity with information furnished by Acquiring Fund for use therein;

4.1.10. Acquired Fund incurred the Liabilities in the ordinary course of its business; and there are no Liabilities other than those disclosed or provided for in Acquired Fund's financial statements referred to in paragraph 4.1.18 and Liabilities incurred by Acquired Fund in the ordinary course of its business subsequent to [October 31, 2007] [December 31, 2007], none of which has been materially adverse to the business, assets, or results of Acquired Fund's operations;

4.1.11. For each taxable year of its operation (including the taxable year ending at the Effective Time), Acquired Fund has met (or for its current taxable year will meet) the requirements of Subchapter M of Chapter 1 of the Code ("SUBCHAPTER M") for qualification as a regulated investment company ("RIC") and has been (or for such year will be) eligible to and has computed (or for such year will compute) its federal income tax under section 852 of the Code; from the time Acquired Fund's Board approved the transactions contemplated hereby ("APPROVAL TIME") through the Effective Time, Acquired Fund has invested and will invest its assets in a manner that ensures its compliance with the foregoing and paragraph 4.1.12; from the time it commenced operations through the Effective Time, Acquired Fund has conducted and will conduct

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its "historic business" (within the meaning of section 1.368-1(d)(2) of the Regulations) in a substantially unchanged manner; from the Approval Time through the Effective Time, Acquired Fund (1) has not disposed of and/or acquired, and will not dispose of and/or acquire, any assets (a) for the purpose of satisfying Acquiring Fund's investment objective or policies or (b) for any other reason except in the ordinary course of its business as a RIC and (2) has not otherwise changed, and will not otherwise change, its historic investment policies; Acquired Fund has no earnings and profits accumulated in any taxable year in which the provisions of Subchapter M did not apply to it; and Acquired Fund has not at any time since its inception been liable for, and is not now liable for, any material tax pursuant to sections 852 or 4982 of the Code, except as previously disclosed in writing to and accepted by Acquiring Fund;

4.1.12. Acquired Fund is in the same line of business as Acquiring Fund is in, for purposes of section 1.368-1(d)(2) of the Regulations, and did not enter into such line of business as part of the plan of reorganization;

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4.1.13. At the Effective Time, at least 33% of Acquired Fund's portfolio assets will meet Acquiring Fund's investment objectives, strategies, policies, risks, and restrictions, and Acquired Fund did not alter and will not alter its portfolio in connection with the Reorganization to meet such 33% threshold;

4.1.14. To the best of Acquired Fund's management's knowledge, at the record date for Acquired Fund's stockholders entitled to vote on approval of this Agreement, there was no plan or intention by its stockholders to sell, exchange, or otherwise dispose of a number of shares of Acquired Fund Common Stock (or Acquiring Fund Shares to be received in the Reorganization), in connection with the Reorganization, that would reduce their ownership of the Acquired Fund Common Stock (or the equivalent Acquiring Fund Shares) to a number of shares that was less than 50% of the number of shares of Acquired Fund Common Stock at such date;

4.1.15. Acquired Fund is not under the jurisdiction of a court in a "title 11 or similar case" (as defined in section 368(a)(3)(A) of the Code);

4.1.16. During the five-year period ending at the Effective Time, (a) neither Acquired Fund nor any person "related" (as defined in section 1.368-1(e)(4) of the Regulations) ("RELATED") to it will have acquired Acquired Fund Common Stock, either directly or through any transaction, agreement, or arrangement with any other person, with consideration other than Acquiring Fund Shares or Acquired Fund Common Stock and (b) no distributions will have been made with respect to Acquired Fund Common Stock, other than normal, regular dividend distributions made pursuant to Acquired Fund's historic dividend-paying practice and other distributions that qualify for the deduction for dividends paid (within the meaning of section 561 of the Code) referred to in sections 852(a)(1) and 4982(c)(1)(A) of the Code;

4.1.17. By the Effective Time, Acquired Fund shall have duly and timely filed all federal, state, local, and foreign tax returns required by law to have been filed by such date (giving effect to properly and timely filed extensions of time to file); Acquired Fund has timely paid all taxes payable pursuant to such filed returns except for amounts that alone or in the aggregate would not reasonably be expected to have a material adverse effect; and Acquired Fund is in compliance in all material respects with applicable Regulations pertaining to the reporting of, and withholding in respect of, distributions on and repurchases, if any, of its stock and is not liable for any material penalties that could be imposed thereunder;

4.1.18. The Statement of Assets and Liabilities (including Schedule of Investments), Statement of Operations, and Statement of Changes in Net Assets (collectively, "STATEMENTS") of Acquired Fund at and for the fiscal year (in the case of the last Statement, for the two fiscal years) ended [October 31, 2007] [December 31, 2007], have been audited by Deloitte & Touche LLP, an independent registered public accounting firm, and are in accordance with generally accepted accounting principles ("GAAP"), and copies thereof have been delivered to Acquiring Fund; to Acquired Fund's management's best knowledge and belief, there are no known contingent liabilities of Acquired Fund required to be reflected on a balance sheet (including the notes thereto) in accordance with GAAP consistently applied at such date that are not disclosed therein; and such audited Statements present fairly, in all material respects, Acquired Fund's financial condition at such

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date in accordance with GAAP consistently applied and the results of its operations and changes in its net assets for the period then ended;

4.1.19. Since [October 31, 2007] [December 31, 2007], there has not been any material adverse change in Acquired Fund's financial condition, assets, liabilities, or business, other than changes occurring in the ordinary course of business, or any incurrence by Acquired Fund of indebtedness maturing more than one year from the date such indebtedness was incurred, except as previously disclosed in writing to and accepted by Acquiring Fund; for purposes of this representation, a decline in NAV or price per share of Acquired Fund Common Stock due to declines in market values of securities Acquired Fund holds or the discharge of Acquired Fund's liabilities shall not constitute a material adverse change;

4.1.20. All issued and outstanding Acquired Fund Common Stock is, and at the Effective Time will be, duly and validly issued and outstanding, fully paid, and non-assessable by Acquired Fund and has been offered and sold in every state and the District of Columbia in compliance in all material respects with applicable registration requirements of the 1933 Act and state securities laws; all issued and outstanding Acquired Fund Common Stock will, at the Effective Time, be held by the persons and in the amounts set forth on Acquired Fund's stockholder records, as provided in paragraph 3.3; and Acquired Fund does not have outstanding any options, warrants, or other rights to subscribe for or purchase any Acquired Fund Common Stock, nor are there outstanding any securities convertible into any Acquired Fund Common Stock;

4.1.21. Not more than 25% of the value of Acquired Fund's total assets (excluding cash, cash items, and U.S. government securities) is invested in the stock and securities of any one issuer, and not more than 50% of the value of such assets is invested in the stock and securities of five or fewer issuers;

4.1.22. No registration of any Asset under the 1933 Act or any state securities or blue sky laws would be required if it was, at the Effective Time, the subject of a public distribution by either Fund, except as previously disclosed in writing to and accepted by Acquiring Fund; and

4.1.23. Its Board has not adopted a resolution electing to be subject to the Maryland Business Combination Act or the Maryland Control Share Acquisition Act.

4.2. Acquiring Fund represents and warrants to Acquired Fund as follows:

4.2.1. Acquiring Fund (a) is a statutory trust that is duly organized, validly existing, and in good standing under the laws of the State of Delaware and (b) has the power to own all its properties and assets and to carry on its business as described in documents filed with the Commission; and its Certificate of Trust has been filed with the office of the Secretary of State of Delaware;

4.2.2. Acquiring Fund is duly registered as a closed-end management investment company under the 1940 Act, such registration is in full force and effect, and no proceeding has been instituted to suspend such registration;

4.2.3. No consideration other than Acquiring Fund Shares (and

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Acquiring Fund's assumption of the Liabilities and, if necessary or desirable, cash in lieu of fractional Acquiring Fund Shares) will be issued in exchange for the Assets in the Reorganization;

4.2.4. The Acquiring Fund Shares to be issued and delivered hereunder will, at the Effective Time, have been duly authorized by Acquiring Fund and, when issued and delivered as provided herein (including the receipt of consideration in exchange therefor exceeding their par value), will be duly and validly issued and outstanding shares of Acquiring Fund, fully paid and non-assessable by Acquiring Fund;

4.2.5. Acquiring Fund's Agreement and Declaration of Trust ("DECLARATION") permits it to vary its shareholders' investment. Acquiring Fund does not have a fixed pool of assets -- it is a managed portfolio of securities, and Adviser has the authority to buy and sell securities for it;

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4.2.6. Acquiring Fund is not currently engaged in, and Acquiring Fund's execution, delivery, and performance of this Agreement will not result in, (1) a material violation of any provision of Delaware law, the Declaration or Acquiring Fund's By-Laws, or any Undertaking to which Acquiring Fund is a party or by which it is bound or (2) the acceleration of any obligation, or the imposition of any penalty, under any Undertaking, judgment, or decree to which Acquiring Fund is a party or by which it is bound;

4.2.7. Except as previously disclosed in writing to and accepted by Acquiring Fund, (a) no litigation, administrative proceeding, action, or investigation of or before any court, governmental body, or arbitrator is presently pending or, to Acquiring Fund's knowledge, threatened against Acquiring Fund or any of its properties or assets that, if adversely determined, would materially and adversely affect Acquiring Fund's financial condition or the conduct of its business, and (b) Acquiring Fund knows of no facts that might form the basis for the institution of any such litigation, proceeding, or investigation and is not a party to or subject to the provisions of any order, decree, or judgment of any court or governmental body that materially or adversely affects Acquiring Fund's business or its ability to consummate the transactions contemplated hereby;

4.2.8. The execution, delivery, and performance of this Agreement have been duly authorized at the date hereof by all necessary action on the part of Acquiring Fund's Board, which has made the determinations required by Rule 17a-8(a) under the 1940 Act; and this Agreement constitutes a valid and legally binding obligation of Acquiring Fund, enforceable in accordance with its terms, subject to the effect of bankruptcy, insolvency, fraudulent transfer, reorganization, receivership, moratorium, and other laws affecting the rights and remedies of creditors generally and general principles of equity;

4.2.9. No governmental consents, approvals, authorizations, or filings are required under the Federal Securities Laws or state securities laws, and no authorizations, consents, or orders of any court are required, for Acquiring Fund's execution or performance of this Agreement, except for (a) the filing with the Commission of the Registration Statement and (b) such consents, approvals, authorizations, and filings as have been made or received or as may be required subsequent to the Effective Time;

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4.2.10. On the effective date of the Registration Statement, at the time of the Stockholders Meeting, and at the Effective Time, the Prospectus/Statement will (a) comply in all material respects with the applicable provisions of the Federal Securities Laws and the rules and regulations thereunder and (b) not contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary to make the statements therein, in light of the circumstances under which such statements were made, not misleading; provided that the foregoing shall not apply to statements in or omissions from the Prospectus/Statement made in reliance on and in conformity with information furnished by Acquired Fund for use therein;

4.2.11. For each taxable year of Acquiring Fund's operation (including the taxable year in which the Effective Time occurs), Acquiring Fund has met (or for its current taxable year will meet) the requirements of Subchapter M for qualification as a RIC and has been (or for such year will be) eligible to and has computed (or for such year will compute) its federal income tax under section 852 of the Code; Acquiring Fund intends to continue to meet all such requirements for the next taxable year; Acquiring Fund has no earnings and profits accumulated in any taxable year in which the provisions of Subchapter M did not apply to it; and Acquiring Fund has not at any time since its inception been liable for, and is not now liable for, any material tax pursuant to sections 852 or 4982 of the Code, except as previously disclosed in writing to and accepted by Acquired Fund;

4.2.12. Following the Reorganization, Acquiring Fund (a) will continue Acquired Fund's "historic business" (within the meaning of section 1.368-1(d)(2) of the Regulations) and (b) will use a significant portion of Acquired Fund's "historic business assets" (within the meaning of section 1.368-1(d)(3) of the Regulations) in a business; moreover, Acquiring Fund (c) has no plan or intention to sell or otherwise dispose of any of the Assets, except for dispositions made in the ordinary course of such business and dispositions necessary to maintain its status as a RIC, and (d) expects to retain substantially all the Assets in the same form as it receives them in the Reorganization, unless and until subsequent investment circumstances

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suggest the desirability of change or it becomes necessary to make dispositions thereof to maintain such status;

4.2.13. Acquiring Fund is in the same line of business as Acquired Fund was in preceding the Reorganization, for purposes of section 1.368-1(d)(2) of the Regulations, and did not enter into such line of business as part of the plan of reorganization; following the Reorganization, Acquiring Fund will continue, and has no intention to change, such line of business; and at the Effective Time, (1) at least 33% of Acquired Fund's portfolio assets will meet Acquiring Fund's investment objectives, strategies, policies, risks, and restrictions and (2) Acquiring Fund has no plan or intention to change any of its investment objectives, strategies, policies, risks, or restrictions after the Reorganization;

4.2.14. There is no plan or intention for Acquiring Fund to be dissolved or merged into another statutory trust or a corporation or business trust or any "fund" thereof (as defined in section 851(g)(2) of the Code) following the Reorganization;

4.2.15. During the five-year period ending at the Effective Time,

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neither Acquiring Fund nor any person Related to it will have acquired Acquired Fund Common Stock with consideration other than Acquiring Fund Shares;

4.2.16. By the Effective Time, Acquiring Fund shall have duly and timely filed all federal, state, local, and foreign tax returns required by law to have been filed by such date (giving effect to properly and timely filed extensions of time to file); Acquiring Fund has timely paid all taxes payable pursuant to such filed returns except for amounts that alone or in the aggregate would not reasonably be expected to have a material adverse effect; and Acquiring Fund is in compliance in all material respects with applicable Regulations pertaining to the reporting of distributions on and repurchases, if any, of its shares and to withholding in respect of distributions to shareholders and is not liable for any material penalties that could be imposed thereunder;

4.2.17. Acquiring Fund's Statements at and for the fiscal year (in the case of its Statement of Changes in Net Assets, for the two fiscal years) ended December 31, 2007, have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, and are in accordance with GAAP, and copies thereof have been delivered to Acquired Fund; to Acquiring Fund's management's best knowledge and belief, there are no known contingent liabilities of Acquiring Fund required to be reflected on a balance sheet (including the notes thereto) in accordance with GAAP consistently applied at such date that are not disclosed therein; and such audited Statements present fairly, in all material respects, Acquiring Fund's financial condition at such date in accordance with GAAP consistently applied and the results of its operations and changes in its net assets for the period then ended;

4.2.18. Since December 31, 2007, there has not been any material adverse change in Acquiring Fund's financial condition, assets, liabilities, or business, other than changes occurring in the ordinary course of business, or any incurrence by Acquiring Fund of indebtedness maturing more than one year from the date such indebtedness was incurred, except as previously disclosed in writing to and accepted by Acquired Fund; for purposes of this representation, a decline in NAV or price per Acquiring Fund Share due to declines in market values of securities Acquiring Fund holds or the discharge of Acquiring Fund's liabilities shall not constitute a material adverse change;

4.2.19. Assuming the truthfulness and correctness of Acquired Fund's representation and warranty in paragraph 4.1.21, immediately after the Reorganization, (a) not more than 25% of the value of Acquiring Fund's total assets (excluding cash, cash items, and U.S. government securities) will be invested in the stock and securities of any one issuer and (b) not more than 50% of the value of such assets will be invested in the stock and securities of five or fewer issuers;

4.2.20. Acquiring Fund does not directly or indirectly own, nor at the Effective Time will it directly or indirectly own, nor has it directly or indirectly owned at any time during the past five years, any Acquired Fund Common Stock;

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4.2.21. Acquiring Fund has no plan or intention to issue additional Acquiring Fund Shares following the Reorganization except to the agent for its dividend reinvestment plan and in connection with the Other Reorganization; nor does Acquiring Fund, or any person Related to

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it, have any plan or intention to acquire -- during the five-year period beginning at the Effective Time, either directly or through any transaction, agreement, or arrangement with any other person -- with consideration other than Acquiring Fund Shares, any Acquiring Fund Shares issued to the Stockholders pursuant to the Reorganization; and

4.2.22. All issued and outstanding Acquiring Fund Shares are, and at the Effective Time will be, duly and validly issued and outstanding, fully paid, and non-assessable by Acquiring Fund and have been offered and sold in every state and the District of Columbia in compliance in all material respects with applicable registration requirements of the 1933 Act and state securities laws; and Acquiring Fund does not have outstanding any options, warrants, or other rights to subscribe for or purchase any Acquiring Fund Shares, nor are there outstanding any securities convertible into any Acquiring Fund Shares.

4.3. Each Fund represents and warrants to the other Fund as follows:

4.3.1. The fair market value of the Acquiring Fund Shares each Stockholder receives (together with cash in lieu of fractional Acquiring Fund Shares, if any) will be approximately equal to the fair market value of its Acquired Fund Common Stock it actually or constructively surrenders in exchange therefor;

4.3.2. Its management (a) is unaware of any plan or intention of Stockholders to sell, or otherwise dispose of (1) any portion of their Acquired Fund Common Stock before the Reorganization to any person Related to either Fund or (2) any portion of the Acquiring Fund Shares they receive in the Reorganization to any person Related to Acquiring Fund, (b) does not anticipate dispositions of such Acquiring Fund Shares at the time of or soon after the Reorganization to exceed the usual rate and frequency of dispositions of Acquired Fund Common Stock, and (c) expects that the percentage of stockholder interests, if any, that will be disposed of as a result of or at the time of the Reorganization will be DE MINIMIS;

4.3.3. The Stockholders will pay their own expenses (such as fees of personal investment or tax advisers for advice concerning the Reorganization), if any, incurred in connection with the Reorganization;

4.3.4. The fair market value of the Assets on a going concern basis will equal or exceed the Liabilities to be assumed by Acquiring Fund and those to which the Assets are subject;

4.3.5. There is no intercompany indebtedness between the Funds that was issued or acquired, or will be settled, at a discount;

4.3.6. Pursuant to the Reorganization, Acquired Fund will transfer to Acquiring Fund, and Acquiring Fund will acquire, at least 90% of the fair market value of the net assets, and at least 70% of the fair market value of the gross assets, Acquired Fund held immediately before the Reorganization; for the purposes of this representation, any amounts Acquired Fund uses to pay its Reorganization expenses and to make redemptions and distributions immediately before the Reorganization (except (a) regular, normal dividend distributions (i) made to conform to its policy of distributing all or substantially all of its income and gains to avoid the obligation to pay federal income tax and/or the excise tax under section 4982 of the Code and (ii) on the Acquired Fund Preferred Stock and (b) redemptions of the Acquired Fund Preferred Stock) will be included as assets it held immediately before the Reorganization;



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4.3.7. None of the compensation received by any Stockholder who or that is an employee of or service provider to Acquired Fund will be separate consideration for, or allocable to, any of the Acquired Fund Common Stock such Stockholder held; none of the Acquiring Fund Shares any such Stockholder receives will be separate consideration for, or allocable to, any employment agreement, investment advisory agreement, or other service agreement; and the compensation paid to any such Stockholder will be for services actually rendered and will be commensurate with amounts paid to third parties bargaining at arm's-length for similar services;

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4.3.8. Immediately after the Reorganization, the Stockholders will not own shares constituting "control" (as defined in section 304(c) of the Code) of Acquiring Fund;

4.3.9. No expenses incurred by Acquired Fund or on its behalf in connection with the Reorganization will be paid or assumed by Acquiring Fund, Adviser, or any third party unless such expenses are solely and directly related to the Reorganization (determined in accordance with the guidelines set forth in Rev. Rul. 73-54, 1973-1 C.B. 187) ("REORGANIZATION EXPENSES"), and no cash or property other than Acquiring Fund Shares will be transferred to Acquired Fund or any of its stockholders with the intention that such cash or property be used to pay any expenses (even Reorganization Expenses) thereof; and

4.3.10. The aggregate value of the acquisitions and distributions limited by paragraphs 4.1.16, 4.2.15, and 4.2.21 will not exceed 50% of the value (without giving effect to such acquisitions and distributions) of the proprietary interest in Acquired Fund at the Effective Time.

### 5. COVENANTS

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5.1. Each Fund covenants to operate its business in the ordinary course between the date hereof and the Closing, it being understood that:

(a) such ordinary course will include declaring and paying customary dividends and other distributions and such changes in operations as are contemplated by each Fund's normal business activities; and

(b) each Fund will retain exclusive control of the composition of its portfolio until the Closing.

5.2. Acquired Fund covenants that the Acquiring Fund Shares to be delivered hereunder are not being acquired for the purpose of making any distribution thereof, other than in accordance with the terms hereof.

5.3. Acquired Fund covenants that it will assist Acquiring Fund in obtaining information Acquiring Fund reasonably requests concerning the beneficial ownership of Acquired Fund Common Stock.

5.4. Acquired Fund covenants that its books and records (including all books and records required to be maintained under the 1940 Act and the rules and regulations thereunder) regarding Acquired Fund will be turned over to Acquiring Fund at the Closing.

5.5. Each Fund covenants to cooperate in preparing the Prospectus/Statement in compliance with applicable federal securities laws.

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5.6. Each Fund covenants that it will, from time to time, as and when requested by the other Fund, execute and deliver or cause to be executed and delivered all assignments and other instruments, and will take or cause to be taken all further action, the other Fund may deem necessary or desirable in order to vest in, and confirm to, (a) Acquiring Fund title to and possession of all the Assets and (b) Acquired Fund title to and possession of the Acquiring Fund Shares to be delivered hereunder, and otherwise to carry out the intent and purpose hereof.

5.7. Acquiring Fund covenants to use all reasonable efforts to obtain the approvals and authorizations required by the 1933 Act, the 1940 Act, and state securities laws it deems appropriate to continue its operations after the Effective Time.

5.8. Acquiring Fund shall cause the Acquiring Fund Shares to be issued hereunder to be listed on the NYSE at the Effective Time.

5.9. Once Acquired Fund files the notice and commences the redemption process described in paragraph 6.5, it covenants to complete such process as expeditiously as possible.

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5.10. Subject to this Agreement, each Fund covenants to take or cause to be taken all actions, and to do or cause to be done all things, reasonably necessary, proper, or advisable to consummate and effectuate the transactions contemplated hereby.

6. CONDITIONS PRECEDENT  
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Each Fund's obligations hereunder shall be subject to (a) performance by the other Fund of all its obligations to be performed hereunder at or before the Effective Time, (b) all representations and warranties of the other Fund contained herein being true and correct in all material respects at the date hereof and, except as they may be affected by the transactions contemplated hereby, at the Effective Time, with the same force and effect as if made at the Effective Time, and (c) the following further conditions that, at or before the Effective Time:

6.1. This Agreement and the transactions contemplated hereby shall have been duly adopted and approved by both Boards, and Acquired Fund shall have called a meeting of its stockholders to consider and act on this Agreement and to take all other action necessary to obtain approval of the transactions contemplated hereby ("STOCKHOLDERS MEETING").

6.2. All necessary filings shall have been made with the Commission and state securities authorities, and no order or directive shall have been received that any other or further action is required to permit the parties to carry out the transactions contemplated hereby; the Registration Statement shall have become effective under the 1933 Act, no stop orders suspending the effectiveness thereof shall have been issued, and, to each Fund's best knowledge, no investigation or proceeding for such purpose shall have been instituted or be pending, threatened, or contemplated under the 1933 Act or the 1940 Act; the Commission shall not have issued an unfavorable report with respect to the Reorganization under section 25(b) of the 1940 Act nor instituted any proceedings seeking to enjoin consummation of the transactions contemplated hereby under section 25(c) of the 1940 Act; and all consents, orders, and permits of federal, state, and local regulatory authorities (including the Commission and state securities authorities) either Fund deems necessary to

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permit consummation, in all material respects, of the transactions contemplated hereby shall have been obtained, except where failure to obtain same would not involve a risk of a material adverse effect on either Fund's assets or properties, provided that either Fund may for itself waive any of such conditions.

6.3. At the Effective Time, no action, suit, or other proceeding shall be pending (or, to either Fund's knowledge, threatened to be commenced) before any court, governmental agency, or arbitrator in which it is sought to enjoin the performance of, restrain, prohibit, affect the enforceability of, or obtain damages or other relief in connection with, the transactions contemplated hereby.

6.4. The Funds shall have received an opinion of Kirkpatrick & Lockhart Preston Gates Ellis LLP ("TAX COUNSEL") as to the federal income tax consequences mentioned below ("TAX OPINION"). In rendering the Tax Opinion, Tax Counsel may rely as to factual matters, exclusively and without independent verification, on (a) the representations and warranties made in this Agreement, which Tax Counsel may treat as representations and warranties made to it, and, if Tax Counsel requests, in separate letters addressed to Tax Counsel and (b) the certificates delivered pursuant to paragraph 3.4. The Tax Opinion shall be substantially to the effect that, based on the facts and assumptions stated therein and conditioned on consummation of the Reorganization in accordance with this Agreement (without taking into account any amendment thereof to which Tax Counsel has not agreed), for federal income tax purposes:

6.4.1. Acquiring Fund's acquisition of the Assets in exchange solely for Acquiring Fund Shares (and, if necessary or desirable, cash in lieu of fractional Acquiring Fund Shares) and its assumption of the Liabilities, followed by Acquired Fund's distribution of such shares PRO RATA to the Stockholders (and of any such cash to the Stockholders entitled thereto) actually or constructively in exchange for their Acquired Fund Common Stock, in complete liquidation of Acquired Fund, will qualify as a "reorganization" (as defined in section 368(a)(1)(C) of the Code), and each Fund will be "a party to a reorganization" (within the meaning of section 368(b) of the Code);

6.4.2. Acquired Fund will recognize no gain or loss on the transfer of the Assets to Acquiring Fund in exchange solely for Acquiring Fund Shares (and, if applicable, cash) and Acquiring Fund's

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assumption of the Liabilities or on the subsequent distribution of such shares (and cash) to the Stockholders in exchange for their Acquired Fund Common Stock;

6.4.3. Acquiring Fund will recognize no gain or loss on its receipt of the Assets in exchange solely for Acquiring Fund Shares (and, if applicable, cash) and its assumption of the Liabilities;

6.4.4. Acquiring Fund's basis in each Asset will be the same as Acquired Fund's basis therein immediately before the Reorganization, and Acquiring Fund's holding period for each Asset will include Acquired Fund's holding period therefor (except where Acquiring Fund's investment activities have the effect of reducing or eliminating an Asset's holding period);

6.4.5. A Stockholder will recognize no gain or loss on the exchange of all its Acquired Fund Common Stock solely for Acquiring Fund Shares pursuant to the Reorganization, except to the extent the

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Stockholder receives cash in lieu of a fractional Acquiring Fund Share in the Reorganization; and

6.4.6. A Stockholder's aggregate basis in the Acquiring Fund Shares it receives in the Reorganization will be the same as the aggregate basis in its Acquired Fund Common Stock it actually or constructively surrenders in exchange for such Acquiring Fund Shares less the basis in any fractional share for which the Stockholder receives cash in the Reorganization; and its holding period for such Acquiring Fund Shares will include, in each instance, its holding period for such Acquired Fund Common Stock, provided the Stockholder holds such stock as a capital asset at the Effective Time.

Notwithstanding subparagraphs 6.4.2 and 6.4.4, the Tax Opinion may state that no opinion is expressed as to the effect of the Reorganization on the Funds or any Stockholder with respect to any Asset as to which any unrealized gain or loss is required to be recognized for federal income tax purposes at the end of a taxable year (or on the termination or transfer thereof) under a mark-to-market system of accounting.

6.5. Before the Stockholders Meeting at which the final vote on this Agreement is taken, Acquired Fund shall irrevocably commence the process for redeeming the Acquired Fund Preferred Stock in accordance with its Articles Supplementary on file with the Department.

6.6. At any time before the Closing, either Fund may waive any of the foregoing conditions (except those set forth in paragraphs 6.1, 6.4, and 6.5) if, in the judgment of its Board, such waiver will not have a material adverse effect on its Fund's stockholders' interests.

### 7. BROKERS AND EXPENSES -----

7.1. Each Fund represents and warrants to the other that there are no brokers or finders entitled to receive any payments in connection with the transactions provided for herein.

7.2. All Reorganization Expenses, including fees and expenses related to printing, mailing, solicitation of proxies, and tabulation of votes, accounting, legal, and custodial fees and expenses, and fees payable to governmental authorities for the registration or qualification of the Acquiring Fund Shares distributable hereunder and all transfer agency costs related thereto, shall be borne by the Funds and the Other Acquired Fund in proportion to their respective net assets determined at the Valuation Time, provided that if the Closings of the Reorganization and the Other Reorganization occur at different times, that determination will be made at the Valuation Time on the date of the first Closing. Notwithstanding the foregoing, expenses shall be paid by the Fund directly incurring them if and to the extent that the payment thereof by another person would result in such Fund's disqualification as a RIC or would prevent the Reorganization from qualifying as a tax-free reorganization.

### 8. ENTIRE AGREEMENT; SURVIVAL -----

Neither Fund has made any representation, warranty, or covenant not set forth herein, and this Agreement constitutes the entire agreement between the parties. The representations, warranties, and covenants contained herein or in

any document delivered pursuant hereto or in connection herewith (except the

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covenant set forth in paragraph 5.9) shall not survive the Closing.

### 9. TERMINATION -----

This Agreement may be terminated at any time at or before the Effective Time:

9.1. By either Fund (a) in the event of the other Fund's material breach of any representation, warranty, or covenant contained herein to be performed at or before the Effective Time, (b) if a condition to its obligations has not been met and it reasonably appears that such condition will not or cannot be met, or (c) if the Closing has not occurred on or before December 31, 2008, or such other date as to which the Funds may agree; or

9.2. By the Funds' mutual agreement.

In the event of termination under paragraphs 9.1(c) or 9.2, neither Fund (nor its directors/trustees, officers, or stockholders/shareholders) shall have any liability to the other Fund.

### 10. AMENDMENT -----

This Agreement may be amended, modified, or supplemented at any time in any manner mutually agreed on in writing by the Funds, notwithstanding Acquired Fund's stockholders' approval thereof; provided that, following such approval no such amendment, modification, or supplement shall have a material adverse effect on the Stockholders' interests.

### 11. MISCELLANEOUS -----

11.1. This Agreement shall be governed by and construed in accordance with the internal laws of the State of Delaware, without giving effect to principles of conflict of laws; provided that, in the case of any conflict between such laws and the federal securities laws, the latter shall govern.

11.2. Nothing expressed or implied herein is intended or shall be construed to confer on or give any person, firm, trust, or corporation other than the parties and their respective successors and assigns any rights or remedies under or by reason of this Agreement.

11.3 This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement, and shall become effective when one or more counterparts have been executed by each Fund and delivered to the other Fund. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

11.4. Any term or provision of this Agreement that is invalid or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such invalidity or unenforceability without rendering invalid or unenforceable the remaining terms and provisions hereof or affecting the validity or enforceability of any of the terms and provisions hereof in any other jurisdiction.

11.5 Notice is hereby given that this instrument is adopted on behalf of Acquiring Fund's trustees solely in their capacities as trustees, and not individually, and that Acquiring Fund's obligations under this instrument are not binding on or enforceable against any of its trustees, officers, or shareholders but are only binding on and enforceable against its property.

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Acquired Fund, in asserting any rights or claims under this Agreement, shall look only to Acquiring Fund's property in settlement of such rights or claims and not to such trustees, officers, or shareholders.

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IN WITNESS WHEREOF, each party has caused this Agreement to be executed and delivered by its duly authorized officers as of the day and year first written above.

[NAME OF ACQUIRED FUND]

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

HIGHLAND CREDIT STRATEGIES FUND

By: \_\_\_\_\_

Name: \_\_\_\_\_

Title: \_\_\_\_\_

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APPE

DESCRIPTION OF INVESTMENT TYPES

ILLIQUID SECURITIES Certain of a Fund's investments may be illiquid. Illiquid securities subject to legal or contractual restrictions on disposition or lack of an established secondary trading market. The sale of restricted and illiquid securities often requires more time and results in higher brokerage charges, dealer discounts and other selling expenses than does the sale of securities eligible for trading on national securities exchanges or in over-the-counter markets. Restricted securities may sell at a price lower than similar securities that are not subject to restrictions on resale.

SENIOR LOANS Senior loans hold the most senior position in the capital structure of a business entity, are typically secured with specific collateral and have a claim on the general assets of the borrower that is senior to that of the subordinated debtholders and stockholders of the borrower. The proceeds of senior loans primarily are used to finance leveraged buyouts, recapitalizations, mergers, acquisitions, stock repurchases, and, to a limited extent, to finance internal growth and for other corporate purposes. Senior loans typically have rates of interest which are redetermined either monthly, quarterly or semi-annually by reference to a base lending rate.

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a premium. These base lending rates generally are LIBOR, the prime rate offered by one or more major United States banks (Prime Rate) certificate of deposit (CD) rate or other base lending rates used by commercial lenders.

Loans and other corporate debt obligations are subject to the risk of non-payment of scheduled interest or principal. Such non-payment would result in a reduction of income to a Fund, a reduction in the value of the investment and a potential decrease in the NAV of a Fund. There can be no assurance that the liquidation of any collateral securing a senior loan would satisfy the borrower's obligation in the event of non-payment of scheduled interest or principal payments, or that such collateral could be readily liquidated in the event of bankruptcy of a borrower, a Fund could experience delimitations with respect to its ability to realize the benefits of the collateral securing a senior loan. To the extent that a senior loan is collateralized by stock in the borrower or its subsidiaries, such stock could lose all or substantially all of its value in the event of the bankruptcy of the borrower. Some senior loans are subject to the risk that a court, pursuant to fraudulent conveyance or other similar laws, could subordinate senior loans to presently existing or future indebtedness of the borrower or take other actions detrimental to the holders of senior loans including, in certain circumstances, invalidating such senior loans or causing interest previously paid to be refunded to the borrower. If interest were required to be refunded, it could negatively affect a Fund's performance. To the extent a senior loan is subordinated in the capital structure, it will have characteristics similar to other subordinated debtholders, including a greater risk of nonpayment of interest or principal.

Many loans in which the Fund may invest, and the issuers of such loans may not be rated by a rating agency, will not be registered with the SEC or state securities commission and will not be listed on any national securities exchange. The amount of public information available with respect to issuers of senior loans will generally be less extensive than that available with respect to issuers of registered or exchange listed securities. In evaluating the creditworthiness of borrowers, the Adviser will consider, and may rely in part, on analyses performed by others. The Adviser does not view ratings as the determinative factor in its investment decisions and relies more upon its credit analysis abilities than upon ratings. Borrowers may have outstanding debt obligations that are rated below investment grade by a rating agency. A high percentage of senior loans held by a Fund may be rated, if at all, below investment grade by independent rating agencies. In the event senior loans are not rated, they are likely to be the equivalent of below investment grade quality. Debt securities which are unsecured and rated below investment grade (i.e., Ba and below by Moody's or BB and below by S&P) and comparable unsecured bonds, are viewed by the rating agencies as having speculative characteristics and are commonly known as "junk bonds." A description of the rating agencies' corporate bonds by Moody's and S&P included as Appendix A to the Statement of Additional Information. Because senior loans are senior in a borrower's capital structure and are often secured by specific collateral, the Adviser believes that senior loans have more favorable loss recovery rates as compared to most other types of below investment grade debt obligations. However, there can be no assurance that a Fund's actual loss recovery experience will

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be consistent with the Adviser's prior experience or that a Fund's senior loans will achieve any specific loss recovery rates.

No active trading market may exist for many senior loans, and some loans may be subject to restrictions on resale. A secondary market subject to irregular trading activity, wide bid/ask spreads and extended settlement periods, which may impair the ability to realize full value disposition of an illiquid senior loan, and cause a material decline in Fund's NAV.

USE OF AGENTS. Senior loans generally are arranged through negotiations between a borrower and a group of financial institutions initially represented by an agent who is usually one of the original lenders. In larger transactions, it is common to have several agents. Generally, however, only one such agent has primary responsibility for the administration of a senior loan. Agents are typically paid fees by the borrower for their services. The agent is primarily responsible for negotiating the credit agreement which establishes the terms and conditions of the senior loan and the rights of the borrower and the lenders. The agent is also responsible for monitoring collateral and for exercising remedies available to the lenders such as foreclosure upon collateral.

Credit agreements may provide for the termination of the agent's status if an event occurs that it fails to act as required under the relevant credit agreement. If the borrower becomes insolvent, enters FDIC receivership or, if not FDIC insured, enters into bankruptcy. Should such an agent, lender or assignor with respect to an assignment inter-positioned between a Fund and the borrower become insolvent or enter FDIC receivership or bankruptcy, any interest in the senior loan held by such person and any loan payment held by such person for the benefit of the Fund should not be included in such person's or entity's bankruptcy estate. However, if however, any such amount were included in such person's or entity's bankruptcy estate, a Fund would incur certain costs and delays in realizing payments and could suffer a loss of principal or interest. In this event, a Fund may experience a decrease in NAV.

FORM OF INVESTMENT. A Fund's investments in senior loans may take several forms, including acting as one of the group of lenders originating a senior loan, purchasing an assignment of a portion of a senior loan from a third party or acquiring a participation in a senior loan. When a Fund is a member of the originating syndicate for a senior loan, it may share in the fees paid to the syndicate. When a Fund acquires a participation in, or an assignment of, a senior loan, it may pay a fee to, or forego a portion of, the interest payments from, the lender selling the participation or assignment. A Fund will act as lender, or purchase an assignment or participation, in respect to a senior loan only if the agent is determined by the Adviser to be creditworthy.

ORIGINAL LENDER. When a Fund is one of the original lenders, it will have a direct contractual relationship with the borrower and can enforce compliance by the borrower with terms of the credit agreement. It also may have negotiated rights with respect to any funds acquired by other lenders to be set-off. Original lenders also negotiate voting and consent rights under the credit agreement. Actions subject to lender vote or consent generally require the vote or consent of the majority of the holders of some specified percentage of the outstanding principal amount of the senior loan. Certain decisions, such as reducing the interest rate, or extending the maturity of a senior loan, or releasing collateral securing a senior loan, among others, frequently require the unanimous vote or consent of all lenders affected.

ASSIGNMENTS. When a Fund is a purchaser of an assignment, it typically succeeds to all the rights and obligations under the credit agreement from the assigning lender and becomes a lender under the credit agreement with the same rights and obligations as the assigning lender. Assignments are, however, arranged through private negotiations between potential assignees



potential assignors, and the rights and obligations acquired by the purchaser of an assignment may be more limited than those held by the assigning lender.

PARTICIPATIONS. A Fund may also invest in participations in senior loans. The rights of a Fund when it acquires a participation are likely to be more limited than the rights of an original lender or an investor who acquires a participation.

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assignment. Participation by a Fund in a lender's portion of a senior loan typically means that the Fund has only a contractual relationship with the lender, not with the borrower. This means that the Fund has 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 of payments from the lender of payments from the borrower.

With a participation, a Fund will have no rights to enforce compliance with the terms of the credit agreement or any rights with respect to any funds acquired by other lenders through setoff against the borrower. In addition, a Fund may not directly benefit from the collateral supporting the senior loan because it may be treated as a general creditor of the borrower instead of a senior secured creditor of the borrower. As a result, the Fund may be subject to delays, expenses and risks that are greater than those that exist when the Fund is the original lender or holds an assignment. This means that the Fund must assume the credit risk of both the borrower and the lender selling the participation. A Fund will consider a purchase of participation only in those situations where the Adviser considers the participating lender to be creditworthy.

In the event of a bankruptcy or insolvency of a borrower, the obligation of the borrower to repay the senior loan may be subject to certain defenses that can be asserted by such borrower against a Fund as a result of the conduct of the lender selling the participation. A participation in a senior loan will be deemed to be a senior loan for the purposes of the Fund's investment objectives and policies.

Investing in senior loans involves investment risk. Some borrowers default on their senior loan payments. A Fund attempts to manage this credit risk through multiple different investments within the portfolio and ongoing analysis and monitoring of borrowers. A Fund also is subject to market, liquidity, interest rate and other risks.

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SECOND LIEN  
LOANS

Second lien loans are loans made by public and private corporations and non-governmental entities and issuers for a variety of purposes. Second lien loans are second in right of payment to one or more senior loans of the related borrower. Second lien loans typically are secured by a second priority security interest or lien to or on specified collateral securing the borrower's obligation under the loan and typically have similar protections and rights as senior loans. Second lien loans are not (and by their nature cannot) become subordinate in right of payment to any obligation of the related borrower other than senior loans of such borrower. Second lien loans, like senior loans, typically have adjustable floating rate interest payments. Because second lien loans are second to senior loans, they present a greater degree of investment risk but often pay interest at higher rates reflecting this additional risk. Such investments generally are of below investment grade quality. Other than their subordinated status, second lien loans have characteristics and risks similar to senior loans discussed above.

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addition, second lien loans of below investment grade quality share many of the risk characteristics of non-investment grade securities. As in the case of senior loans, a Fund may purchase interests in second lien loans through assignments or participations.

Second lien loans are subject to the same risks associated with investment grade senior loans and non-investment grade securities. Because second lien loans are second in right of payment to one or more senior loans of the borrower, they therefore are subject to additional risk that the cash flow of the borrower and any property securing the loan may be insufficient to meet scheduled payments after giving effect to the senior secured obligations of the borrower. Second lien loans are also expected to have greater volatility than senior loans and may be less liquid. There is a possibility that originators will not be able to sell participations in second lien loans, which would create greater credit risk exposure.

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### OTHER SECURED LOANS

Secured loans other than senior loans and second lien loans are made by public and private corporations and other non-governmental entities and issuers for a variety of purposes. Such secured loans may rank lower in right of payment to one or more senior loans and second lien loans of the borrower. Such secured loans typically are secured by a lower priority security interest or lien on specified collateral securing the borrower's obligation under the loan and typically have more subordinated protections and rights than senior loans and second lien loans. Secured loans may become subordinated in right of

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payment to more senior obligations of the borrower issued in the future. Other secured loans may have fixed or adjustable floating rate interest payments. Because such secured loans may rank lower as to right of payment to senior loans and second lien loans of the borrower, they may present a greater amount of investment risk than senior loans and second lien loans but often pay interest at higher rates reflecting this additional risk. Such investments generally are of below investment grade quality. Other than their subordinated status, such investments have many characteristics and risks similar to senior loans and second lien loans discussed above. In addition, other secured loans of below investment grade quality share many of the risk characteristics of non-investment grade securities. As in the case of senior loans and second lien loans, a Fund may purchase interests in other secured loans through assignments or participations. Other secured loans are subject to the same risks associated with investment in senior loans, second lien loans and non-investment grade securities. Because such loans, however, rank lower in right of payment to senior loans and second lien loans of the borrower, they may be subject to additional risk that the cash flow of the borrower and any property securing the loan may be insufficient to meet scheduled payments after giving effect to more senior secured obligations of the borrower. Such secured loans are also expected to have greater volatility than senior loans and second lien loans and may be less liquid. There is also a possibility that originators will not be able to sell participations in other secured loans, which would create greater credit risk exposure.

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### UNSECURED LOANS

Unsecured loans are loans made by public and private corporations and other non-governmental entities and issuers for a variety of purposes. Unsecured loans generally have lower priority in right of payment compared to held senior secured debt of the borrower. Unsecured loans are not secured by a security

interest or lien to or on specified collateral securing the borrower's obligation under the loan. Unsecured loans by their terms may be or may not subordinate in right of payment to other obligations of the borrower, including senior loans, second lien loans and other secured loans. Unsecured loans may have fixed or adjustable floating rate interest payments. Because unsecured loans are subordinate to the secured debt of the borrower, they present a greater degree of investment risk but often pay interest at rates reflecting this additional risk. Such investments generally are of non-investment grade quality. Other than their subordinated and unsecured status, such investments have many characteristics and risks similar to secured loans, second lien loans and other secured loans discussed above. In addition, unsecured loans of non-investment grade quality share many of the characteristics of non-investment grade securities. As in the case of secured loans, a Fund may purchase interests in unsecured loans through assignment or participations.

Unsecured loans are subject to the same risks associated with investments in senior loans, second lien loans, other secured loans and non-investment grade securities. However, because unsecured loans rank lower in right of payment than any secured obligations of the borrower, they may be subject to additional risk that the cash flow of the borrower and available assets may be insufficient to meet scheduled payments after giving effect to the senior obligations of the borrower. Unsecured loans are also expected to have greater price volatility than secured loans and may be less liquid. There is also the possibility that loan originators will not be able to sell participations in unsecured loans, which would create greater credit risk exposure.

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INVESTMENT GRADE  
SECURITIES

A Fund may invest in a wide variety of bonds that are rated or determined by the Adviser to be of investment grade quality of varying maturities issued by U.S. corporations and other business entities. Bonds are fixed or variable rate debt obligations, including bills, notes, debentures, money market instruments and similar instruments and securities. Bonds generally are issued by corporations and other issuers to borrow money from investors for a variety of business purposes. The issuer pays the investor a fixed or variable 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. Some investment grade securities, such as zero coupon bonds, do not pay a coupon interest, but are sold at a discount from their face values. Although they are creditworthy and generally less risky than non-investment grade securities, investment grade securities are still subject to market and credit risk. Market risk relates to changes in a security's value as a result of interest rate changes generally. Investment grade securities have varying levels of sensitivity to changes in interest rates and varying degrees of credit quality. In general, bond prices rise when interest rates fall, and fall when interest rates rise. Longer-term bonds and zero coupon bonds are generally

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more sensitive to interest rate changes. Credit risk relates to the ability of the issuer to make payments of principal and interest. The value of investment grade securities like those of other debt securities may be affected by changes in the credit rating or financial condition of an issuer. Investment grade securities are generally considered medium- and high-quality securities. Some, however, may possess speculative characteristics, and may be more sensitive to economic changes and to changes in the financial condition of issuers. The market prices of investment grade securities in the

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investment grade categories may fluctuate more than higher-quality securities and may decline significantly in periods of general or regional economic difficulty. Like non-investment grade securities, such investment securities in the lowest investment grade categories may be thinly traded, making them difficult to sell promptly at an acceptable price.

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### NON-INVESTMENT GRADE SECURITIES

A Fund may invest in securities rated below investment grade, such as securities rated Ba or lower by Moody's and BB or lower by S&P or securities comparable to those rated by other rating agencies or in unrated securities determined by Highland to be of comparable quality. Securities rated Ba by Moody's are judged to contain speculative elements, their future cannot be considered as well assured, and often the protection of interest and principal payments may be very modest. Securities rated BB by S&P are regarded as having predominantly speculative characteristics and, while such obligations have less near-term vulnerability to default than other speculative grade debt, they face major uncertainties or exposure to adverse business, financial or economic conditions which could lead to inadequate capacity to meet timely interest and principal payments. Securities rated C are regarded as having extremely poor prospects of ever attaining any real investment standing. Securities rated below C are in default and the payment of interest and/or repayment of principal is in arrears.

Lower grade securities, though high yielding, are characterized by high volatility. They may be subject to certain risks with respect to the issuing entity and to greater market fluctuations than certain lower yielding, higher quality securities. The secondary market for lower grade securities may be less liquid than that of higher rated securities. Adverse conditions could make it difficult at times for a Fund to sell certain securities or could result in lower prices than those used in calculating the Fund's NAV.

The prices of debt securities generally are inversely related to interest rate changes; however, the price volatility caused by fluctuating interest rates on securities also is inversely related to the coupon of such securities. Accordingly, lower grade securities may be relatively less sensitive to interest rate changes than higher quality securities of comparable maturity because of their higher coupon. This higher coupon is what the investor receives in return for bearing greater credit risk. The higher credit risk associated with lower grade securities potentially can have a greater impact on the value of such securities than may be the case with higher quality issues of comparable maturity, and will be a substantial factor in a Fund's relative share price volatility.

Lower grade securities may be particularly susceptible to economic downturns. It is likely that an economic recession could disrupt severely the market for such securities and may have an adverse impact on the value of such securities. In addition, it is likely that any such economic downturn could adversely affect the ability of the issuers of such securities to pay interest and principal and pay interest thereon and increase the incidence of default on such securities.

The ratings of Moody's and S&P and the other rating agencies represent their opinions as to the quality of the obligations which they undertake to rate. Ratings are relative and subjective and, although ratings may be used in evaluating the safety of interest and principal payments, they do not evaluate the market value risk of such obligations. Although these ratings may be an initial criterion for selection of portfolio investments, Highland also independently evaluates these securities and the ability of the issuers of such securities to pay interest and principal. To the extent that a Fund invests in lower grade securities that have not been rated by a rating agency, the Fund's ability to achieve its investment objectives will be more dependent on Highland's credit analysis than would be the case when the Fund invests in rated securities.

ASSET-BACKED  
SECURITIES

Asset-backed securities are generally issued as pass-through certificates which represent undivided fractional ownership interests in an underlying pool of assets, or as debt instruments, which are also known as collateralized debt obligations, and are generally issued as the debt of a special purpose vehicle organized solely for the purpose of owning such assets and issuing such securities. Asset-backed securities are often backed by a pool of assets representing the obligations of a number of different parties. Credit card receivables are generally unsecured, and the debtors are entitled to the protection afforded by a number of state and federal consumer credit laws which give debtors the right to set off certain amounts owed on the credit cards, thereby reducing the balance due. Most issuers of automobile receivables permit the servicer to retain possession of the underlying obligations. If the servicer were to assign these obligations to another party, there is a risk that the purchaser could acquire an interest superior to that of the holders of the related automobile receivables. In addition, because of the large number of vehicles involved in a typical issuance and technical requirements under state laws, the trustee for the holders of the automobile receivables may not have an efficient security interest in all of the obligations backing such receivables. Therefore, there is a possibility that recoveries on repossessed collateral may not, in some cases, be able to support payments on these securities.

COLLATERALIZED  
LOAN OBLIGATIONS  
AND BOND  
OBLIGATIONS

A Fund may invest in certain asset-backed securities that are secured by certain financial assets by issuing securities in the form of negotiable instruments that are issued by a financing company (generally called a Special Purpose Vehicle or "SPV"). These securitized assets are, as a rule, commercial financial assets brought into a pool according to specific diversification rules. The SPV is a company founded solely for the purpose of securing these claims and its only asset is the diversified asset pool. On this basis, marketable securities are issued which, due to the diversification of the underlying risk, generally represent a lower level of risk than the original assets. The redemption of the securities issued by the SPV takes place at maturity out of the cash flow generated by the collected claims.

A collateralized loan obligation ("CLO") is a structured debt security issued by an SPV that was created to reapportion the risk and return characteristics of a pool of assets. The assets, typically senior loans, are used as collateral supporting the various debt tranches issued by the SPV. The primary feature of the CLO structure is the prioritization of the cash flows from the pool of debt securities among the several classes of securities issued in the CLO.

A Fund may also invest in collateralized bond obligations ("CBOs"), which are structured debt securities backed by a diversified pool of high yield, investment grade or private fixed income securities. These may be fixed pools or may be "managed value" (or managed) pools of collateral. The CBO issues debt securities which are typically separated into tranches representing different degrees of credit quality. The top tranche of securities has the greatest collateralization and pays the lowest interest rate. Lower CBO tranches have a lesser degree of collateralization quality and pay higher interest rates intended to compensate for the attendant risks. The bottom tranche specifically receives the residual interest payments (i.e., money that is left over after the higher tranches have been paid) rather than a fixed interest rate. The return on the bottom tranches of CBOs is especially sensitive to the rate of defaults

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collateral pool.

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### DISTRESSED DEBT

A Fund may invest in the securities and other obligations of distressed bankrupt issuers, including debt obligations that are in covenant or payment default. Such investments generally trade significantly below par and are considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid only through a lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments. Typically such workout or bankruptcy proceedings result in only partial recovery of cash payments or an exchange of the defaulted obligation for other debt or equity securities of the issuer or its affiliates, which may in turn be illiquid or speculative. A Fund may invest in securities of a company for purposes of gaining control.

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### STRESSED DEBT

A Fund may invest in securities and other obligations of stressed issuers. Stressed issuers are issuers that are not yet deemed distressed or bankrupt and whose debt securities are trading at a discount to par, but not at distressed levels. An example would be an issuer that is in technical default of its credit agreement, or undergoing strategic or operational changes,

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results in market pricing uncertainty.

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### COMMON STOCKS

Common stocks are shares of a corporation or other entity that entitle the holder to a pro rata share of the profits, if any, of the corporation with no preference over any other shareholder or class of shareholders, including holders of such entity's preferred stock and other senior equity securities. Common stock usually carries with it the right to vote and frequent exercise of an exclusive right to do so. In selecting common stocks for investment, the Fund generally expects to focus primarily on the security's dividend yield and capacity rather than on its potential for capital appreciation. A Fund may acquire an interest in common stocks in various ways, including purchasing common stock in default of a senior loan secured by such common stock or by acquiring common stock for investment. A Fund may also acquire warrants or other rights to purchase a borrower's common stock in connection with the making of a loan.

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### PREFERRED SECURITIES

Preferred securities are equity securities, but they have many characteristics of fixed income securities, such as a fixed dividend payment rate and a liquidity preference over the issuer's common shares. However, because preferred securities are equity securities, they may be more susceptible to the risks traditionally associated with equity investments than a Fund's fixed income securities.

Fixed rate preferred stocks have fixed dividend rates. They can be perpetual with no mandatory redemption date, or issued with a fixed mandatory redemption date. Certain issues of preferred stock are convertible into other securities. Perpetual preferred stocks provide a fixed dividend throughout the life of the issue, with no mandatory retirement provisions, but are callable. Sinking fund preferred stocks provide for the redemption of a portion of the issue on a regularly scheduled basis with, in most cases, the entire issue being retired at a future date. The value of fixed rate preferred stocks can be expected to vary inversely with interest rates.

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Adjustable rate preferred stocks have a variable dividend rate which is determined periodically, typically quarterly, according to a formula based on a specified premium or discount to the yield on particular U.S. Treasury securities, typically the highest base-rate yield of one of three Treasury securities: the 90-day Treasury bill; the 10-year Treasury note; or either the 20-year or 30-year Treasury bond or other index. The premium or discount to be added to or subtracted from this base-rate yield is fixed at the time of issuance and cannot be changed without the approval of the holder of the adjustable rate preferred stock. Some adjustable rate preferred stocks have a maximum and a minimum rate and in some cases are convertible into common stock.

Auction rate preferred stocks pay dividends that adjust based on periodic auctions. Such preferred stocks are similar to short-term corporate debt market instruments in that an auction rate preferred stockholder has the opportunity to sell the preferred stock at par in an auction, normally conducted at least every 49 days, through which buyers set the dividend rate in a bidding process for the next period. The dividend rate set in the auction depends on market conditions and the credit quality of the particular issuer. Typically, the auction rate preferred stock's dividend rate is limited to a specified maximum percentage of an external commercial paper index as of the auction date. Further, the terms of the auction rate preferred stocks generally provide that they are redeemable by the issuer at certain times under certain conditions.

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### CONVERTIBLE SECURITIES

A convertible security is a bond, debenture, note, preferred stock or other security that may be converted into or exchanged for a prescribed amount of common stock or other equity security of the same or a different issuer at a particular period of time at a specified price or formula. A convertible security entitles the holder to receive interest paid or accrued on debt or the dividend paid on preferred stock until the convertible security matures or is redeemed, converted or exchanged. Before conversion, convertible securities have characteristics similar to nonconvertible income securities in that they ordinarily provide a stable stream of income with generally higher yields than those of common stocks of the same or similar issuers, but lower yields than comparable nonconvertible securities. Depending on the relationship between the conversion price to the market value of the underlying securities, convertible securities may trade more like equity securities than debt instruments.

The value of a convertible security is influenced by changes in interest rates, with investment value declining as interest rates increase and increasing as interest rates decline. The credit standing of the issuer and other factors also may have an effect on the convertible security's investment value. Convertible securities rank senior to common stock in a corporation's capital structure but are usually subordinated to comparable nonconvertible securities. Convertible securities may be subject to redemption at the option of the issuer at a price established in the convertible security's governing instrument.

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### MONEY MARKET INSTRUMENTS

Money market instruments include short-term U.S. government securities, dollar-denominated, high quality commercial paper (unsecured promissory notes issued by corporations to finance their short-term credit needs), certificates of deposit, bankers' acceptances and repurchase agreements relating to the foregoing. U.S. government securities include Treasury notes, bonds

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bills, which are direct obligations of the U.S. government backed by the full faith and credit of the United States and securities issued by agencies and instrumentalities of the U.S. government, which may be guaranteed by the U.S. Treasury, may be supported by the issuer's right to borrow from the U.S. Treasury or may be backed only by the credit of the federal agency or instrumentality itself.

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### U.S. GOVERNMENT SECURITIES

U.S. government securities may include debt obligations of varying maturities issued by the U.S. Treasury or issued or guaranteed by an agency or instrumentality of the U.S. government, including the Federal Reserve Administration, Federal Financing Bank, Farmers Home Administration, Export-Import Bank of the United States, Small Business Administration, Government National Mortgage Association (GNMA), General Services Administration, Central Bank for Cooperatives, Federal Farm Credit Administration, Federal Home Loan Banks, Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Association (FNMA), Maritime Administration, Tennessee Valley Authority, District of Columbia Armory Board, Student Marketing Association, Resolution Trust Corporation and various instrumentalities that previously were or currently are part of the Farm Credit System (which has been undergoing reorganization since 1987). Some U.S. government securities, such as U.S. Treasury bills, Treasury notes and Treasury bonds, which differ only in their interest rates, maturities and times of issuance, are supported by the full faith and credit of the United States government. Others are supported by (i) the right of the issuer to borrow from the U.S. Treasury, such as securities of the Federal Home Loan Banks; (ii) the discretionary authority of the U.S. government to purchase the agency's obligations, such as securities of the FNMA; or (iii) only the credit of the issuer. No assurance can be given that the U.S. government will provide financial support in the future to U.S. government agencies, authorities or instrumentalities that are not supported by the full faith and credit of the United States. Securities guaranteed as to principal and interest by the U.S. government, its agencies, authorities or instrumentalities include (i) securities for which the payment of principal and interest is backed by an irrevocable letter of credit issued by the U.S. government or any agency, authority or instrumentality; and (ii) participations in securities made to non-U.S. governments or other entities that are so guaranteed in the secondary market for certain of these participations is limited and the securities may be regarded as illiquid.

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### OTHER INVESTMENT COMPANIES

A Fund may invest in the securities of other investment companies to the extent that such investments are consistent with the Fund's investment objectives and principal investment strategies and permissible under the Investment Company Act. Under one provision of the 1940 Act, a Fund may not acquire securities of other investment companies if, as a result, (i) more than 10% of the Fund's total assets would be invested in securities of other investment companies, (ii) such purchase would result in more than 3% of the outstanding voting securities of any one investment company being held by the Fund or (iii) more than 5% of the Fund's total assets would be invested in securities of one investment company. Other provisions of the 1940 Act are less restrictive, provided that a Fund is able to meet certain conditions. These limitations do not apply to the acquisition of shares of any investment company in connection with a merger, consolidation, reorganization or acquisition of substantially all of the assets of another investment company.

A Fund, as a holder of the securities of other investment companies, will bear its pro rata portion of the other investment companies' expenses, including



	<p>advisory fees. These expenses will be in addition to the direct expenses incurred by a Fund.</p>
<p>EXCHANGE TRADED FUNDS</p>	<p>Subject to the limitations on investment in other investment companies, a Fund may invest in exchange traded funds ("ETFs"). ETFs, such as SPDRs, NASDAQ Index Trading Stock (QQQs), iShares and various country index funds, are securities whose shares are traded on a national exchange or the National Association of Securities Dealers' Automatic Quotation System (NASDAQ). ETFs may be based on underlying equity or fixed income securities. SPDRs, for example, seek to provide investment results that generally correspond to the performance of a component common stocks of the S&amp;P 500. ETFs do not sell individual shares directly to investors and only issue their shares in large blocks known as "creation units." The investor purchasing a creation unit may receive a number of individual shares on a secondary market. Therefore, the liquidity of an ETF depends on the adequacy of the secondary market. There can be no assurance that an ETF's investment objective will be achieved. ETFs based on an index may not replicate and maintain exactly the composition and relative weight of securities in the index. ETFs are subject to the risks of investing in the underlying securities. A Fund, as a holder of the securities of the ETF, will bear its pro rata portion of the ETF's expenses, including advisory fees. These expenses are in addition to the direct expenses of the Fund's operations.</p>
<p>ZERO COUPON SECURITIES</p>	<p>Zero coupon securities are debt obligations that are issued or purchased at a significant discount from face value. The discount approximates the amount of interest the security will accrue and compound over the period to maturity or the particular interest payment date at a rate of interest reflecting the market rate of the security at the time of issuance. Zero coupon securities do not require the periodic payment of interest. Zero coupon investments benefit the issuer by mitigating its need for cash to meet its service but generally require a higher rate of return to attract investors who are willing to defer receipt of cash. These investments may experience greater volatility in market value than securities that make regular payments of interest. A Fund accrues income on these investments for tax and accounting purposes, which is distributable to shareholders and which, because no cash is received at the time of accrual, may require the liquidation of other portfolio securities to satisfy the Fund's distribution obligations, in which case the Fund will forego the purchase of additional income producing securities with these funds.</p>
<p>DEFERRED PAYMENT OBLIGATIONS</p>	<p>Deferred payment securities are securities that remain zero coupon securities until a predetermined date, at which time the stated coupon rate becomes effective and interest becomes payable at regular intervals. Deferred payment securities are subject to greater fluctuations in value and may have less liquidity in the event of adverse market conditions than comparably structured securities paying cash interest at regular interest payment periods.</p>
<p>DERIVATIVE TRANSACTIONS</p>	<p>A Fund may purchase and sell derivative instruments such as exchange-traded and over-the-counter put and call options on securities, financial futures on equity, fixed-income and interest rate indices, and other financial instruments, purchase and sell financial futures contracts and options thereon, enter into various interest rate transactions such as swaps, interest rate floors or collars and enter into various currency transactions such as currency forward contracts, currency futures contracts, currency swap contracts, options on currency or currency futures or credit transactions and default swaps. A Fund also may purchase derivative instruments that contain other features of these instruments. A Fund may use Derivative Transactions as a portfolio management or hedging technique to seek to protect against potential adverse changes in the market value of senior loans or other securities.</p>

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in or to be purchased for the Fund's portfolio, protect the value of the Fund's portfolio, facilitate the sale of certain securities for investment purposes, manage the effective interest rate exposure of the Fund, protect against changes in currency exchange rates, manage the effective maturity and duration of the Fund's portfolio, or establish positions in the derivative markets as a temporary substitute for purchasing or selling particular securities.

Derivative Transactions have risks, including the imperfect correlation between the value of such instruments and the underlying assets, the possibility of default of the other party to the transaction or illiquidity of the derivative instruments. Furthermore, the ability to use successfully Derivative Transactions depends on the Adviser's ability to predict pertinent market movements, which cannot be assured. Thus, the use of Derivative Transactions

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may result in losses greater than if they had not been used, may require the Fund to sell or purchase portfolio securities at inopportune times at prices other than current market values, may limit the amount of appreciation a Fund can realize on an investment, or may cause a Fund to hold a security that it might otherwise sell. The use of currency transactions can result in the Fund incurring losses as a result of the imposition of exchange controls, suspension of settlements or the inability of a Fund to deliver or receive the specified currency. Additionally, amounts paid by a Fund as premiums on derivatives or other assets held in margin accounts with respect to Derivative Transactions are not otherwise available to the Fund for investment purposes.

### SENIOR LOAN BASED DERIVATIVES

A Fund may obtain exposure to senior loans and baskets of senior loans through the use of derivative instruments. Such derivative instruments have recently become increasingly available. The Adviser reserves the right to utilize derivative instruments and similar instruments that may be available in the future. For example, a Fund may invest in a derivative instrument known as the Synthetic Aggregate Market Index ("SAMI"), which provides investors with exposure to a reference basket of senior loans. SAMIs are structured as floating rate derivative instruments. SAMIs consist of a basket of credit default swaps whose underlying reference securities are senior loans. While investing in SAMIs will increase the universe of floating rate debt securities to which a Fund is exposed, such investments entail risks that are not typically associated with investments in other floating rate debt securities. The liquidity of the market for SAMIs will be subject to liquidity in the secured loan and derivatives markets. Investment in SAMIs involves many of the risks associated with investments in derivative instruments discussed generally below. SAMIs may also be subject to the risk that the counterparty in a derivative transaction will default on its obligations. Derivative transactions generally involve the risk of loss due to unanticipated adverse changes in security prices, interest rates, the inability to close out a position, imperfect correlation between a position and the desired hedge, tax constraints on closing out positions and portfolio management constraints on securities subject to such transactions. The potential loss on derivative instruments may be substantially greater than the initial investment therein.

### CREDIT DEFAULT SWAPS

To the extent consistent with Subchapter M of the Internal Revenue Code of 1986, as amended (the "Code"), a Fund may enter into credit default swap agreements. The "buyer" in a credit default contract is obligated to pay to the "seller" a periodic stream of payments over the term of the contract plus

that no event of default on an underlying reference obligation has occurred. If an event of default occurs, the seller must pay the buyer the "par" (full notional value) of the reference obligation in exchange for the reference obligation. A Fund may be either the buyer or seller in a swap transaction. If a Fund is a buyer and no event of default occurs, the Fund loses its investment and recovers nothing. However, if an event of default occurs, the buyer receives full notional value for a reference obligation. The reference obligation may have little or no value. As a seller, a Fund receives income throughout the term of the contract, which typically is between six months and five years, provided that there is no default event.

Credit default swaps involve greater risks than if a Fund had invested in the reference obligation directly. In addition to general market risks, credit default swaps are subject to illiquidity risk, counterparty risk and credit risk. A Fund will enter into swap agreements only with counterparties that are rated investment grade quality by at least one nationally recognized statistical rating organization at the time of entering into such transaction or whose creditworthiness is believed by the Adviser to be equivalent to the rating. A buyer also will lose its investment and recover nothing should an event of default occur. If an event of default were to occur, the value of the reference obligation received by the seller, coupled with the periodic payments previously received, may be less than the full notional value paid to the buyer, resulting in a loss of value to the seller. When a Fund acts as a seller of a credit default swap agreement it is exposed to many of the risks of leverage described under "Risk Factors And Other Considerations--Leverage Risk" since if an event of default occurs the Fund must pay the buyer the full notional value of the reference obligation.

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SWAPS

Swap contracts may be purchased or sold to obtain investment exposure and to hedge against fluctuations in securities prices, currencies, interest rates and market conditions, to change the duration of the overall portfolio.

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mitigate default risk. In a standard "swap" transaction, two parties agree to exchange the returns (or differentials in rates of return) on different currencies, securities, baskets of currencies or securities, indices or other instruments, which returns are calculated with respect to a "notional value." i.e., the designated reference amount of exposure to the underlying instruments. A Fund intends to enter into swaps primarily on a net basis, i.e., the two payment streams are netted out, with the Fund receiving one payment and paying, as the case may be, only the net amount of the two payments. If the other party to a swap contract defaults, the Fund's risk of loss will consist of the net amount of payments that the Fund is contractually entitled to receive. The net amount of the excess, if any, of the Fund's obligation to the other party will be maintained in a segregated account by the Fund's custodian. A Fund will not enter into a swap agreement unless the credit claims-paying ability of the other party thereto is considered to be investment grade by the Adviser. If there is a default by the other party in such a transaction, the Fund will have contractual remedies pursuant to the swap agreements related to the transaction. Swap instruments are not exchange-listed securities and may be traded only in the over-the-counter market.

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INTEREST RATE

Interest rate swaps involve the exchange by a Fund with another party of

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SWAPS                                    respective commitments to pay or receive interest (e.g., an exchange of floating rate payments for floating rate payments).

TOTAL RETURN SWAPS                    Total return swaps are contracts in which one party agrees to make payments for the total return from the designated underlying asset(s), which may include equities, securities, baskets of securities, or securities indices, during the specified period, in return for receiving payments equal to a fixed or floating rate of interest or the total return from the other designated underlying asset(s).

CURRENCY SWAPS                        Currency swaps involve the exchange of the two parties' respective commitments to pay or receive fluctuations with respect to a notional amount denominated in different currencies (e.g., an exchange of payments with respect to interest rate fluctuations in the value of the U.S. dollar relative to the Japanese yen).

CREDIT-LINKED NOTES                    A credit-linked note ("CLNs") is a derivative instrument. It is a synthetic obligation between two or more parties where the payment of principal and interest is based on the performance of some obligation (a reference obligation). In addition to credit risk of the reference obligation, the interest rate risk, the buyer/seller of the CLN is subject to counterparty risk.

OPTIONS                                    An option on a security is a contract that gives the holder of the option the right to receive the 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 at a specified exercise or "strike" price. The writer of an option 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. Certain options, known as "American style" options may be exercised at any time during the term of the option. Other options, known as "European style" options, may be exercised only on the expiration date of the option.

If an option written by a Fund expires unexercised, the Fund realizes at the expiration date a capital gain equal to the premium received by the Fund at the time the option was written. If an option purchased by a Fund expires unexercised, the Fund realizes a capital loss equal to the premium paid. If an option is exercised before expiration, an exchange-traded option may be closed out by an offsetting purchase or sale of an option of the same type, underlying security, exercise price and expiration). There can be no assurance, however, that a closing purchase or sale transaction can be effected when a Fund desires. A Fund may sell put or call options 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 received and other transaction costs paid on the put or call option when purchased. If the amount realized on the closing purchase transaction is less than the premium received from writing the option, the Fund will realize a capital loss. If the amount realized is more than the premium received from a closing sale transaction is more than the premium paid to purchase the option, a Fund will realize a capital gain or, if it is less than the premium paid, the Fund will realize a capital loss.

FUTURES CONTRACTS                    The sale of a futures contract creates an obligation by a Fund, as seller, to deliver the specific type of financial instrument called for in the contract.

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AND OPTIONS ON                        the contract at a specified future time for a specified price. Options on

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### FUTURES CONTRACTS

futures contracts are similar to options on securities except that an option on a futures contract gives the purchaser the right in return for the premium paid to assume a position in a futures contract (a long position if the option is a call and a short position if the option is a put).

At the time a futures contract is purchased or sold, a Fund must allocate cash or securities as a deposit payment ("initial margin"). It is expected that the initial margin that a Fund will pay may range from approximately 5% of the value of the securities or commodities underlying the contract. In certain circumstances, however, such as periods of market volatility, a Fund may be required by an exchange to increase the level of its initial margin payment. Additionally, initial margin requirements have increased generally in the future by regulatory action. An outstanding futures contract is valued daily and the payment in case of "variation margin" is required, a process known as "marking to the market." Transactions in futures and options are usually settled by entering into an offsetting transaction, and are subject to the risk that the position may not be able to be closed if no offsetting transaction can be arranged.

A Fund's use of futures and options on futures will in all cases be consistent with applicable regulatory requirements and in particular the rules and regulations of the CFTC.

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### FORWARD FOREIGN CURRENCY CONTRACTS

A Fund may enter into forward currency contracts to purchase or sell foreign currencies for a fixed amount of U.S. dollars or another foreign currency. A forward currency contract involves an obligation to purchase or sell a specific currency at a future date, which may be any fixed number of days after the date of the forward currency contract agreed upon by the parties, at a price set at the time the forward currency contract is entered into. Forward currency contracts are traded directly between currency traders (usually commercial banks) and their customers.

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### SHORT SALES

A short sale is a transaction in which a Fund sells a security it does not own in anticipation that the market price of that security will decline. When a Fund makes a short sale, it must borrow the security sold short from a broker-dealer and deliver it to the buyer 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 payments received on such borrowed securities.

A Fund's obligation to replace the borrowed security will be secured by collateral deposited with the broker-dealer, usually cash, U.S. government securities or other liquid securities. A Fund will also be required to designate on its books and records similar collateral with its custodian to the extent, if any, necessary so that the aggregate collateral value is at least equal to the current market value of the security sold short. Depending on arrangements made with the broker-dealer from which it borrows the security regarding payment over of any payments received by a Fund on the security, the Fund may not receive any payments (including interest) on the collateral deposited with such broker-dealer.

If the price of the security sold short increases between the time of the short sale and the time a Fund replaces the borrowed security, the Fund will incur a loss; conversely, if the price declines, the Fund will realize a gain. Any gain will be decreased, and any loss increased, by the transaction costs described above. Although a Fund's gain is limited to the price at which it sold the security short, its potential loss is unlimited.

A Fund may also sell a security short if it owns at least an equal amount of the security sold short or another security convertible or exchangeable into an equal amount of the security sold short without payment of any cash compensation (a short sale against-the-box). In a short sale against-the-box, the short seller is exposed to the risk of being forced to deliver stock

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it holds to close the position if the borrowed stock is called in by the lender, which would cause gain or loss to be recognized on the delisted stock.

Purchasing securities to close out the short position can itself cause the price of the securities to rise further, thereby exacerbating the loss. Short-selling exposes a Fund to unlimited risk with respect to that security.

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due to the lack of an upper limit on the price to which an instrument's price may rise.

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### CAPITAL STRUCTURE ARBITRAGE

Capital structure arbitrage typically involves establishing long and short positions in securities (or their derivatives) at different tiers within an issuer's capital structure in ratios designed to maintain a generally neutral overall exposure to the issuer while exploiting a pricing inefficiency. Some issuers may also have more than one class of shares or an equivalent class of shares that trades in a different market (e.g., European equities and their American Depositary Receipt counterparts). This strategy seeks to profit from a temporary disparity in prices between the various related securities in anticipation that over time all tiers and classes will become more efficiently priced relative to one another.

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### PAIR TRADES

Pair trades involve the establishment of a long position in one security and a short position in another security at the same time. A pair trade attempt to minimize the effect of larger market trends and emphasizes the performance of one security relative to another.

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### REPURCHASE AGREEMENTS

Repurchase agreements are loans or arrangements under which a Fund purchases securities and the seller agrees to repurchase the securities within a specific time and at a specific price. The repurchase price is generally higher than the Fund's purchase price, with the difference being income to the Fund. Under the direction of the Board, the Adviser reviews and monitors the creditworthiness of any institution which enters into a repurchase agreement with a Fund. The counterparty's obligations under the repurchase agreement are collateralized with U.S. Treasury and/or agency obligations with a value of not less than 100% of the obligations, valued daily. Collateral is held by a Fund's custodian in a segregated, safekeeping account for the benefit of the Fund. Repurchase agreements afford a Fund an opportunity to earn income on temporarily available cash at low risk. In the event of the commencement of bankruptcy or insolvency proceedings with respect to the seller of the security before repurchase of the security under a repurchase agreement, a Fund may encounter delay and incur costs before being able to sell the security. Such a delay may involve loss of interest or a decline in the price of the security. If the court characterizes the transaction as a secured transaction and a Fund has not perfected a security interest in the security, the Fund may be required to return the security to the seller's estate and be treated as an unsecured creditor of the seller. As an unsecured creditor, a Fund would have a high risk of losing some or all of the principal and interest involved in the transaction. A Fund may enter into repurchase agreements with broker-dealers, member banks of the Federal Reserve System and other financial institutions.

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### REVERSE REPURCHASE AGREEMENTS

A reverse repurchase agreement is an instrument under which a Fund sells securities and simultaneously obtains the commitment of a purchaser (generally, a commercial bank or a broker or dealer) to repurchase the securities.

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security back to the Fund at an agreed upon price on an agreed upon Reverse repurchase agreements could involve certain risks in the event of default or insolvency of the other party, including possible del restrictions upon a Fund's ability to dispose of the underlying securiti additional risk is that the market value of securities sold by a Fund u reverse repurchase agreement could decline below the price at which th is obligated to repurchase them. Reverse repurchase agreements w considered borrowings by a Fund and as such would be subject t restrictions on borrowing.

Reverse repurchase agreements are also generally subject to earmarki coverage requirements, with the result that, the Fund will designate books and records on an ongoing basis, cash, U.S. government securitie other liquid high grade debt obligations in an amount at least equal Fund's obligations under the reverse repurchase agreement.

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PAY-IN-KIND BONDS

Pay-in-kind, or "PIK" bonds, are bonds which pay interest through the is of additional debt or equity securities. Similar to zero coupon obliga PIK bonds also carry additional risk as holders of these types of secu realize no cash until the cash payment date unless a portion o securities is sold and, if the issuer defaults, a Fund may obtain no ret all on its investment. The market price of PIK bonds is affected by in rate changes to a greater extent, and therefore tends to be more vol than that of securities which pay interest in cash. Additionally, c federal tax law requires the holder of certain PIK bonds to accrue incom respect to these securities prior to the receipt of cash payments. To ma its qualification as a regulated investment company and avoid liabili federal income and excise taxes, a Fund may be required to distribute accrued with respect to these securities and may have to dispose of por

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securities under disadvantageous circumstances in order to generate c satisfy these distribution requirements.

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WHEN-ISSUED,  
DELAYED-DELIVERY  
AND FORWARD  
COMMITMENT  
PURCHASES

A Fund may purchase securities on a "when-issued" basis and may purch sell securities on a "forward commitment" basis in order to acquir security or to offset against anticipated changes in interest rat prices. When such transactions are negotiated, the price, which is gen expressed in yield terms, is fixed at the time the commitment is made delivery and payment for the securities take place at a later When-issued securities and forward commitments may be sold prior settlement date, but a Fund will enter into when-issued and f commitments only with the intention of actually receiving or deliverin securities, as the case may be. If a Fund disposes of the right to acq when-issued security prior to its acquisition or disposes of its ri deliver or receive against a forward commitment, it might incur a g loss. At the time a Fund enters into a transaction on a when-issued or f commitment basis, it will designate on its books and records cash or debt securities equal to at least the value of the when-issued or f commitment securities. The value of these assets will be monitored da ensure that their marked to market value will at all times equal or exce corresponding obligations of a Fund. There is always a risk tha securities may not be delivered and that a Fund may incur a loss. Sett in the ordinary course, which may take substantially more than five bu days, are not treated by a Fund as when-issued or forward comm

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transactions and accordingly are not subject to the foregoing restrictions.

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### SECURITIES LOANS

A Fund may lend assets to registered broker-dealers or other institutional investors deemed by the Adviser to be of good standing under agreements that require that the loans be secured continuously by collateral in cash, equivalents or U.S. Treasury bills maintained on a current basis at an amount at least equal to the market value of the securities loaned. A Fund cannot receive the equivalent of the interest or dividends paid by the issuer of the securities loaned as well as the benefit of an increase and the detriment of any decrease in the market value of the securities loaned and would not receive compensation based on investment of the collateral. A Fund would not, however, have the right to vote any securities having voting rights during the existence of the loan, but would call the loan in anticipation of an important vote to be taken among holders of the securities or of the giving or withholding of consent on a material matter affecting the investment.

As with other extensions of credit, there are risks of delay in recovery and even loss of rights in the collateral should the borrower of the securities fail financially. A Fund will lend portfolio securities only to firms that have been approved in advance by the Board, which will monitor the creditworthiness of any such firms.

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### FOREIGN SECURITIES

A Fund may invest in non-U.S. securities, which may include securities denominated in U.S. dollars or in non-U.S. currencies or multinational currency units. A Fund may invest in non-U.S. securities of so-called emerging market issuers. For purposes of Credit Strategies Fund, a company is deemed to be a non-U.S. company if it meets the following tests: (i) such company is not organized in the United States; (ii) such company's primary business office is not in the United States; (iii) the principal trading market for such company's securities is not located in the United States; (iv) less than 50% of such company's assets are located in the United States; or (v) more than 50% of such issuer's revenues are derived from outside the United States. Non-U.S. securities markets generally are not as developed or efficient as those in the United States. Securities of some non-U.S. issuers are less liquid and more volatile than securities of comparable U.S. issuers. Similarly, volume and liquidity in most non-U.S. securities markets are less than in the United States and, at times, volatility of price can be greater than in the United States.

Because evidences of ownership of such securities usually are held outside the United States, A Fund would be subject to additional risks if it invests in non-U.S. securities, which include possible adverse political and economic developments, seizure or nationalization of foreign deposits and adoption of governmental restrictions which might adversely affect or restrict the payment of principal and interest on the non-U.S. securities to investors located outside the country of the issuer, whether from currency blockages or otherwise.

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Since non-U.S. securities may be purchased with and payable in foreign currencies, the value of these assets as measured in U.S. dollars may be affected favorably or unfavorably by changes in currency rates and exchange control regulations.

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### INVERSE FLOATERS

A Fund may invest in leveraged inverse floating rate debt instruments.



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("Inverse Floaters"). The interest rate of an Inverse Floater resets in the opposite direction from the market rate of interest to which it is indexed. An Inverse Floater may be considered to be leveraged to the extent that the interest rate varies by a magnitude that exceeds the magnitude of the variation in the index rate of interest. The higher degree of leverage inherent in Inverse Floaters is associated with greater volatility in their market value.

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 TEMPORARY  
 DEFENSIVE POSITION

During periods in which Highland determines that it is temporarily unable to follow a Fund's investment strategy or that it is impractical to do so pending re-investment of proceeds received in connection with the sale of securities, the Fund may deviate from its investment strategy and invest any portion of its assets in cash or cash equivalents. Highland's determination that it is temporarily unable to follow a Fund's investment strategy or that it is impractical to do so will generally occur only in situations in which a market disruption event has occurred and where the application of the securities selected through application of the Fund's investment strategy is extremely limited or absent. In such a case, shares of a Fund may be adversely affected and the Fund may not pursue or achieve its investment objectives.

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APPENDIX C

OWNERSHIP OF SHARES OF THE FUNDS

Set forth in the table below is the dollar range of shares beneficially owned by each Director/Trustee in each Fund.

NAME OF BOARD MEMBER	DOLLAR RANGE OF SHARES OF HIGH INCOME PORTFOLIO	DOLLAR RANGE OF SHARES OF INCOME SHARES*	DOLLAR RANGE OF SHARES OF CREDIT STRATEGIES FUND*	AGGREGATE DOLLAR RANGE OF EQUITY SECURITIES IN ALL REGISTERED INVESTMENT COMPANIES OVERSEEN BY BOARD MEMBER IN HIGHLAND FAMILY OF INVESTMENT COMPANIES**
INTERESTED DIRECTOR				

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R. Joseph Dougherty [ ] [ ] [ ] [ ]

NON-INTERESTED DIRECTORS

Timothy K. Hui [ ] [ ] [ ] [ ]

Scott F. Kavanaugh [ ] [ ] [ ] [ ]

James F. Leary [ ] [ ] [ ] [ ]

Bryan A. Ward [ ] [ ] [ ] [ ]

\* Valued as of March 31, 2008.

\*\* Valued as of December 31, 2007. "Family of Investment Companies" consists of twelve registered investment companies that share the Adviser as their investment adviser and that hold themselves out to the investors as related companies for purposes of investment and investor services.

As of March 31, 2008, the Directors and officers of each of High Income Portfolio, Income Shares and Credit Strategies Fund, as a group, owned [ ]% of High Income Portfolio's outstanding common shares, [ ]% of Income Shares' outstanding common shares, and [ ]% of Credit Strategies Fund's outstanding common shares and did not own any preferred shares of either Fund.

Set forth in the tables below is the security ownership in each Fund of each Director/Trustee and executive officer.

HIGH INCOME PORTFOLIO

(1) Title of Class	(2) Name of Beneficial Owner	(3) Amount and Nature of Beneficial Ownership*	(4) Value of Securities	(5) Percent of Class
Common Stock	R. Joseph Dougherty	[ ] shares	\$[ ]	[ ]
Common Stock	Timothy K. Hui	[ ] shares	\$[ ]	[ ]
Common Stock	Scott F. Kavanaugh	[ ] shares	\$[ ]	[ ]
Common Stock	James F. Leary	[ ] shares	\$[ ]	[ ]
Common Stock	Bryan A. Ward	[ ] shares	\$[ ]	[ ]
Common Stock	James D. Dondero	[ ] shares	\$[ ]	[ ]
Common Stock	Mark Okada	[ ] shares	\$[ ]	[ ]
Common Stock	M. Jason Blackburn	[ ] shares	\$[ ]	[ ]
Common Stock	Michael Colvin	[ ] shares	\$[ ]	[ ]

\* Valued as of March 31, 2008. Except as otherwise indicated, each person has sole voting and investment power.

INCOME SHARES

(1) Title of Class	(2) Name of Beneficial Owner	(3) Amount and Nature of Beneficial Ownership*	(4) Value of Securities	(5) Percent of Class
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Common Stock	R. Joseph Dougherty	[ ] shares	\$[ ]	[ ]
Common Stock	Timothy K. Hui	[ ] shares	\$[ ]	[ ]
Common Stock	Scott F. Kavanaugh	[ ] shares	\$[ ]	[ ]
Common Stock	James F. Leary	[ ] shares	\$[ ]	[ ]
Common Stock	Bryan A. Ward	[ ] shares	\$[ ]	[ ]
Common Stock	James D. Dondero	[ ] shares	\$[ ]	[ ]
Common Stock	Mark Okada	[ ] shares	\$[ ]	[ ]
Common Stock	M. Jason Blackburn	[ ] shares	\$[ ]	[ ]
Common Stock	Michael Colvin	[ ] shares	\$[ ]	[ ]

\* Valued as of March 31, 2008. Except as otherwise indicated, each person has sole voting and investment power.

CREDIT STRATEGIES FUND

(1) Title of Class	(2) Name of Beneficial Owner	(3) Amount and Nature of Beneficial Ownership*	(4) Value of Securities	(5) Percent of Class
Common Stock	R. Joseph Dougherty	[ ] shares	\$[ ]	[ ]
Common Stock	Timothy K. Hui	[ ] shares	\$[ ]	[ ]
Common Stock	Scott F. Kavanaugh	[ ] shares	\$[ ]	[ ]
Common Stock	James F. Leary	[ ] shares	\$[ ]	[ ]
Common Stock	Bryan A. Ward	[ ] shares	\$[ ]	[ ]
Common Stock	James D. Dondero	[ ] shares	\$[ ]	[ ]
Common Stock	Mark Okada	[ ] shares	\$[ ]	[ ]
Common Stock	M. Jason Blackburn	[ ] shares	\$[ ]	[ ]
Common Stock	Michael Colvin	[ ] shares	\$[ ]	[ ]

\* Valued as of March 31, 2008. Except as otherwise indicated, each person has sole voting and investment power.

SHARE OWNERSHIP AND CERTAIN BENEFICIAL OWNERS

To the knowledge of management of the Funds and the Board, the following stockholder(s)/shareholder(s) or "groups", as the term is defined in Section 13(d) of the Securities Exchange Act of 1934, as amended (the "1934 Act"), beneficially owned, or were owners of record of, more than 5% of each Fund's outstanding shares as of April 14, 2008:

CREDIT STRATEGIES FUND

(1) Title of Class	(2) Name and Address of Beneficial Owner	(3) Amount and Nature of Beneficial Ownership*	(4) Percent of Class
Common Stock	Loomis Sayles & Co., L.P. One Financial Center Boston, MA 02111	3,638,380 shares*	10.54%

\* Reflects sole voting power with respect to 3,143,747 shares, shared voting power with

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respect to 84,774 shares and sole dispositive power with respect to all shares. Loomis, Sayles & Co., L.P. disclaims beneficial ownership of all shares.

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HIGH INCOME PORTFOLIO

(1) Title of Class	(2) Name and Address of Beneficial Owner	(3) Amount and Nature of Beneficial Ownership*	(4) Percent of Class
Common Stock	First Trust Portfolios L.P. 1001 Warrenville Road Lisle, Illinois 60532	2,188,768 shares*	7.1%

\* Reflects shared voting and shared dispositive power with respect to all shares.

The management of the Funds and the Board is not aware of any stockholder(s)/shareholder(s) or "groups", as the term is defined in Section 13(d) of the 1934 Act, that beneficially owned, or were owners of record of, more than 5% of Income Shares' outstanding shares as of April 14, 2008.

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APPENDIX D

SELECTION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

At meetings held on December 14, 2007 (for High Income Portfolio) and March 7, 2008 (for Income Shares), each of High Income Portfolio's and Income Shares' Audit Committees approved, and each of High Income Portfolio's and Income Shares' Boards, including a majority of the Non-Interested Directors, ratified the selection of Deloitte & Touche LLP ("D&T") as High Income Portfolio's and Income Shares' independent registered public accounting firm for the fiscal year ending October 31, 2008 for High Income Portfolio and December 31, 2008 for Income Shares. Representatives of D&T will not be present at the Meeting, but will be available by telephone and will have an opportunity to make a statement (if the representatives so desire) and to respond to appropriate questions. After reviewing High Income Portfolio's and Income Shares' audited financial statements for the fiscal year ended October 31, 2007 for High Income Portfolio and December 31, 2007 for Income Shares, the Audit Committee of each of High Income Portfolio and Income Shares recommended to the respective Fund's Board that such statements be included in the Fund's annual report to shareholders. A copy of the Audit Committee's report appears below.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FEES AND SERVICES

The following chart reflects fees to D&T in each of High Income Portfolio's and Income Shares's last two fiscal years. One hundred percent (100%) of all

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services provided by D&T to each of High Income Portfolio and Income Shares were pre-approved. The audit services are approved by the Audit Committee pursuant to an audit engagement letter, and, in accordance with High Income Portfolio's and Income Shares's pre-approval policies and procedures, the Audit Committee of each of High Income Portfolio and Income Shares must pre-approve all non-audit services provided by D&T, and all non-audit services provided by D&T to the Adviser, or any entity controlling, controlled by, or under common control with the Adviser that provides ongoing services to High Income Portfolio and Income Shares that are related to the operations and financial reporting of High Income Portfolio and Income Shares. The pre-approval requirement is waived if the aggregate amount of the fees for such non-audit services constitutes less than five percent of the total amount of revenues paid to D&T by the relevant fund during the fiscal year in which the non-audit services are provided. In February 2008, it was determined by D&T that D&T provided personal income tax services to James D. Dondero, President of each of High Income Portfolio and Income Shares and President and Director of Strand Advisors, Inc. ("Strand"), the general partner of the Adviser, and Mark Okada, Executive Vice President of each of High Income Portfolio and Income Shares and Executive Vice President of Strand, during the 2006 tax year. D&T reported that the total fees related to these services were \$80,575. The Audit Committee considered the nature of the services provided by D&T to Messrs. Dondero and Okada and the fee for such services and concluded that the provision of such services did not impair D&T's independence with respect to High Income Portfolio and Income Shares. D&T did not provide any other services during last two fiscal years of High Income Portfolio and Income Shares to the Adviser or any entity controlling, controlled by or under common control with the Adviser that provides ongoing services to the relevant Fund, and which services are related to the operations and financial reporting of the relevant Fund.

FISCAL YEAR ENDED	HIGH INCOME PORTFOLIO		INCOME SHARES	
	2006 (1)	2007 (1)	2006 (2)	2007 (2)
AUDIT FEES	\$31,000	\$32,000	\$36,000	\$37,000
AUDIT-RELATED FEES	\$15,000 (3)	\$15,000 (3)	\$15,000 (3)	\$11,250 (3)
TAX FEES	\$5,000 (4)	\$5,000 (4)	\$5,000 (4)	\$5,000 (4)
ALL OTHER FEES	\$7,000 (5)	\$0 (5)	\$7,000 (5)	\$0 (5)
AGGREGATE NON-AUDIT FEES	\$497,550	\$676,050	\$497,550	\$751,525

(1) For each of the fiscal years ended October 31, 2006 and October 31, 2007.

(2) For each of the fiscal years ended December 31, 2006 and December 31, 2007.

(3) Services to High Income Portfolio consisted of review of quarterly reports and services to Income Shares consisted of a review of a semi-annual regulatory filing.

(4) Services to High Income Portfolio and Income Shares consisted of (i) review or preparation of U.S. federal, state, local and excise tax returns and (ii) U.S. federal, state and local tax planning, advice and assistance regarding statutory, regulatory or administrative developments.

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(5) Services consisted of agreed-upon procedures related to compliance with rating agency guidelines for the Preferred Shares.

AUDIT FEES. Audit fees consist of fees billed for professional services rendered for the audit of the Company's year-end consolidated financial statements and reviews of the interim consolidated financial statements included in quarterly reports and services that are normally provided by D&T in connection with statutory and regulatory filings. These services also include the required audits of the Company's internal controls over financial reporting.

AUDIT-RELATED FEES. Audit-related fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of High Income Portfolio's and Income Shares' consolidated financial statements and are not reported under "Audit Fees." These services include attest services that are not required by statute or regulation, consultations concerning financial accounting and reporting standards, and fees related to requests for documentation and information from regulatory and other government agencies.

TAX FEES. Tax fees consist of fees billed for professional services for tax compliance. These services include assistance regarding federal, state, and local tax compliance.

ALL OTHER FEES. All other fees would include fees for products and services other than the services reported above.

### REPORTS OF THE AUDIT COMMITTEE

The Audit Committee oversees each of High Income Portfolio's and Income Shares' accounting and financial reporting processes and the audits of each of its financial statements. Management is responsible for the preparation, presentation and integrity of the financial statements, the accounting and financial and reporting principles and internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations of each of High Income Portfolio and Income Shares. In fulfilling its oversight responsibilities, the Committee reviewed the audited financial statements in the Annual Report dated October 31, 2007 with respect to High Income Portfolio, and in the Annual Report dated December 31, 2007 with respect to Income Shares, with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

In the performance of its oversight function, the Committee has considered and discussed the above described October 31, 2007 and December 31, 2007 audited financial statements with management and with D&T. The Committee has also discussed with D&T the matters required to be discussed by the Public Company Accounting Oversight Board ("PCAOB") Rule AU 380, THE AUDITOR'S COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE. The Committee reviewed with D&T, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgment as to the quality, not just the acceptability, of the applicable Fund's accounting principles and such other matters as are required to be discussed with the Committee under generally accepted auditing standards. Finally, the Committee reviewed the written disclosures and the letters from D&T required by Independence Standards Board Standard No. 1, INDEPENDENCE DISCUSSIONS WITH AUDIT COMMITTEES, as currently in effect, has considered whether the provision of other non-audit services by D&T and PwC to the applicable Funds are compatible with maintaining D&T's independence, and has discussed with D&T the independence of each independent registered public accounting firm.

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The Committee discussed with D&T the overall scope and plans for the applicable audit. The Committee met with D&T, with and without management present, to discuss the results of their audits, their evaluations of the applicable Fund's internal controls, and the overall quality of the applicable Fund's financial reporting. Based upon the reports and discussions described in this report, and subject to the limitations on the role and responsibilities of the Committee referred to above and in the Committee Charter, the Committee recommended to the Board (and the Board has approved) that the applicable Fund's audited financial statements be included in (i) the annual report to shareholders for High Income Portfolio for the fiscal year ended October 31, 2007 and (ii) the annual report to shareholders for Income Shares for the fiscal year ended December 31, 2007 and as filed with the SEC.

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Shareholders are reminded, however, that the members of the Committee are not professionally engaged in the practice of auditing or accounting. Members of the Committee rely without independent verification on the information provided to them and on the representations made by management and D&T. Accordingly, the Committee's oversight does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or appropriate internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Committee's considerations and discussions referred to above do not assure that each audit of the financial statements of High Income Portfolio and Income Shares has been carried out in accordance with the standards of the PCAOB, that the financial statements are presented in conformity with accounting principles generally accepted in the United States of America or that the independent registered public accounting firm of each of High Income Portfolio and Income Shares is, in fact, "independent."

Scott F. Kavanaugh, Audit Committee Chair  
Timothy K. Hui, Audit Committee Member  
James F. Leary, Audit Committee Member  
Bryan A. Ward, Audit Committee Member

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### STATEMENT OF ADDITIONAL INFORMATION RELATING TO REORGANIZATION OF

PROSPECT STREET HIGH INCOME PORTFOLIO INC.

AND

PROSPECT STREET INCOME SHARES INC.

(each an "Acquired Fund" and collectively the "Acquired Funds")

INTO

HIGHLAND CREDIT STRATEGIES FUND

(the "Acquiring Fund," and together with the Acquired Funds, the "Funds")

DATED [\_\_\_\_\_], 2008

This Statement of Additional Information ("SAI") is available to the shareholders of Prospect Street High Income Portfolio Inc. ("High Income Portfolio") and Prospect Street Income Shares Inc. ("Income Shares") in connection with proposed reorganizations (each a "Reorganization" and

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collectively the "Reorganizations") whereby each Acquired Fund will reorganize into the Acquiring Fund and shareholders of each Acquired Fund will receive common shares of the Acquiring Fund equal to the net asset value of their holdings in that Acquired Fund. Each Acquired Fund will then (1) de-register with the Securities and Exchange Commission (the "SEC"), (2) de-list from the NYSE and (3) dissolve under Maryland corporate law. Unless otherwise defined herein, capitalized terms have the meanings given to them in the Proxy Statement and Prospectus dated [\_\_\_\_], 2008, relating to the Reorganizations (the "Proxy Statement/Prospectus").

THIS SAI IS NOT A PROSPECTUS AND SHOULD BE READ IN CONJUNCTION WITH THE PROXY STATEMENT/PROSPECTUS. A copy of the Proxy Statement/Prospectus may be obtained, without charge, by writing to Highland Funds, c/o PFPC Inc., P.O. Box 9840, Providence, RI 02940. You may also obtain a copy of the Proxy Statement/Prospectus on the SEC's web site at (<http://www.sec.gov>).

Credit Strategies Fund's annual report to shareholders dated December 31, 2007, High Income Portfolio's annual report to shareholders dated October 31, 2007, and Income Shares' annual report to shareholders dated December 31, 2007 are incorporated by reference into (and therefore legally part of) this Statement of Additional Information.

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### INVESTMENT RESTRICTIONS

#### CREDIT STRATEGIES FUND

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Except as described below, the Acquiring Fund, as a fundamental policy, may not, without the approval of the holders of a majority of the outstanding common shares and preferred shares, if any, voting together as a single class, and of the holders of a majority of the outstanding preferred shares, if any, voting as a separate class:

(1) invest 25% or more of the value of its total assets in any single industry or group of industries;

(2) issue senior securities or borrow money other than as permitted by the Investment Company Act of 1940, as amended (the "1940 Act"), or pledge its assets other than to secure such issuances or in connection with hedging transactions, short sales, securities lending, when-issued and forward commitment transactions and similar investment strategies;



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(3) make loans of money or property to any person, except through loans of portfolio securities up to a maximum of 33% of the Acquiring Fund's total assets, the purchase of debt securities, including bank loans (senior loans) and participations therein, or the entry into repurchase agreements up to a maximum of 33% of the Acquiring Fund's total assets;

(4) underwrite the securities of other issuers, except to the extent that, in connection with the disposition of portfolio securities or the sale of its own securities, the Acquiring Fund may be deemed to be an underwriter;

(5) purchase or sell real estate, except that the Acquiring Fund may invest in securities of companies that deal in real estate or are engaged in the real estate business, including real estate investment trusts and real estate operating companies, and instruments secured by real estate or interests therein and the Acquiring Fund may acquire, hold and sell real estate acquired through default, liquidation, or other distributions of an interest in real estate as a result of the Acquiring Fund's ownership of such other assets; or

(6) purchase or sell commodities or commodity contracts for any purposes except as, and to the extent, permitted by applicable law without the Acquiring Fund becoming subject to registration with the Commodity Futures Trading Commission (the "CFTC") as a commodity pool.

As currently relevant to the Acquiring Fund, the 1940 Act requires an asset coverage of 200% for a closed-end fund issuing preferred stock and for borrowings exceeding 5% of the Acquiring Fund's assets (excluding temporary borrowings).

The Acquiring Fund will not engage in any activities described under investment restriction number 2 pursuant to which the lenders would be able to foreclose on more than 33 1/3% of the Acquiring Fund's total assets.

The Acquiring Fund is also subject to the following non-fundamental restrictions and policies, which may be changed by the Acquiring Fund's Board of Trustees ("Acquiring Fund Board") and without shareholder approval. The Acquiring Fund may not:

(1) make any short sale of securities except in conformity with applicable laws, rules and regulations and unless after giving effect to such sale, the market value of all securities sold short does not exceed 25% of the value of the Acquiring Fund's total assets and the Acquiring Fund's aggregate short sales of a particular class of securities of an issuer does not exceed 25% of the then outstanding securities of that class. The Acquiring Fund may also make short sales "against the box" without respect to such limitations. In this type of short sale, at the time of the sale, the Acquiring Fund owns or has the immediate and unconditional right to acquire at no additional cost the identical security; and

(2) purchase securities of open-end or closed-end investment companies except in compliance with the 1940 Act or any exemptive relief obtained thereunder. Under the 1940 Act, the Acquiring Fund may invest up to 10% of its total assets in the aggregate in shares of other investment companies and up to 5% of its total assets in shares of any one investment company, provided the

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investment does not represent more than 3% of the voting stock of the acquired investment company at the time such shares are purchased. As a shareholder in any investment company, the Acquiring Fund will bear its ratable share of that investment company's expenses and will remain subject to payment of advisory fees and other expenses with respect to assets invested therein. Holders of

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common shares will therefore be subject to duplicative expenses to the extent the Acquiring Fund invests in other investment companies. In addition, the securities of other investment companies may be leveraged and will therefore be subject to the risks of leverage. 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.

In addition, to comply with the federal tax requirements for qualification as a regulated investment company, the Acquiring Fund's investments must meet certain diversification requirements. See "Tax Matters."

For purposes of this SAI, a "majority of the outstanding" shares means (a) 67% or more of a Fund's outstanding voting securities present at a meeting, if the holders of more than 50% of its outstanding voting securities are present or represented by proxy, or (b) more than 50% of its outstanding voting securities, whichever is less (a "1940 Act Majority Vote").

The percentage limitations applicable to the Acquiring Fund's portfolio described in the Proxy Statement/Prospectus and this SAI apply only at the time of investment, except that the percentage limitation with respect to borrowing applies at all times, and the Acquiring Fund will not be required to sell securities due to subsequent changes in the value of securities it owns.

### INCOME SHARES

Income Shares' investment objectives, its policy to invest at least 50% of its total assets in debt securities rated in the four highest rating categories assigned by nationally recognized rating agencies, or other securities such as U.S. and Canadian government securities, obligations of or guaranteed by banks, commercial paper and cash equivalents, or nonrated debt securities deemed by Highland Capital Management, L.P. ("Highland" or "Adviser") to be of comparable quality, and all of the investment restrictions listed below have been adopted by Income Shares as fundamental policies. Fundamental policies of Income Shares may not be changed without a 1940 Act Majority Vote of the shares of common stock and preferred stock, voting as separate classes. All other investment policies or practices are considered by Income Shares not to be fundamental and accordingly may be changed by Income Shares' Board of Directors ("Income Shares Board") without stockholder approval.

Income Shares will not:

1. Issue senior securities as defined in the 1940 Act, except in connection with borrowing permitted in restriction 2 below, issuing a class or classes of preferred stock to the extent permitted under the 1940 Act or to the extent investments in interest rate futures contracts or fixed income options permitted in restriction 19 below are considered to result in the issuance of senior securities.

2. Borrow money, except for investment leverage.

3. Mortgage, pledge or hypothecate its assets, except in connection with borrowing money as mentioned in restriction 2 above or the issuance of a class or classes of preferred stock as described in restriction 1 above. This provision shall not apply to deposits, or similar arrangements, made in connection with the entering into or holding of interest rate futures contracts or purchasing, selling, holding or writing fixed income options.

4. Act as underwriter, except to the extent that, in connection with the disposition of restricted portfolio securities, Income Shares may be deemed to be an underwriter under applicable laws.

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5. Purchase or sell real estate or interests in real estate, except that Income Shares may invest in securities secured by real estate or interests therein or issued by companies, including real estate investment trusts, which deal in real estate or interests therein.

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6. Purchase or sell commodities or commodity contracts, except that Income Shares may enter into interest rate futures contracts or fixed income options and make deposits or have similar arrangements in connection therewith.

7. Invest more than 5% of the value of its total assets in the securities of any one issuer (other than cash items and securities of the U.S. government or its agencies or instrumentalities), or purchase more than 10% of any class of the outstanding voting securities of any one issuer.

8. Invest more than 25% of the value of its total assets in restricted securities, which are securities acquired in private placement transactions.

9. Invest more than 25% of the value of its total assets in securities of issuers in any one industry (gas, electric and telephone companies will be considered to be in separate industries, as will banks, finance companies, savings and loan associations, insurance companies and other credit institutions) except that at times when a significant portion of the market for corporate debt securities is composed of issues in the electric utility industry or the telephone utility industry, as the case may be, Income Shares may invest up to 35% of its assets in the issues of such industry if Income Shares has cash for such investment and if, in the judgment of management, the return available from such securities and the marketability, quality and availability thereof justify such concentration in light of Income Shares' investment objectives. The market for corporate debt securities will be considered to be composed of a significant portion of debt securities of either, the electric utility industry or the telephone utility industry, as the case may be, at any time that, to the best of Income Shares' knowledge, 10% or more of the principal amounts of all new issue offerings of corporate debt securities in principal amounts of \$25,000,000 or more and within the four highest grades assigned by Moody's Investors Service, Inc. ("Moody's"), Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("Standard & Poor's"), or Fitch, Inc., offered within the prior 60-day period or scheduled to be offered during the subsequent 30-day period consists of such issues in such industry.

10. Purchase or retain the securities of any issuer, if, to Income Shares' knowledge, those officers or directors of Income Shares or of the Adviser who individually own beneficially more than 0.5% of the outstanding securities of such issuer, together own beneficially more than 5% of such outstanding securities.

11. Make loans to other persons, except for the purchase of debt securities in private placement transactions or public offerings in accordance with Income Shares' investment objectives and policies and for loans of portfolio securities as described above.

12. Purchase securities on margin, except that Income Shares may obtain such short-term credits as may be necessary for the clearance of purchases or sales of securities, and except that Income Shares may enter into and hold interest rate futures contracts and purchase, sell, hold or write fixed income options and may make deposits or make similar arrangements in connection therewith.

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13. Participate on a joint or joint and several basis in any securities trading account. The "bunching" of orders for the sale or purchase of marketable portfolio securities and other accounts under the management of the Adviser or affiliates to save commissions or to average prices among them is not deemed to result in a securities trading account.

14. Purchase interests in oil, gas, or other mineral exploration programs; however, this limitation will not prohibit the acquisition of securities of companies engaged in the production of or transmission of oil, gas or other materials.

15. Invest in puts, calls or combinations thereof except fixed income options.

16. Make short sales, except sales "against the box."

17. Purchase the securities of other investment companies.

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18. Invest for the purposes of exercising control or management.

19. Enter into any interest rate futures contract or write any fixed income option if, immediately thereafter, the sum of (a) the then aggregate futures and option market prices of financial instruments and fixed income options required to be delivered under open futures contract sales of Income Shares and open fixed income call options written by Income Shares and (b) the aggregate purchase price under open futures contract purchases of Income Shares and open fixed income put options written by Income Shares, would exceed, in the aggregate, an amount equal to the lesser of (i) 5% of Income Shares' net asset value or (ii) one-third of the total assets of Income Shares less all liabilities not related to fixed income options written by Income Shares and interest rate futures contracts.

Although the provisions of restriction 3 (with respect to futures contracts), 6 and 12 permit Income Shares to certain practices to a limited extent, Income Shares does not have any current intention of engaging in such practices. Income Shares will not make any investment permitted by the exceptions to Income Shares' investment restrictions if the investment would adversely affect the ratings assigned by Moody's and/or Standard & Poor's to its outstanding preferred stock.

Notwithstanding restriction 6, Income Shares is permitted to buy certain debt securities, known as Principal Exchange Rate Linked Securities (PERLS), in which the interest or principal component is determined by calculating with reference to a formula based on one or more commodities, including currencies, so long as the security does not constitute a commodity or commodity contract. For example, Income Shares may buy certain debt securities issued by the Federal National Mortgage Association ("FNMA"), a U.S. government agency, which carry an additional risk not associated with other FNMA issues. They pay interest based upon a specified interest rate and a principal amount denominated in U.S. dollars. At maturity, the principal is paid in U.S. dollars, but the amount of principal that will be paid is calculated according to a predetermined formula involving the value of one or more foreign currencies on a particular date near the maturity date (the "principal payment formula"). This kind of security is subject to the risk that the currency that is part of the principal payment formula may be valued at an amount which could cause the principal paid at maturity to be greater or less than the amount of principal upon which the interest rate is calculated.

By virtue of restriction 8, it would be possible for Income Shares to

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invest up to 25% of its assets in restricted securities, which are securities acquired in private placement transactions. Such securities generally may not be resold without registration under the Securities Act of 1933, as amended (the "Securities Act"), except in transactions exempt from the registration requirements of the Securities Act. This limitation on resale can have an adverse effect on the price obtainable for such securities. Also, if in order to permit resale, the securities are registered under the Securities Act at Income Shares' expense, Income Shares' expenses would be increased.

By virtue of restriction 9, it would be possible for Income Shares to invest up to 70% of its assets in securities of the electric utility and telephone utility industries (up to 35% in each of such industries) if Income Shares had cash for such investment and if, in Income Shares' judgment, the return available from such industry, and the marketability, quality and availability of the debt securities of such industry, justified such concentration in light of Income Shares' investment objectives. However, if sufficient cash was not available or if the securities available did not meet the above-mentioned tests of return, marketability, quality and availability, such concentration would not occur. Also, Income Shares would not be required to sell portfolio securities in order to make cash available for such concentration, although Income Shares would not be prohibited from doing so. Furthermore, Income Shares' ability to so concentrate its assets would always be contingent upon compliance with other applicable investment restrictions. Concentration of Income Shares' assets in either the electric utility or the telephone utility industries could result in increased risks. Risks of investments in either industry may arise from difficulties in obtaining an adequate return on capital because of financing costs and construction programs and the fact that regulatory authorities might not approve rate increases sufficient to offset increases in operating expenses. In addition, risks of investments in the electric utility industry may arise from environmental conditions, fuel shortages and government-mandated energy conservation programs.

By virtue of restriction 19, Income Shares has a limited ability to enter into interest rate futures contracts and to write fixed income options. Interest rate futures contracts and fixed income options create an obligation by Income Shares to purchase or to sell a specific financial instrument at a specified future time at a specified price. The principal risk of interest rate futures

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contracts and fixed income options is that unexpected changes in the general level of interest rates could adversely affect the value of the investment. Income Shares has not written fixed income options for several years and has never entered into interest rate futures contracts.

If a percentage restriction is adhered to at the time of investment, a later increase or decrease in percentage resulting from a change in value of Income Shares' investments or amount of total assets will not be considered a violation of any of the foregoing restrictions. With respect to restriction 2, however, if borrowings exceed the amount permitted under the 1940 Act as a result of a change in values or assets, Income Shares must take steps to reduce such borrowings at least to the extent of such excess.

### HIGH INCOME PORTFOLIO

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High Income Portfolio's investment objective, its policy to invest at least 65% of its total assets in high-yield securities rated in the lower categories by recognized rating agencies or nonrated fixed-income securities deemed by the Adviser to be of comparable quality and the following investment restrictions have been adopted by High Income Portfolio as fundamental policies. Fundamental

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policies of High Income Portfolio may not be changed without a 1940 Act Majority Vote of the shares of common stock and preferred stock, voting as separate classes. All other investment policies or practices are considered by High Income Portfolio not to be fundamental and accordingly may be changed by High Income Portfolio's Board of Directors ("High Income Board") (collectively, High Income Board, Income Shares Board and Acquiring Fund Board, the "Boards") without stockholder approval.

High Income Portfolio may not:

1. Borrow money (through reverse repurchase agreements or otherwise) or issue any senior securities (as defined in the 1940 Act), except as permitted by the 1940 Act.

2. Pledge, hypothecate, mortgage or otherwise encumber its assets, except to secure borrowings permitted by restriction 1 above. Collateral arrangements with respect to margin for futures contracts and options are not deemed to be pledges or other encumbrances for purposes of this restriction.

3. Purchase securities on margin, except such short-term credits as may be necessary for the clearance of purchases and sales of securities and except that High Income Portfolio may make margin payments in connection with transactions in futures contracts and options.

4. Make short sales of securities or maintain a short position for the account of High Income Portfolio unless at all times when a short position is open High Income Portfolio owns an equal amount of such securities or owns securities which, without payment of any further consideration, are convertible into or exchangeable for securities of the same issuer as, and in equal amount to, the securities sold short.

5. Underwrite securities issued by other persons, except to the extent that, in connection with the disposition of its portfolio investments, High Income Portfolio may be deemed to be an underwriter under the federal securities laws.

6. Purchase or sell real estate, although High Income Portfolio may purchase securities of issuers that deal in real estate, securities that are secured by interests in real estate and securities representing interests in real estate.

7. Purchase or sell commodities or commodity contracts, except that High Income Portfolio may purchase or sell financial futures contracts and related options as provided in the Proxy Statement/Prospectus and this SAI.

8. Make loans, except by the acquisition of loan interests and other debt obligations in which High Income Portfolio may invest consistent with its investment policies, by entering into repurchase agreements with respect to not more than 25% of the value of its total assets, or through the lending of its portfolio securities with respect to not more than one-third of the value of its total assets.

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9. With respect to 75% of the value of High Income Portfolio's total assets, invest in securities of any issuer if, immediately after such investment, more than 5% of the value of High Income Portfolio's total assets would be invested in the securities of such issuer, provided that this limitation does not apply to obligations issued or guaranteed as to interest and principal by the U.S. government or its agencies or instrumentalities.

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10. With respect to 75% of the value of High Income Portfolio's total assets, acquire more than 10% of the outstanding voting securities of any issuer.

11. Invest 25% or more of the value of its total assets in any one industry, provided that this limitation does not apply to obligations issued or guaranteed as to interest and principal by the U.S. government or its agencies or instrumentalities.

12. Invest in the securities of other registered investment companies, except as they may be acquired as part of a merger or consolidation or acquisition of assets or by purchases in the open market involving only customary brokers' commissions.

13. Buy or sell oil, gas or other mineral leases, rights or royalty contracts, although High Income Portfolio may purchase securities of issuers which deal in, represent interests in or are secured by interests in such leases, rights or contracts.

14. Make investments for the purpose of exercising control or management over the issuer of any security.

15. Write, purchase or sell puts, calls or combinations thereof, or purchase or sell futures contracts or related options, except that High Income Portfolio may write call options and invest in futures contracts and related options as provided in the Proxy Statement/Prospectus and this SAI.

With respect to restriction 1, the 1940 Act permits a closed-end investment company, such as High Income Portfolio, to issue a note in consideration for any privately arranged loan that is not intended to be publicly distributed, or a note evidencing a temporary loan that does not exceed 5% of the company's total assets at the time it is made. The 1940 Act also permits closed-end investment companies to issue senior securities representing debt or preferred stock, subject to certain conditions. With respect to restrictions 1 and 2, the 1940 Act permits a closed-end investment company to borrow (leverage) by issuing debt in an amount up to 33% of its total assets and by issuing preferred stock in an amount up to 50% of its total assets (as described in the Proxy Statement/Prospectus, in the case of debt, the company must have asset coverage of 300% immediately after such issuance, and, in the case of stock, 200% coverage is required). As such, under restriction 2, High Income Portfolio may pledge, hypothecate, mortgage or otherwise encumber its assets in connection with such borrowings permitted under restriction 1 in amounts up to 33% of its total assets. In addition to the prohibitions listed in restriction 6, High Income Portfolio has no intention to purchase or sell real estate or invest in real estate mortgages.

Although the provisions of certain restrictions permit High Income Portfolio to engage in transactions in futures contracts to a limited extent, High Income Portfolio does not have any current intention of engaging in such transactions. High Income Portfolio will not make any investment permitted by the exceptions to High Income Portfolio's investment restrictions if the investment would adversely affect the ratings assigned by Standard & Poor's and/or Moody's to its outstanding preferred stock.

If a percentage restriction is adhered to at the time of investment, a later increase or decrease in percentage resulting from a change in value of High Income Portfolio's investments or amount of total assets will not be considered a violation of any of the foregoing restrictions. With respect to restriction 1, however, if borrowings exceed the amount permitted under the 1940 Act as a result of a change in values or assets, High Income Portfolio must take steps to reduce such borrowings at least to the extent of such excess.

ADDITIONAL INVESTMENT INFORMATION

CREDIT STRATEGIES FUND  
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The following is a description of the various investments Acquiring Fund may acquire, whether as a primary or secondary strategy. The information supplements the discussion of the Acquiring Fund's investment objectives, policies and techniques that are described in the Proxy Statement/Prospectus.

SHORT-TERM DEBT SECURITIES

For temporary defensive purposes or to keep cash on hand, the Acquiring Fund may invest up to 100% of its total assets in cash equivalents and short-term debt securities. Short-term debt investments are defined to include, without limitation, the following:

(1) U.S. government securities, including bills, notes and bonds differing as to maturity and rates of interest that are either issued or guaranteed by the U.S. Treasury or by U.S. government agencies or instrumentalities. U.S. government securities include securities issued by (a) the Federal Housing Administration, Farmers Home Administration, Export-Import Bank of the United States, Small Business Administration, and Government National Mortgage Association, whose securities are supported by the full faith and credit of the United States; (b) the Federal Home Loan Banks, Federal Intermediate Credit Banks, and Tennessee Valley Authority, whose securities are supported by the right of the agency to borrow from the U.S. Treasury; (c) the Federal National Mortgage Association, whose securities are supported by the discretionary authority of the U.S. government to purchase certain obligations of the agency or instrumentality; and (d) the Student Loan Marketing Association, whose securities are supported only by its credit. While the U.S. government provides financial support to such U.S. government-sponsored agencies or instrumentalities, no assurance can be given that it always will do so since it is not so obligated by law. The U.S. government, its agencies and instrumentalities do not guarantee the market value of their securities. Consequently, the value of such securities may fluctuate.

(2) Certificates of deposit issued against funds deposited in a bank or a savings and loan association. Such certificates are for a definite period of time, earn a specified rate of return, and are normally negotiable. The issuer of a certificate of deposit agrees to pay the amount deposited plus interest to the bearer of the certificate on the date specified thereon. Certificates of deposit purchased by the Acquiring Fund may not be fully insured by the Federal Deposit Insurance Corporation.

(3) Repurchase agreements, which involve purchases of debt securities. At the time the Acquiring Fund purchases securities pursuant to a repurchase agreement, it simultaneously agrees to resell and redeliver such securities to the seller, who also simultaneously agrees to buy back the securities at a fixed price and time. This assures a predetermined yield for the Acquiring Fund during its holding period, since the resale price is always greater than the purchase price and reflects an agreed-upon market rate. Such actions afford an opportunity for the Acquiring Fund to invest temporarily available cash. The Acquiring Fund may enter into repurchase agreements only with respect to obligations of the U.S. government, its agencies or instrumentalities; certificates of deposit; or bankers'



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acceptances in which the Acquiring Fund may invest. Repurchase agreements may be considered loans to the seller, collateralized by the underlying securities. The risk to the Acquiring Fund is limited to the ability of the seller to pay the agreed-upon sum on the repurchase date; in the event of default, the repurchase agreement provides that the Acquiring Fund is entitled to sell the underlying collateral. If the value of the collateral declines after the agreement is entered into, and if the seller defaults under a repurchase agreement when the value of the underlying collateral is less than the repurchase price, the Acquiring Fund could incur a loss of both principal and interest. Highland monitors the value of the collateral at the time the action is entered into and at all times during the term of the repurchase agreement. Highland does so in an effort to determine that the value of the collateral always equals or exceeds the agreed-upon repurchase price to be paid to the Acquiring Fund. If the seller were to be subject to a federal bankruptcy proceeding, the ability of the Acquiring Fund to liquidate the collateral could be delayed or impaired because of certain provisions of the bankruptcy laws.

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(4) Commercial paper, which consists of short-term unsecured promissory notes, including variable rate master demand notes issued by corporations to finance their current operations. Master demand notes are direct lending arrangements between the Acquiring Fund and a corporation. There is no secondary market for such notes. However, they are redeemable by the Acquiring Fund at any time. Highland will consider the financial condition of the corporation (e.g., earning power, cash flow and other liquidity ratios) and will continually monitor the corporation's ability to meet all of its financial obligations, because the Acquiring Fund's liquidity might be impaired if the corporation were unable to pay principal and interest on demand. Investments in commercial paper will be limited to commercial paper rated in the highest categories by a major rating agency and which mature within one year of the date of purchase or carry a variable or floating rate of interest.

### EQUITY SECURITIES

The Acquiring Fund may invest in equity securities including preferred stock, warrants and depository receipts.

**PREFERRED STOCK.** Preferred stock has a preference over common stock in liquidation (and generally dividends as well) but is subordinated to the liabilities of the issuer in all respects. As a general rule, the market value of preferred stock with a fixed dividend rate and no conversion element varies inversely with interest rates and perceived credit risk, while the market price of convertible preferred stock generally also reflects some element of conversion value. Because preferred stock is junior to debt securities and other obligations of the issuer, deterioration in the credit quality of the issuer will cause greater changes in the value of a preferred stock than in a more senior debt security with similar stated yield characteristics. Unlike interest payments on debt securities, preferred stock dividends are payable only if declared by the issuer's board of directors. Preferred stock also may be subject to optional or mandatory redemption provisions.

**WARRANTS.** Warrants, which are privileges issued by corporations enabling the owners to subscribe to and purchase a specified number of shares of the corporation at a specified price during a specified period of time. Subscription rights normally have a short life span to expiration. The purchase of warrants involves the risk that the Acquiring Fund could lose the purchase value of a right or warrant if the right to subscribe to additional shares is not exercised

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prior to the warrants' expiration. Also, the purchase of warrants involves the risk that the effective price paid for the warrant added to the subscription price of the related security may exceed the value of the subscribed security's market price such as when there is no movement in the level of the underlying security.

DEPOSITORY RECEIPTS. The Acquiring Fund may invest in both sponsored and unsponsored American Depositary Receipts ("ADRs"), European Depositary Receipts ("EDRs"), Global Depositary Receipts ("GDRs") and other similar global instruments. ADRs typically are issued by an American bank or trust company and evidence ownership of underlying securities issued by a non-U.S. corporation. EDRs, which are sometimes referred to as Continental Depositary Receipts, are receipts issued in Europe, typically by non-U.S. banks and trust companies, that evidence ownership of either non-U.S. or U.S. underlying securities. GDRs are depository receipts structured like global debt issues to facilitate trading on an international basis. Unsponsored ADR, EDR and GDR programs are organized independently and without the cooperation of the issuer of the underlying securities. As a result, available information concerning the issuer may not be as current as for sponsored ADRs, EDRs and GDRs, and the prices of unsponsored ADRs, EDRs and GDRs may be more volatile than if such instruments were sponsored by the issuer. Investments in ADRs, EDRs and GDRs may present additional investment considerations of non-U.S. securities.

### VARIABLE AND FLOATING RATE INSTRUMENTS

The Acquiring Fund may purchase rated and unrated variable and floating rate instruments. These instruments may include variable amount master demand notes that permit the indebtedness thereunder to vary in addition to providing for periodic adjustments in the interest rate. The Acquiring Fund may invest in leveraged inverse floating rate debt instruments ("Inverse Floaters"). The interest rate of an Inverse Floater resets in the opposite direction from the market rate of interest to which it is indexed. An Inverse Floater may be considered to be leveraged to the extent that its interest rate varies by a magnitude that exceeds the magnitude of the change in the index rate of interest. The higher degree of leverage inherent in Inverse Floaters is associated with greater volatility in their market values. Issuers of unrated

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variable and floating rate instruments must satisfy the same criteria as set forth above for the Acquiring Fund. The absence of an active secondary market with respect to particular variable and floating rate instruments, however, could make it difficult for the Acquiring Fund to dispose of a variable or floating rate instrument if the issuer defaulted on its payment obligation or during periods when the Acquiring Fund is not entitled to exercise its demand rights.

With respect to purchasable variable and floating rate instruments, Highland will consider the earning power, cash flows and liquidity ratios of the issuers and guarantors of such instruments and, if the instruments are subject to a demand feature, will monitor their financial status to meet payment on demand. Such instruments may include variable amount master demand notes that permit the indebtedness thereunder to vary in addition to providing for periodic adjustments in the interest rate. The absence of an active secondary market with respect to particular variable and floating rate instruments could make it difficult for the Acquiring Fund to dispose of a variable or floating rate note if the issuer defaulted on its payment obligation or during periods that the Acquiring Fund is not entitled to exercise its demand rights, and the Acquiring Fund could, for these or other reasons, suffer a loss, with respect to such instruments. In determining average-weighted portfolio maturity, an instrument

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will be deemed to have a maturity equal to either the period remaining until the next interest rate adjustment or the time the Acquiring Fund involved can recover payment of principal as specified in the instrument, depending on the type of instrument involved.

### DERIVATIVE TRANSACTIONS AND RISK MANAGEMENT

Consistent with its investment objectives and policies set forth in the Proxy Statement/Prospectus and in addition to its option strategy, the Acquiring Fund may also enter into certain risk management transactions. In particular, the Acquiring Fund may purchase and sell futures contracts, exchange listed and over-the-counter put and call options on securities, equity and other indices and futures contracts, forward foreign currency contracts, and may enter into various interest rate transactions. Derivative Transactions may be used to attempt to protect against possible changes in the market value of the Acquiring Fund's portfolio resulting from fluctuations in the securities markets and changes in interest rates, to protect the Acquiring Fund's unrealized gains in the value of its portfolio securities, to facilitate the sale of such securities for investment purposes and to establish a position in the securities markets as a temporary substitute for purchasing particular securities. Any or all of these Derivative Transactions may be used at any time. There is no particular strategy that requires use of one technique rather than another. Use of any Derivative Transaction is a function of market conditions. The ability of the Acquiring Fund to manage them successfully will depend on Highland's ability to predict pertinent market movements as well as sufficient correlation among the instruments, which cannot be assured. The Derivative Transactions that the Acquiring Fund may use are described below. Although the Acquiring Fund recognizes it is not likely that it will use certain of these strategies in light of its investment policies, it nevertheless describes them here because the Acquiring Fund may seek to use these strategies in certain circumstances.

**FUTURES CONTRACTS AND OPTIONS ON FUTURES CONTRACTS.** In connection with its Derivative Transactions and other risk management strategies, the Acquiring Fund may also enter into contracts for the purchase or sale for future delivery ("futures contracts") of securities, aggregates of securities or indices or prices thereof, other financial indices and U.S. government debt securities or options on the above. The Acquiring Fund will engage in such transactions only for bona fide risk management and other portfolio management purposes.

**FORWARD FOREIGN CURRENCY CONTRACTS.** The Acquiring Fund may enter into forward currency contracts to purchase or sell foreign currencies for a fixed amount of U.S. dollars or another foreign currency. A forward currency contract 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 forward currency contract agreed upon by the parties, at a price set at the time the forward currency contract is entered into. Forward currency contracts are traded directly between currency traders (usually large commercial banks) and their customers.

The Acquiring Fund may engage in various forward currency contract strategies:

- o The Acquiring Fund may purchase a forward currency contract to lock in the U.S. dollar price of a security denominated in a foreign currency that the Acquiring Fund intends to acquire. The Acquiring Fund may

sell a forward currency contract to lock in the U.S. dollar equivalent of the proceeds from the anticipated sale of a security or a dividend

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or interest payment denominated in a foreign currency.

- o The Acquiring Fund may also use forward currency contracts to shift the Acquiring Fund's exposure to foreign currency exchange rate changes from one currency to another. For example, if the Acquiring Fund owns securities denominated in a foreign currency and Highland believes that currency will decline relative to another currency, the Acquiring Fund might enter into a forward currency contract to sell the appropriate amount of the first foreign currency with payment to be made in the second currency.
- o The Acquiring Fund may also purchase forward currency contracts to enhance income when Highland anticipates that the foreign currency will appreciate in value but securities denominated in that currency do not present attractive investment opportunities.
- o The Acquiring Fund may also use forward currency contracts to offset against a decline in the value of existing investments denominated in a foreign currency. Such a transaction would tend to offset both positive and negative currency fluctuations, but would not offset changes in security values caused by other factors.
- o The Acquiring Fund could also enter into a forward currency contract to sell another currency expected to perform similarly to the currency in which the Acquiring Fund's existing investments are denominated. This type of transaction could offer advantages in terms of cost, yield or efficiency, but may not offset currency exposure as effectively as a simple forward currency transaction to sell U.S. dollars. This type of transaction may result in losses if the currency sold does not perform similarly to the currency in which the Acquiring Fund's existing investments are denominated.
- o The Acquiring Fund may also use forward currency contracts in one currency or a basket of currencies to attempt to offset against fluctuations in the value of securities denominated in a different currency if Highland anticipates that there will be a correlation between the two currencies.
- o The cost to the Acquiring Fund of engaging in forward currency contracts varies with factors such as the currency involved, the length of the contract period and the market conditions then prevailing. Because forward currency contracts are usually entered into on a principal basis, no fees or commissions are involved.
- o When the Acquiring Fund enters into a forward currency contract, it relies on the counterparty to make or take delivery of the underlying currency at the maturity of the contract. Failure by the counterparty to do so would result in the loss of some or all of any expected benefit of the transaction. Secondary markets generally do not exist for forward currency contracts, with the result that closing transactions generally can be made for forward currency contracts only by negotiating directly with the counterparty. Thus, there can be no assurance that the Acquiring Fund will in fact be able to close out a forward currency contract at a favorable price prior to maturity. In addition, in the event of insolvency of the counterparty, the Acquiring Fund might be unable to close out a forward currency contract. In either event, the Acquiring Fund would continue to be subject to market risk with respect to the position, and would continue to be required to maintain a position in securities denominated in the foreign currency or to maintain cash or liquid assets in a segregated account. The precise matching of forward currency contract amounts and the value of the securities involved

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generally will not be possible because the value of such securities, measured in the foreign currency, will change after the forward currency contract has been established. Thus, the Acquiring Fund might need to purchase or sell foreign currencies in the spot (cash) market to the extent such foreign currencies are not covered by forward currency contracts. The projection of short-term currency market movements is extremely difficult, and the successful execution of a short-term strategy is highly uncertain.

**CALLS ON SECURITIES, INDICES AND FUTURES CONTRACTS.** In addition to its option strategy, in order to enhance income or reduce fluctuations on net asset value, the Acquiring Fund may sell or purchase call options ("calls") on securities and indices based upon the prices of futures contracts and debt or equity securities that are traded on U.S. and non-U.S. securities exchanges and in the over-the-counter markets. A call option gives the purchaser of the option the right to buy, and obligates the seller to sell, the underlying security, futures contract or index at the exercise price at any time or at a specified

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time during the option period. All such calls sold by the Acquiring Fund must be "covered" as long as the call is outstanding (i.e., the Acquiring Fund must own the instrument subject to the call or other securities or assets acceptable for applicable segregation and coverage requirements). A call sold by the Acquiring Fund exposes the Acquiring Fund during the term of the option to possible loss of opportunity to realize appreciation in the market price of the underlying security, index or futures contract and may require the Acquiring Fund to hold an instrument which it might otherwise have sold. The purchase of a call gives the Acquiring Fund the right to buy a security, futures contract or index at a fixed price. Calls on futures on securities must also be covered by assets or instruments acceptable under applicable segregation and coverage requirements.

**PUTS ON SECURITIES, INDICES AND FUTURES CONTRACTS.** In addition to its option strategy, the Acquiring Fund may purchase put options ("puts") that relate to securities (whether or not it holds such securities in its portfolio), indices or futures contracts. For the same purposes, the Acquiring Fund may also sell puts on securities, indices or futures contracts on such securities if the Acquiring Fund's contingent obligations on such puts are secured by segregated assets consisting of cash or liquid debt securities having a value not less than the exercise price. In selling puts, there is a risk that the Acquiring Fund may be required to buy the underlying security at a price higher than the current market price.

**INTEREST RATE TRANSACTIONS.** Among the Derivative Transactions in which the Acquiring Fund may enter into are interest rate swaps and the purchase or sale of interest rate caps and floors. The Acquiring Fund expects to enter into these transactions primarily to preserve a return or spread on a particular investment or portion of its portfolio as a duration management technique or to protect against any increase in the price of securities the Acquiring Fund anticipates purchasing at a later date. The Acquiring Fund intends to use these transactions for risk management purposes and not as a speculative investment. The Acquiring Fund will not sell interest rate caps or floors that it does not own. Interest rate swaps involve the exchange by the Acquiring Fund with another party 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. The purchase of an interest rate cap entitles the purchaser, to the extent that a specified index exceeds a predetermined interest rate, to receive payments of interest on a notional principal amount from the party selling such interest rate cap. The purchase of an interest rate floor entitles the purchaser, to the extent that a specified index falls below a predetermined interest rate, to receive payments of interest on a notional principal amount

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from the party selling such interest rate floor.

The Acquiring Fund may enter into interest rate swaps, caps and floors on either an asset based or liability-based basis, depending on whether it is offsetting volatility with respect to its assets or liabilities, and will usually enter into interest rate swaps on a net basis, i.e., the two payment streams are netted out, with the Acquiring Fund receiving or paying, as the case may be, only the net amount of the two payments on the payment dates. Inasmuch as these Derivative Transactions are incurred into for good faith risk management purposes. Highland and the Acquiring Fund believe such obligations do not constitute senior securities, and, accordingly will not treat them as being subject to its borrowing restrictions. The Acquiring Fund will accrue the net amount of the excess, if any, of the Acquiring Fund's obligations over its entitlements with respect to each interest rate swap on a daily basis and will designate on its books and records with a custodian an amount of cash or liquid high grade securities having an aggregate net asset value at all times at least equal to the accrued excess. The Acquiring Fund will not enter into any interest rate swap, cap or floor transaction unless the unsecured senior debt or the claims paying ability of the other party thereto is rated in the highest rating category of at least one nationally recognized statistical rating organization at the time of entering into such transaction. If there is a default by the other party to such a transaction, the Acquiring Fund will have contractual remedies pursuant to the agreements related to the transaction. The swap market has grown substantially in recent years with a large number of banks and investment banking firms acting both as principals and as agents utilizing standardized swap documentation. Caps and floors are more recent innovations for which standardized documentation has not yet been developed and, accordingly, they are less liquid than swaps.

CREDIT DERIVATIVES. The Acquiring Fund may engage in credit derivative transactions. There are two broad categories of credit derivatives: default price risk derivatives and market spread derivatives. Default price risk derivatives are linked to the price of reference securities or loans after a default by the issuer or borrower, respectively. Market spread derivatives are based on the risk that changes in market factors, such as credit spreads, can cause a decline in the value of a security, loan or index.

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There are three basic transactional forms for credit derivatives: swaps, options and structured instruments. The use of credit derivatives is a highly specialized activity which involves strategies and risks different from those associated with ordinary portfolio security transactions. If Highland is incorrect in its forecasts of default risks, market spreads or other applicable factors, the investment performance of the Acquiring Fund would diminish compared with what it would have been if these techniques were not used. Moreover, even if Highland is correct in its forecasts, there is a risk that a credit derivative position may correlate imperfectly with the price of the asset or liability being purchased. There is no limit on the amount of credit derivative transactions that may be entered into by the Acquiring Fund. The Acquiring Fund's risk of loss in a credit derivative transaction varies with the form of the transaction. For example, if the Acquiring Fund purchases a default option on a security, and if no default occurs with respect to the security, the Acquiring Fund's loss is limited to the premium it paid for the default option. In contrast, if there is a default by the grantor of a default option, the Acquiring Fund's loss will include both the premium that it paid for the option and the decline in value of the underlying security that the default option protects.

Below under "General Characteristics of Risks of Derivative Transactions"

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is further information about the characteristics, risks and possible benefits of Derivative Transactions and the Acquiring Fund's other policies and limitations (which are not fundamental policies) relating to investment in futures contracts and options. The principal risks relating to the use of futures contracts and other Derivative Transactions are: (i) less than perfect correlation between the prices of the instrument and the market value of the securities in the Acquiring Fund's portfolio; (ii) possible lack of a liquid secondary market for closing out a position in such instruments; (iii) losses resulting from interest rate or other market movements not anticipated by Highland; and (iv) the obligation to meet additional variation margin or other payment requirements, all of which could result in the Acquiring Fund being in a worse position than if such techniques had not been used.

Certain provisions of the Internal Revenue Code of 1986, as amended ("Code"), may affect the Acquiring Fund's ability to engage in Derivative Transactions. See "Tax Matters."

### GENERAL CHARACTERISTICS AND RISKS OF DERIVATIVE TRANSACTIONS

In order to manage the risk of its securities portfolio, or to enhance income or gain as described in the Proxy Statement/Prospectus, the Acquiring Fund will engage in Derivative Transactions. The Acquiring Fund will engage in such activities in the Adviser's discretion, and may not necessarily be engaging in such activities when movements in interest rates that could affect the value of the assets of the Acquiring Fund occur. The Acquiring Fund's ability to pursue certain of these strategies may be limited by applicable regulations of the CFTC. Certain Derivative Transactions may give rise to taxable income.

### PUT AND CALL OPTIONS ON SECURITIES AND INDICES

The Acquiring Fund may purchase and sell put and call options on securities and indices. A put option gives the purchaser of the option the right to sell and the writer the obligation to buy the underlying security at the exercise price during the option period. The Acquiring Fund may also purchase and sell options on securities indices ("index options"). Index options are similar to options on securities except that, rather than taking or making delivery of securities underlying the option at a specified price upon exercise, an index option gives the holder the right to receive cash upon exercise of the option if the level of the securities index upon which the option is based is greater, in the case of a call, or less, in the case of a put, than the exercise price of the option. The purchase of a put option on a security could protect the Acquiring Fund's holdings in a security or a number of securities against a substantial decline in the market value. A call option gives the purchaser of the option the right to buy and the seller the obligation to sell the underlying security or index at the exercise price during the option period or for a specified period prior to a fixed date. The purchase of a call option on a security could protect the Acquiring Fund against an increase in the price of a security that it intended to purchase in the future. In the case of either put or call options that it has purchased, if the option expires without being sold or exercised, the Acquiring Fund will experience a loss in the amount of the option premium plus any related commissions. When the Acquiring Fund sells put and call options, it receives a premium as the seller of the option. The premium that the Acquiring Fund receives for selling the option will serve as a partial offset, in the amount of the option premium, against changes in the value of the securities in its portfolio. During the term of the option, however, a covered call seller has, in return for the premium on the option, given up the opportunity for capital appreciation above the exercise price of the option if the value of the underlying security increases, but has retained the risk of

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loss should the price of the underlying security decline. Conversely, a secured put seller retains the risk of loss should the market value of the underlying security decline below the exercise price of the option, less the premium received on the sale of the option. The Acquiring Fund is authorized to purchase and sell exchange listed options and over-the-counter options ("OTC Options") which are privately negotiated with the counterparty. Listed options are issued by the Options Clearing Corporation ("OCC") which guarantees the performance of the obligations of the parties to such options.

The Acquiring Fund's ability to close out its position as a purchaser or seller of an exchange listed put or call option is dependent upon the existence of a liquid secondary market on option exchanges. Among the possible reasons for the absence of a liquid secondary market on an exchange are: (i) insufficient trading interest in certain options; (ii) restrictions on transactions imposed by an exchange; (iii) trading halts, suspensions or other restrictions imposed with respect to particular classes or series of options or underlying securities; (iv) interruption of the normal operations on an exchange; (v) inadequacy of the facilities of an exchange or OCC to handle current trading volume; or (vi) a decision by one or more exchanges to discontinue the trading of options (or a particular class or series of options), in which event the secondary market on that exchange (or in that class or series of options) would cease to exist, although outstanding options on that exchange that had been listed by the OCC as a result of trades on that exchange would generally continue to be exercisable in accordance with their terms. OTC Options are purchased from or sold to dealers, financial institutions or other counterparties which have entered into direct agreements with the Acquiring Fund. With OTC Options, such variables as expiration date, exercise price and premium will be agreed upon between the Acquiring Fund and the counterparty, without the intermediation of a third party such as the OCC. If the counterparty fails to make or take delivery of the securities underlying an option it has written, or otherwise settle the transaction in accordance with the terms of that option as written, the Acquiring Fund would lose the premium paid for the option as well as any anticipated benefit of the transaction.

The hours of trading for options on securities may not conform to the hours during which the underlying securities are traded. To the extent that the option markets close before the markets for the underlying securities, significant price movements can take place in the underlying markets that cannot be reflected in the option markets.

### FUTURES CONTRACTS AND RELATED OPTIONS

**CHARACTERISTICS.** The Acquiring Fund may sell financial futures contracts or purchase put and call options on such futures as an offset against anticipated market movements. The sale of a futures contract creates an obligation by the Acquiring Fund, as seller, to deliver the specific type of financial instrument called for in the contract at a specified future time for a specified price. Options on futures contracts are similar to options on securities except that an option on a futures contract gives the purchaser the right in return for the premium paid to assume a position in a futures contract (a long position if the option is a call and a short position if the option is a put).

**MARGIN REQUIREMENTS.** At the time a futures contract is purchased or sold, the Acquiring Fund must allocate cash or securities as a deposit payment ("initial margin"). It is expected that the initial margin that the Acquiring Fund will pay may range from approximately 1% to approximately 5% of the value of the securities or commodities underlying the contract. In certain circumstances, however, such as periods of high volatility, the Acquiring Fund may be required by an exchange to increase the level of its initial margin payment. Additionally, initial margin requirements may be increased generally in the future by regulatory action. An outstanding futures contract is valued daily and the payment in case of "variation margin" may be required, a process known



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as "marking to the market." Transactions in listed options and futures are usually settled by entering into an offsetting transaction, and are subject to the risk that the position may not be able to be closed if no offsetting transaction can be arranged.

LIMITATIONS ON USE OF FUTURES AND OPTIONS ON FUTURES. The Acquiring Fund's use of futures and options on futures will in all cases be consistent with applicable regulatory requirements and in particular the rules and regulations of the CFTC. The Acquiring Fund currently may enter into such transactions without limit for bona fide strategic purposes, including risk management and duration management and other portfolio strategies. The Acquiring Fund may also engage in transactions in futures contracts or related options for non-strategic purposes to enhance income or gain provided that the Acquiring Fund will not enter into a futures contract or related option (except for closing transactions) for purposes other than bona fide strategic purposes, or risk management including duration management if, immediately thereafter, the sum of

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the amount of its initial deposits and premiums on open contracts and options would exceed 5% of the Acquiring Fund's liquidation value, i.e., net assets (taken at current value); provided, however, that in the case of an option that is in-the-money at the time of the purchase, the in-the-money amount may be excluded in calculating the 5% limitation. The above policies are non-fundamental and may be changed by the Acquiring Fund's Board at any time. Also, when required, an account of cash equivalents designated on the books and records will be maintained and marked to market on a daily basis in an amount equal to the market value of the contract.

SEGREGATION AND COVER REQUIREMENTS. Futures contracts, interest rate swaps, caps, floors and collars, short sales, reverse repurchase agreements and dollar rolls, and listed or OTC options on securities, indices and futures contracts sold by the Acquiring Fund are generally subject to earmarking and coverage requirements of either the CFTC or the SEC, with the result that, if the Acquiring Fund does not hold the security or futures contract underlying the instrument, the Acquiring Fund will be required to designate on its books and records an ongoing basis, cash, U.S. government securities, or other liquid high grade debt obligations in an amount at least equal to the Acquiring Fund's obligations with respect to such instruments.

SUCH AMOUNTS FLUCTUATE AS THE OBLIGATIONS INCREASE OR DECREASE. The earmarking requirement can result in the Acquiring Fund maintaining securities positions it would otherwise liquidate, segregating assets at a time when it might be disadvantageous to do so or otherwise restrict portfolio management.

DERIVATIVE TRANSACTIONS PRESENT CERTAIN RISKS. With respect to Derivative Transactions and risk management, the variable degree of correlation between price movements of strategic instruments and price movements in the position being offset create the possibility that losses using the strategy may be greater than gains in the value of the Acquiring Fund's position. The same is true for such instruments entered into for income or gain. In addition, certain instruments and markets may not be liquid in all circumstances. As a result, in volatile markets, the Acquiring Fund may not be able to close out a transaction without incurring losses substantially greater than the initial deposit. Although the contemplated use of these instruments predominantly for Derivative Transactions should tend to minimize the risk of loss due to a decline in the value of the position, at the same time they tend to limit any potential gain which might result from an increase in the value of such position. The ability of the Acquiring Fund to successfully utilize Derivative Transactions will depend on the Adviser's and the sub-adviser's ability to predict pertinent

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market movements and sufficient correlations, which cannot be assured. Finally, the daily deposit requirements in futures contracts that the Acquiring Fund has sold create an on going greater potential financial risk than do options transactions, where the exposure is limited to the cost of the initial premium. Losses due to the use of Derivative Transactions will reduce net asset value.

REGULATORY CONSIDERATIONS. The Acquiring Fund has claimed an exclusion from the term "commodity pool operator" under the Commodity Exchange Act and, therefore, is not subject to registration or regulation as a commodity pool operator under the Commodity Exchange Act.

### OTHER INVESTMENT POLICIES AND TECHNIQUES

#### BRADY BONDS

The Acquiring Fund's emerging market debt securities may include emerging market governmental debt obligations commonly referred to as Brady Bonds. Brady Bonds are debt securities, generally denominated in U.S. dollars, issued under the framework of the Brady Plan, an initiative announced by U.S. Treasury Secretary Nicholas F. Brady in 1989 as a mechanism for debtor nations (primarily emerging market countries) to restructure their outstanding external indebtedness (generally, commercial bank debt). Brady Bonds are created through the exchange of existing commercial bank loans to foreign entities for new obligations in connection with debt restructuring. A significant amount of the Brady Bonds that the Acquiring Fund may purchase have no or limited collateralization, and the Acquiring Fund will be relying for payment of interest and (except in the case of principal collateralized Brady Bonds) principal primarily on the willingness and ability of the foreign government to make payment in accordance with the terms of the Brady Bonds. A substantial portion of the Brady Bonds and other sovereign debt securities in which the Acquiring Fund may invest are likely to be acquired at a discount.

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#### MEZZANINE INVESTMENTS

The Acquiring Fund may invest in certain high yield securities known as mezzanine investments, which are subordinated debt securities which are generally issued in private placements in connection with an equity security (e.g., with attached warrants). Such mezzanine investments may be issued with or without registration rights. Similar to other high yield securities, maturities of mezzanine investments are typically seven to ten years, but the expected average life is significantly shorter at three to five years. Mezzanine investments are usually unsecured and subordinate to other obligations of the issuer.

#### LOAN PARTICIPATIONS AND ASSIGNMENTS

The Acquiring Fund may invest in fixed and floating rate loans ("Loans") arranged through private negotiations between a corporation or foreign government and one or more financial institutions ("Lenders"). The Acquiring Fund's investments in Loans are expected in most instances to be in the form of participations in Loans ("Participations") and assignments of all or a portion of Loans ("Assignments") from third parties. Participations typically will result in the Acquiring Fund having a contractual relationship only with the Lender not the borrower. The Acquiring Fund will 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 the Acquiring Fund and only upon receipt by the Lender of the payments by the borrower. In connection with purchasing Participations, the Acquiring Fund generally has no direct right to

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enforce compliance by the borrower with the terms of the loan agreement relating to the Loan, nor any rights of set-off against the borrower, and the Acquiring Fund may not directly benefit from any collateral supporting the Loan in which it has purchased the Participation. As a result the Acquiring Fund will assume the credit risk of both the borrower and the Lender that is selling the Participation. In the event of the insolvency of the Lender selling a Participation, the Acquiring Fund may be treated as a general creditor of the Lender and may not benefit from any set-off between the Lender and the borrower. The Acquiring Fund will acquire Participations only if the Lender interpositioned between the Acquiring Fund and the borrower is determined by Highland to be creditworthy. When the Acquiring Fund purchases Assignments from Lenders, the Acquiring Fund will acquire direct rights against the borrower on the Loan. However, since Assignments are arranged through private negotiations between potential assignees and assignors, the rights and obligations acquired by the Acquiring Fund as the purchaser of an Assignment may differ from, and be more limited than, those held by the assigning Lender.

The Acquiring Fund may have difficulty disposing of Assignments and Participations. Because there is no liquid market for such securities, the Acquiring Fund anticipates that such securities could be sold only to a limited number of institutional investors. The lack of a liquid secondary market will have an adverse impact on the value of such securities and on the Acquiring Fund's ability to dispose of particular Assignments or Participations when necessary to meet the Acquiring Fund's liquidity needs or in response to a specific economic event, such as a deterioration in the creditworthiness of the borrower. The lack of a liquid secondary market for Assignments and Participations also may make it more difficult for the Acquiring Fund to assign a value to those securities for purposes of valuing the Acquiring Fund's portfolio and calculating its net asset value.

### STRUCTURED INVESTMENTS

The Acquiring Fund may invest a portion of its assets in interests in entities organized and operated solely for the purpose of restructuring the investment characteristics of securities. This type of restructuring involves the deposit with or purchase by an entity, such as a corporation or a trust, of specified instruments and the issuance by that entity of one or more classes of securities ("Structured Investments") backed by, or representing interests in the underlying instruments. The cash flow on the underlying instruments may be apportioned among the newly issued Structured Investments to create securities with different investment characteristics such as varying maturities, payment priorities and interest rate provisions, and the extent of the payments made with respect to Structured Investments is dependent on the extent of the cash flow on the underlying instruments. Because Structured Investments of the type in which the Acquiring Fund anticipates it will invest typically involve no credit enhancement, their credit risk generally will be equivalent to that of the underlying instruments.

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The Acquiring Fund is permitted to invest in a class of Structured Investments that is either subordinated or not subordinated to the right of payment of another class. Subordinated Structured Investments typically have higher yields and present greater risks than unsubordinated Structured Investments.

Certain issuers of Structured Investments may be deemed to be "investment companies" as defined in the 1940 Act. As a result, the Acquiring Fund's investment in these Structured Investments may be limited by the restrictions contained in the 1940 Act. Structured Investments are typically sold in private

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placement transaction, and there currently is no active trading market for Structured Investments.

### PROJECT LOANS

The Acquiring Fund may invest in project loans, which are fixed income securities of issuers whose revenues are primarily derived from mortgage loans to multi-family, nursing home and other real estate development projects. The principal payments on these mortgage loans will be insured by agencies and authorities of the U.S. government.

### HIGH INCOME PORTFOLIO

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The following is a description of the investments of High Income Portfolio may acquire, whether as a primary or secondary strategy. The following information supplements the discussion of the High Income Portfolio's investment objectives, policies and techniques that are described in the Proxy Statement/Prospectus.

### FOREIGN INVESTMENTS

High Income Portfolio may invest up to 10% of the value of its total assets in securities principally traded in foreign markets and Eurodollar certificates of deposit issued by branches of U.S. and foreign banks. Foreign investments may involve risks not present to the same degree in domestic investments, such as future political and economic developments, the imposition of withholding taxes on interest income, seizure or nationalization of foreign deposits, the establishment of exchange controls or the adoption of other foreign governmental restrictions which might adversely affect the payment of principal and interest on such obligations. Foreign securities may be less liquid and more volatile than U.S. securities, and foreign accounting and disclosure standards may differ from U.S. standards. In addition, settlement of transactions in foreign securities may be subject to delays, which could result in adverse consequences to High Income Portfolio including restrictions on the subsequent resale of such securities. The value of foreign investments may rise or fall because of changes in currency exchange rates. In addition, the costs of exchanging foreign currencies for payments in U.S. dollars and nonnegotiated brokerage commissions in foreign countries may reduce the yield on foreign securities. In the event of a default in payment on foreign securities, High Income Portfolio may incur increased costs to obtain a judgment against the foreign issuer in the United States or abroad.

High Income Portfolio may buy or sell foreign currencies or deal in forward foreign currency contracts to hedge against possible fluctuations in exchange rates that may affect the yield of High Income Portfolio when the foreign currencies are converted in payment in U.S. dollars. High Income Portfolio will use currency transactions only for hedging and not speculative purposes. High Income Portfolio may engage in currency exchange transactions to protect against uncertainty in the level of future exchange rates. A forward currency contract 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. High Income Portfolio's dealings in forward currency exchange will be limited to hedging involving either specific transactions or portfolio positions. Transaction hedging is the purchase or sale of forward currency with respect to specific receivables or payables of High Income Portfolio generally arising in connection with the purchase or sale of its portfolio securities. Position hedging is the sale of forward currency with respect to portfolio security positions denominated or quoted in the currency. High Income Portfolio may not use position hedging with respect to a particular currency to an extent greater than the aggregate market value (at the time of entering into the position hedge) of

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the securities held in its portfolio denominated or quoted in or currently convertible into that particular currency. If High Income Portfolio enters into a position hedging transaction, High Income Portfolio will set aside cash or permissible liquid securities in an amount equal to the value of High Income Portfolio's total assets committed to the consummation of the forward contract. If the value of the securities set aside declines, High Income Portfolio will

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set aside additional cash or permissible liquid securities to equal the amount of High Income Portfolio's commitment with respect to the forward contract.

### OPTIONS

High Income Portfolio may write (sell) call options which are traded on national securities exchanges with respect to securities in its portfolio. High Income Portfolio may only write "covered" call options, that is, options on securities it holds in its portfolio or has an immediate right to acquire through conversion or exchange of securities held in its portfolio. High Income Portfolio may write call options on its portfolio securities in an attempt to realize a greater current return than would be realized on the securities alone. High Income Portfolio also may write call options as a partial hedge against a possible market decline. In view of its investment objective, High Income Portfolio generally would write call options only in circumstances in which the Adviser does not anticipate significant appreciation of the underlying security in the near future or has otherwise determined to dispose of the security. As the writer of a call option, High Income Portfolio receives a premium for undertaking the obligation to sell the underlying security at a fixed price during the option period if the option is exercised. So long as High Income Portfolio remains obligated as a writer of a call option, it forgoes the opportunity to profit from increases in the market price of the underlying security above the exercise price of the option, except insofar as the premium represents such a profit (and retains the risk of loss should the value of the underlying security decline). High Income Portfolio also may enter into "closing purchase transactions" to terminate its obligation as a writer of a call option prior to the expiration of the option. Although the writing of call options only on national securities exchanges increases the likelihood that High Income Portfolio will be able to make closing purchase transactions, there is no assurance that High Income Portfolio will be able to effect such transactions at any particular time or at any acceptable price. The writing of call options could result in increases in High Income Portfolio's portfolio turnover rate, especially during periods when market prices of the underlying securities appreciate. The extent to which High Income Portfolio may enter into transactions involving call options also may be limited by the requirements of the Code for qualification as a regulated investment company.

### FINANCIAL FUTURES CONTRACTS AND RELATED OPTIONS

Currently, High Income Portfolio has no intention to trade in financial futures contracts or options on financial futures contracts. However, High Income Portfolio has reserved the right, subject to the approval of the High Income Board, to purchase and sell financial futures contracts and options on such futures contracts for the purpose of hedging its portfolio securities (or portfolio securities which it expects to acquire) against anticipated changes in prevailing interest rates. This technique could be employed if the Adviser anticipates that interest rates may rise, in which event High Income Portfolio could sell a futures contract to protect against the potential decline in the value of its portfolio securities. Conversely, if declining interest rates were anticipated, High Income Portfolio could purchase a futures contract to protect against a potential increase in the price of securities High Income Portfolio

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intends to purchase.

High Income Portfolio will not be a commodity pool. In addition, High Income Portfolio has claimed an exclusion from the definition of commodity pool operator and, therefore, is not subject to registration or regulation as a pool operator under the Commodity Exchange Act.

### RISKS OF HEDGING TRANSACTIONS

The use of options, financial futures and options on financial futures may involve risks not associated with other types of investments which High Income Portfolio intends to purchase and it is possible that a portfolio that utilizes hedging strategies may not perform as well as a portfolio that does not make use of such strategies. In particular, High Income Portfolio's positions in options and financial futures may be entered and closed out only on a federally licensed exchange which provides a market therefor, and there can be no assurance that a liquid market will exist for any particular option or futures contract. Because financial futures and related options markets generally impose limits on daily price movement, it is possible that the Adviser will not be able to close out hedge positions promptly. The inability to close out options and futures positions could have an adverse impact on High Income Portfolio's ability to hedge its securities effectively and might, in some cases, require High Income Portfolio to deposit substantial amounts of additional cash to meet applicable margin requirements. High Income Portfolio's ability to hedge effectively through transactions in financial futures or options depends on the degree to which price movements, which include, in part, changes in interest rates, in

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High Income Portfolio's holdings correlate with price movements of the hedging instruments. Inasmuch as High Income Portfolio's options and futures will not duplicate such underlying securities, the correlation probably will not be perfect. Consequently, the prices, which include, in part, changes in interest rates, of the securities being hedged may not move in the same amount as the hedging instrument. It is possible that there may be a negative correlation between the hedging instrument and the hedged securities, which would prevent High Income Portfolio from achieving the anticipated benefits of hedging transactions or may cause High Income Portfolio to realize losses and thus be in a worse position than if such strategies had not been used.

### ADDITIONAL LEVERAGE

Although it has no current intention of doing so, High Income Portfolio may borrow to the extent then permitted by the 1940 Act through the public or private issuance of debt securities and/or from lenders of all types, such as banks, savings and loan associations, insurance companies and similar financial institutions. In addition, High Income Portfolio may borrow up to 5% of its total assets for temporary purposes.

### MANAGEMENT OF THE FUNDS

#### DIRECTORS/TRUSTEES

The Boards provide broad oversight over the operations and affairs of the Funds and they protect the interests of shareholders. The Boards have overall responsibility to manage and control the business affairs of the Funds, including the complete and exclusive authority to establish policies regarding the management, conduct and operation of the Funds' business. The names and ages of the Directors/Trustees and officers of the Funds, the year each was first elected or appointed to office, their principal business occupations during the

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last five years, the number of funds overseen by each director/trustee and other directorships or trusteeships they hold are shown below.

NAME, ADDRESS(1) AND AGE	POSITION WITH EACH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED(2)	PRINCIPAL OCCUPATION(S) PAST FIVE YEARS	NUMBER OF PORTFOLIOS IN HIGHLAND FUND COMPLEX OVERSEEN(3)
INDEPENDENT DIRECTORS/TRUSTEES(4) -----				
Timothy Hui (Age 59)	Director of Income Shares and High Income Portfolio; Trustee of Credit Strategies Fund	Director of High Income Portfolio since January 2000, current High Income Portfolio Nominee for a term to expire at the 2011 annual meeting; Director of Income Shares since July 2001 (with a term expiring at the 2009 annual meeting); Trustee of Credit Strategies Fund 2006 (with a term expiring at the 2008 annual meeting).	Vice President since February 2008, Dean of Educational Resources from July 2006 to January 2008; Assistant Provost for Graduate Education, July 2004 to June 2006; and Assistant Provost for Educational Resources, July 2001 to June 2004, Philadelphia Biblical University.	12
Scott Kavanaugh (Age 47)	Director of Income Shares and High Income Portfolio; Trustee of Credit Strategies Fund	Director of High Income Portfolio since January 2000, current High Income Portfolio Nominee for a term to expire at the 2011 annual meeting; Director of Income Shares since July 2001 (with a term expiring at the 2009 annual meeting); Trustee of Credit Strategies Fund since 2006 (with a term expiring at the 2008 annual meeting).	Vice-Chairman, President and Chief Operating Officer, Keller Financial Group since September 2007; Chairman and Chief Executive Officer, First Foundation Bank since September 2007; Private Investor since February 2004; Sales Representative at Round Hill Securities, March 2003 to January 2004; Executive at Provident Funding Mortgage Corporation, February 2003 to July 2003; Executive Vice President, Director and CAO, Commercial Capital	12

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Bank, January 2000 to February 2003; Managing Principal and Chief Operating Officer, Financial Institutional Partners Mortgage Company and the Managing Principal and President of Financial Institutional Partners, LLC (an investment banking firm), April 1998 to February 2003.

James F. Leary (Age 78)	Director of Income Shares and High Income Portfolio; Trustee of Credit Strategies Fund	Director of High Income Portfolio since January 2000 (with a term expiring at the 2009 annual meeting); Director of Income Shares since July 2001 (with a term expiring at the 2010 annual meeting); Trustee of Credit Strategies Fund since 2006 (with a term expiring at the 2010 annual meeting)	Managing Director, Benefit Capital Southwest, Inc. (a financial consulting firm) since January 1999.	12
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Bryan A. Ward (Age 53)	Director of Income Shares and High Income Portfolio; Trustee of Credit Strategies Fund	Director of High Income Portfolio since November 2001 (with a term expiring at the 2009 annual meeting); Director of Income Shares since November 2001 (with a term expiring at the 2010 annual meeting); Trustee of Credit Strategies Fund since 2006 (with a term expiring at the 2010 annual meeting)	Senior Manager, Accenture, LLP (a consulting firm) since January 2002.	12
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INTERESTED DIRECTOR/TRUSTEE

R. Joseph	Senior	Director and	Senior Portfolio	12
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<p>Dougherty (5) (Age 37)</p>	<p>Vice President of the Funds; Director of Income Shares and High Income Portfolio; Trustee of Credit Strategies Fund</p>	<p>Chairman of the Board of High Income Portfolio since May 2004 (with a term expiring at the 2010 annual meeting) and Senior Vice President of High Income Portfolio since January 2000; Director and Chairman of the Board of Income Shares since May 2004 and Senior Vice President of Income Shares since July 2001, current Income Shares Nominee for a term to expire at the 2011 annual meeting; Trustee and Chairman of the Board of Credit Strategies Fund since 2006 (with a term expiring at the 2008 annual meeting) and Senior Vice President of Credit Strategies Fund since 2006.</p>	<p>Manager of the Adviser since 2000; Director/Trustee, Chairman of the Board and Senior Vice President of the funds in the Highland Fund Complex.</p>
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- (1) The address of each Director/Trustee 13455 Noel Road, Suite 800, Dallas, Texas 75240.
- (2) Each Fund's Board is divided into three classes with the term of office of one class expiring each year.
- (3) The Highland Fund Complex consists of all of the registered investment companies advised by the Adviser as of the date of this SAI. In addition, each of the Directors/Trustees oversees Highland Distressed Opportunities Fund, Inc., a closed-end company that has filed an election to be regulated as a business development company under the 1940 Act.
- (4) Independent Directors/Trustees are those who are not "interested persons" as that term is defined under section 2(a)(19) of the 1940 Act.
- (5) Mr. Dougherty is deemed to be an "interested person" of each Fund under the 1940 Act because of his position with the Adviser.

In addition to Mr. Dougherty, each Fund's other executive officers are James D. Dondero, Mark K. Okada, M. Jason Blackburn and Michael Colvin. Set forth below are the names and certain biographical and other information for Messrs. Dondero, Okada, Blackburn and Colvin as reported by them to each Fund.

OFFICERS(1)

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Name and Age and Address (2) -----	Position with each Fund, Term of Office (3) and Length of Time Served -----	Principal Occupat Five -----
James D. Dondero (Age 45)	Chief Executive Officer and President of Credit Strategies Fund since May 2006, High Income Portfolio since January 2000 and Income Shares since July 2001.	President and Dir Advisors, Inc. (" General Partner o Chairman of the B of Highland Finan L.P.; and Preside the Highland Fund
Mark Okada (Age 46)	Executive Vice President of Credit Strategies Fund since May 2006, High Income Portfolio since January 2000 and Income Shares since July 2001.	Executive Vice Pr Chief Investment Adviser; and Exec President of the Highland Fund Com
M. Jason Blackburn (Age 32)	Secretary and Treasurer of Credit Strategies Fund since May 2006, High Income Portfolio and Income Shares since March 2003.	Assistant Control since November 20 and Treasurer of Highland Fund Com
Michael Colvin (Age 38)	Chief Compliance Officer of the Funds since July 2007.	General Counsel a Officer of the Ad 2007 and Chief Co the funds in the Complex since Jul in the Corporate Group at Greenber January 2007 to J Partner (from Jan January 2007) and 1995 to 2002) in Practice Group at Manges, LLP.

- (1) Each officer serves in the same capacity for each of the Highland Funds.
- (2) The address of each officer is 13455 Noel Road, Suite 800, Dallas, Texas 75240.
- (3) Each officer serves for an indefinite term.

COMPENSATION OF DIRECTORS/TRUSTEES

The executive officers of the Funds and the Directors/Trustees who are "interested persons" (as defined in the 1940 Act) receive no direct remuneration from the Funds. Effective January 1, 2008, each Independent Director/Trustee receives an annual retainer of \$150,000 payable in quarterly installments and allocated among each portfolio in the Highland Funds Complex based upon relative

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net assets. Prior to January 1, 2008, the Independent Directors/Trustees of High Income Portfolio, Income Shares and Credit Strategies Fund were compensated at a rate of \$15,000, \$5,000 and \$7,500 annually. Independent Directors/Trustees are reimbursed for actual out-of-pocket expenses relating to attendance at meetings.

The following table summarizes the compensation paid by each Fund to the Directors/Trustees and the aggregate compensation paid by the Highland Fund Complex to the Directors/Trustees.

Name of Trustee	Aggregate Compensation from High Income Portfolio for the fiscal year ended October 31, 2007	Aggregate Compensation from Income Shares for the fiscal year ended December 31, 2007	Aggregate Compensation from Credit Strategies Fund for the fiscal year ended December 31, 2007	Aggreg from Complex year en
<b>INTERESTED TRUSTEE</b>				
R. Joseph Dougherty	\$0	\$0	\$0	
<b>INDEPENDENT TRUSTEES</b>				
Bryan A. Ward	\$15,000	\$5,000	\$7,500	
Scott F. Kavanaugh	\$15,000	\$5,000	\$7,500	
James F. Leary	\$15,000	\$5,000	\$7,500	
Timothy K. Hui	\$15,000	\$5,000	\$7,500	

### BOARD COMMITTEES

In connection with the Boards' responsibility for the overall management and supervision of the Funds' affairs, the Directors/Trustees meet periodically throughout the year to oversee the Funds' activities, review contractual arrangements with service providers for the Funds and review the Funds' performance. To fulfill these duties, each Fund has an Audit Committee, a Nominating Committee, a Litigation Committee and a Qualified Legal Compliance Committee.

The Audit Committee consists of Bryan Ward, Scott Kavanaugh, James Leary and Timothy Hui. The Audit Committee acts according to the Audit Committee charter. Scott Kavanaugh has been appointed as Chairman of the Audit Committee. The Audit Committee is responsible for (i) oversight of each Fund's accounting and financial reporting processes and the audits of each Fund's financial statements and (ii) providing assistance to the board of directors/trustees of each Fund in connection with its oversight of the integrity of each Fund's financial statements, each Fund's compliance with legal and regulatory requirements and the independent registered public accounting firm's qualifications, independence and performance. The Boards have determined that each Fund has one audit committee financial expert serving on its Audit Committee, Mr. Leary, who is independent for the purpose of the definition of audit committee financial expert as applicable to each Fund. The Audit Committee for High Income Portfolio met three times in the fiscal year ended October 31, 2007. The Audit Committee for Income Shares met three times in the fiscal year ended December 31, 2007. The Audit Committee for Credit Strategies Fund met

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three times in the fiscal year ended December 31, 2007.

The Nominating Committee's function is to canvass, solicit, recruit, interview and nominate directors/trustees. The Nominating Committee will consider recommendations for nominees from shareholders sent to the Secretary of each Fund, Two Galleria Tower, 13455 Noel Road, Suite 800, Dallas, Texas 75240. A nomination submission must include all information relating to the recommended nominee that is required to be disclosed in solicitations or proxy statements for the election of directors/trustees, as well as information sufficient to

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evaluate the factors listed above. Nomination submissions must be accompanied by a written consent of the individual to stand for election if nominated by a Board and to serve if elected by the shareholders, and such additional information must be provided regarding the recommended nominee as reasonably requested by the Nominating Committee. The Nominating Committee is comprised of Messrs. Ward, Kavanaugh, Leary and Hui. The Nominating Committee for High Income Portfolio met one time in the fiscal year ended October 31, 2007. The Nominating Committee for Income Shares met one time in the fiscal year ended December 31, 2007. The Nominating Committee for Credit Strategies Fund met one time in the fiscal year ended December 31, 2007.

The Litigation Committee's function is to seek to address any potential conflicts of interest between or among each Fund and the Adviser in connection with any potential or existing litigation or other legal proceeding relating to securities held by each Fund and the Adviser or another client of the Adviser. The Litigation Committee is comprised of Messrs. Ward, Kavanaugh, Leary and Hui. The Litigation Committee for High Income Portfolio met 4 times in the fiscal year ended October 31, 2007. The Litigation Committee for Income Shares did not meet in the fiscal year ended December 31, 2007. The Litigation Committee for Credit Strategies Fund also did not meet in the fiscal year ended December 31, 2007.

The Qualified Legal Compliance Committee (the "QLCC") is charged with compliance with Rules 205.2(k) and 205.3(c) of the Code of Federal Regulations regarding alternative reporting procedures for attorneys representing the each Fund who appear and practice before the SEC on behalf of that Fund. The QLCC is comprised of Messrs. Ward, Kavanaugh, Leary and Hui. There were no QLCC meetings during the fiscal years ended October 31, 2007 or December 31, 2007.

### PROXY VOTING POLICIES AND PROCEDURES

The Boards of the Funds have delegated the voting of proxies for each Fund's securities to Highland pursuant to Highland's proxy voting policies and procedures. Under these policies and procedures, Highland will vote proxies related to each Fund's securities in the best interests of each Fund and its shareholders. A copy of Highland's proxy voting policies and procedures is attached as Appendix B to this SAI. Each Fund's proxy voting record for the most recent 12-month period ending December 31 will be available (i) without charge, upon request, by calling 1-877-665-1287 and (ii) on the SEC's web site (<http://www.sec.gov>).

### CODES OF ETHICS

Each Fund and the Adviser have adopted codes of ethics under Rule 17j-1 of the 1940 Act. These codes permit personnel subject to the codes to invest in securities, including securities that may be purchased or held by each Fund. These codes can be reviewed and copied at the SEC's Public Reference Room in Washington, D.C. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-202-551-8090. The codes of ethics are

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available on the EDGAR Database on the SEC's web site (<http://www.sec.gov>), and copies of these codes may be obtained, after paying a duplicating fee, by electronic request at the following e-mail address: [publicinfo@sec.gov](mailto:publicinfo@sec.gov), or by writing the SEC's Public Reference Section, Washington, D.C. 20549-0102.

### ADMINISTRATION SERVICES

Pursuant to the Acquiring Fund's administration services agreement, Highland performs the following services: (i) prepare monthly security transaction listings; (ii) supply various normal and customary statistical data as requested on an ongoing basis; (iii) prepare for execution and file the Acquiring Fund's federal and state tax returns; prepare a fiscal tax provision in coordination with the annual audit; prepare an excise tax provision; and prepare all relevant Form 1099 calculations; (iv) coordinate contractual relationships and communications between the Acquiring Fund and its contractual service providers; (v) coordinate printing of the Acquiring Fund's annual and semi-annual shareholder reports; (vi) prepare income and capital gain distributions; (vii) prepare the semiannual and annual financial statements; (viii) monitor the Acquiring Fund's compliance with Code, SEC and prospectus requirements; (ix) prepare, coordinate with the Acquiring Fund's counsel and coordinate the filing with the SEC: semi-annual reports on Form N-SAR and Form N-CSR; Form N-Q; and Form N-PX based upon information provided by the Acquiring Fund, assist in the preparation of Forms 3, 4 and 5 pursuant to Section 16 of the Securities Exchange Act of 1934, as amended, and Section 30(f) of the 1940 Act for the officers and trustees of the Acquiring Fund, such filings to be based on information provided by those persons; (x) assist in the preparation of

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notices of meetings of shareholders; (xi) assist in obtaining the fidelity bond and trustees' and officers'/errors and omissions insurance policies for the Acquiring Fund in accordance with the requirements of Rule 17g-1 and 17d-1(d)(7) under the 1940 Act as such bond and policies are approved by the Acquiring Fund's board of trustees; (xii) monitor the Acquiring Fund's assets to assure adequate fidelity bond coverage is maintained; (xiii) draft agendas and resolutions for quarterly and special board meetings; (xiv) coordinate the preparation, assembly and distribution of board materials; (xv) attend board meetings and draft minutes thereof; (xvi) maintain the Acquiring Fund's calendar to assure compliance with various filing and board approval deadlines; (xvii) furnish the Acquiring Fund office space in the offices of Highland, or in such other place or places as may be agreed upon from time to time, and all necessary office facilities, simple business equipment, supplies, utilities and telephone service for managing the affairs and investments of the Acquiring Fund; (xviii) assist the Acquiring Fund in the handling of SEC examinations and responses thereto; (xix) perform clerical, bookkeeping and all other administrative services not provided by the Acquiring Fund's other service providers; (xx) determine or oversee the determination and publication of the Acquiring Fund's net asset value in accordance with the Acquiring Fund's policy as adopted from time to time by the Board of Trustees; (xxi) oversee the maintenance by the Acquiring Fund's custodian and transfer agent and dividend disbursing agent of certain books and records of the Acquiring Fund as required under Rule 31a-1(b)(2)(iv) of the 1940 Act and maintain (or oversee maintenance by such other persons as approved by the board of trustees) such other books and records required by law or for the proper operation of the Acquiring Fund; (xxii) prepare such information and reports as may be required by any stock exchange or exchanges on which the Acquiring Fund's shares are listed; (xxiii) determine the amounts available for distribution as dividends and distributions to be paid by the Acquiring Fund to its shareholders; prepare and arrange for the printing of dividend notices to shareholders; and provide the Acquiring Fund's dividend disbursing agent and custodian with such information as is required for such parties to effect the payment of dividends and distributions and to implement

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the Acquiring Fund's dividend reinvestment plan; (xxiv) serve as liaison between the Acquiring Fund and each of its service providers; and (xxv) perform such additional administrative duties relating to the administration of the Acquiring Fund as may subsequently be agreed upon in writing between the Acquiring Fund and Highland. Highland shall have the authority to engage a sub-administrator in connection with the administrative services of the Acquiring Fund, which sub-administrator may be an affiliate of Highland; provided, however, that Highland shall remain responsible to the Acquiring Fund with respect to its duties and obligations set forth in the administration services agreement.

### ADMINISTRATION AND ACCOUNTING SERVICES

Each Acquired Fund is a party to an administration and accounting services agreement with PFPC Inc. dated April 10, 2006 pursuant to which PFPC Inc. provides administrative and accounting services to each Acquired Fund. PFPC Inc. will receive an annual fee, payable monthly, in an amount equal to 0.026%, subject to a minimum fee, of the average weekly value of each Acquired Fund's Managed Assets plus certain other fees.

### PORTFOLIO MANAGERS

Each Acquired Fund is managed by Brad Borud and R. Joseph Dougherty. Mark Okada, Kurtis Plumer and Brad Borud manage the Acquiring Fund.

As of December 31, 2007, Kurtis Plumer managed the following client accounts:

TYPE OF ACCOUNT -----	NUMBER OF ACCOUNTS -----	ASSETS OF ACCOUNTS (\$ MILLIONS) -----	NUMBER OF ACCOUNTS SUBJECT TO A PERFORMANCE FEE -----
Registered Investment Companies.....	2	933	1
Other Pooled Investment Vehicles.....	6	3,189	4
Other Accounts.....	0	0	0

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As of December 31, 2007, Mark Okada managed the following client accounts:

NUMBER OF  
ACCOUNTS  
SUBJECT TO

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TYPE OF ACCOUNT -----	NUMBER OF ACCOUNTS -----	ASSETS OF ACCOUNTS (\$ MILLIONS) -----	A PERFORMANCE FEE -----
Registered Investment Companies.....	12	8,076	0
Other Pooled Investment Vehicles.....	30	21,227	26
Other Accounts.....	0	0	0

As of December 31, 2007, R. Joseph Dougherty managed the following client accounts:

TYPE OF ACCOUNT -----	NUMBER OF ACCOUNTS -----	ASSETS OF ACCOUNTS (\$ MILLIONS) -----	NUMBER OF ACCOUNTS SUBJECT TO A PERFORMANCE FEE -----
Registered Investment Companies.....	6	6,647	0
Other Pooled Investment Vehicles.....	1	359	0
Other Accounts.....	0	0	0

As of December 31, 2007, Brad Borud managed the following client accounts:

TYPE OF ACCOUNT -----	NUMBER OF ACCOUNTS -----	ASSETS OF ACCOUNTS (\$ MILLIONS) -----	NUMBER OF ACCOUNTS SUBJECT TO A PERFORMANCE FEE -----
Registered Investment Companies.....	0	0	0
Other Pooled Investment Vehicles.....	0	0	0
Other Accounts.....	0	0	0

The Adviser has built a professional working environment, a firm-wide compliance culture and compliance procedures and systems designed to protect against potential incentives that may favor one account over another. The

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Adviser has adopted policies and procedures that address the allocation of investment opportunities, execution of portfolio transactions, personal trading by employees and other potential conflicts of interest that are designed to ensure that all client accounts are treated equitably over time. Nevertheless, the Adviser furnishes advisory services to numerous clients in addition to each Fund, and the Adviser may, consistent with applicable law, make investment recommendations to other clients or accounts (including accounts which are hedge funds or have performance or higher fees paid to the Adviser, or in which portfolio managers have a personal interest in the receipt of such fees), which may be the same as or different from those made to each Fund. In addition, the Adviser, its affiliates and any officer, director, stockholder or employee may or may not have an interest in the securities whose purchase and sale the Adviser recommends to each Fund. Actions with respect to securities of the same kind may be the same as or different from the action which the Adviser, or any of its affiliates, or any officer, director, stockholder, employee or any member of their families may take with respect to the same securities. Moreover, the Adviser may refrain from rendering any advice or services concerning securities of companies of which any of the Adviser's (or its affiliates') officers, directors or employees are directors or officers, or companies as to which the Adviser or any of its affiliates or the officers, directors and employees of any of them has any substantial economic interest or possesses material non-public information. In addition to its various policies and procedures designed to address these issues, the Adviser includes disclosure regarding these matters to its clients in both its Form ADV and investment advisory agreements.

The Adviser, its affiliates or their officers and employees serve or may serve as officers, directors or principals of entities that operate in the same or related lines of business or of investment funds managed by affiliates of the Adviser. Accordingly, these individuals may have obligations to investors in those entities or funds or to other clients, the fulfillment of which might not be in the best interests of each Fund. As a result, the Adviser will face conflicts in the allocation of investment opportunities to each Fund and other funds and clients. In order to enable such affiliates to fulfill their fiduciary

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duties to each of the clients for which they have responsibility, the Adviser will endeavor to allocate investment opportunities in a fair and equitable manner which may, subject to applicable regulatory constraints, involve pro rata co-investment by each Fund and such other clients or may involve a rotation of opportunities among each Fund and such other clients.

While the Adviser does not believe there will be frequent conflicts of interest, if any, the Adviser and its affiliates have both subjective and objective procedures and policies in place designed to manage the potential conflicts of interest between the Adviser's fiduciary obligations to each Fund and their similar fiduciary obligations to other clients so that, for example, investment opportunities are allocated in a fair and equitable manner among each Fund and such other clients. An investment opportunity that is suitable for multiple clients of the Adviser and its affiliates may not be capable of being shared among some or all of such clients due to the limited scale of the opportunity or other factors, including regulatory restrictions imposed by the 1940 Act. There can be no assurance that the Adviser's or its affiliates' efforts to allocate any particular investment opportunity fairly among all clients for whom such opportunity is appropriate will result in an allocation of all or part of such opportunity to each Fund. Not all conflicts of interest can be expected to be resolved in favor of each Fund.

### COMPENSATION

The Adviser's financial arrangements with its portfolio managers, its



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competitive compensation and its career path emphasis at all levels reflect the value senior management places on key resources. Compensation may include a variety of components and may vary from year to year based on a number of factors including the relative performance of a portfolio managers' underlying account, the combined performance of the portfolio managers underlying accounts, and the relative performance of the portfolio managers underlying accounts measured against other employees. The principal components of compensation include a base salary, a discretionary bonus, various retirement benefits and one or more of the incentive compensation programs established by the Adviser such as Option It Plan and the Long-Term Incentive Plan.

BASE COMPENSATION

Generally, portfolio managers receive base compensation based on their seniority and/or their position with the firm, which may include the amount of assets supervised and other management roles within the firm.

DISCRETIONARY COMPENSATION

In addition to base compensation, portfolio managers may receive discretionary compensation, which can be a substantial portion of total compensation. Discretionary compensation can include a discretionary cash bonus as well as one or more of the following:

OPTION IT PLAN. The purpose of this plan is to attract and retain the highest quality employees for positions of substantial responsibility, and to provide additional incentives to a select group of management or highly compensated employees of Highland so as to promote the success of Highland.

LONG TERM INCENTIVE PLAN. The purpose of this plan is to create positive morale and teamwork, to attract and retain key talent, and to encourage the achievement of common goals. This plan seeks to reward participating employees based on the increased value of Highland through the use of Long-Term Incentive Units.

Senior portfolio managers who perform additional management functions may receive additional compensation in these other capacities. Compensation is structured such that key professionals benefit from remaining with the firm.

SECURITIES OWNERSHIP OF PORTFOLIO MANAGERS

The following table sets forth the dollar range of equity securities of each Fund beneficially owned by each portfolio manager as of the end of each Fund's most recently completed fiscal year.

Name of Portfolio Manager	Dollar Range of Equity Securities Beneficially Owned by Portfolio Manager in High Income Portfolio for the fiscal year ended October 31, 2007	Dollar Range of Equity Securities Beneficially Owned by Portfolio Manager in Income Shares for the fiscal year ended December 31, 2007

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Mark Okada	Not applicable	Not applicable
Kurtis Plumer	Not applicable	Not applicable
R. Joseph Dougherty	\$100,001 - \$500,000	\$100,001 - \$500,000
Brad Borud	\$100,001 - \$500,000	\$100,001 - \$500,000

PORTFOLIO TRANSACTIONS AND BROKERAGE

In placing portfolio transactions for each Fund, the Adviser will give primary consideration to securing the most favorable price and efficient execution. Consistent with this policy, the Adviser may consider the financial responsibility, research and investment information and other services provided by brokers or dealers who may effect or be a party to any such transaction or other transactions to which other clients of the Adviser may be a party. Neither the Funds nor the Adviser has adopted a formula for allocation of the Funds' investment transaction business. The Adviser has access to supplemental investment and market research and security and economic analysis provided by brokers who may execute brokerage transactions at a higher cost to each Fund than would otherwise result when allocating brokerage transactions to other brokers on the basis of seeking the most favorable price and efficient execution. The Adviser, therefore, is authorized to place orders for the purchase and sale of securities for each Fund with such brokers, subject to review by each Fund's Board from time to time with respect to the extent and continuation of this practice. The services provided by such brokers may be useful or beneficial to the Adviser in connection with its services to other clients.

On occasions when the Adviser deems the purchase or sale of a security to be in the best interest of each Fund as well as other clients, the Adviser, to the extent permitted by applicable laws and regulations, may, but shall be under no obligation to, aggregate the securities to be so sold or purchased in order to obtain the most favorable price or lower brokerage commissions and efficient execution. In such event, allocation of the securities so purchased or sold, as well as the expenses incurred in the transaction, will be made by the Adviser in the manner it considers to be the most equitable and consistent with its fiduciary obligations to each Fund and to such other clients.

During the fiscal year ended October 31, 2006, High Income Portfolio paid brokerage commissions of \$0, of which \$0 was paid to NexBank Securities, Inc. ("NexBank"), an affiliate of Highland.

During the fiscal year ended October 31, 2007, High Income Portfolio paid brokerage commissions of \$58,124, of which \$55 was paid to NexBank. During the fiscal year ended October 31, 2007, transactions in which High Income Portfolio used NexBank as broker comprised 0.16% of the aggregate dollar amount of transactions involving the payment of commissions, and 0.01% of the aggregate brokerage commissions paid by High Income Portfolio. 100% of the \$58,069 paid to other brokers by High Income Portfolio during the fiscal year ended October 31, 2007 (representing commissions on transactions involving approximately \$13,587,070) was directed to those brokers at least partially on the basis of research services they provided. During the fiscal year ended October 31, 2007, High Income Portfolio acquired securities of the following of its regular brokers or dealers: Credit Suisse, JP Morgan Chase, Morgan Stanley & Co., Inc.,

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Merrill, Lynch, Fenner & Smith, Inc., Bank of America, Lehman Brothers, Deutsche Bank, Goldman Sachs & Co., UBS and Citigroup. At that date, High Income Portfolio did not hold any securities of its regular brokers or dealers.

During the fiscal year ended December 31, 2006, Income Shares paid brokerage commissions of \$0, of which \$0 was paid to NexBank.

During the fiscal year ended December 31, 2007, Income Shares paid brokerage commissions of \$6,423, of which \$0 was paid to NexBank. During the fiscal year ended December 31, 2007, transactions in which Income Shares used

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NexBank as broker comprised 0.00% of the aggregate dollar amount of transactions involving the payment of commissions, and 0.00% of the aggregate brokerage commissions paid by Income Shares. 100% of the \$6,423 paid to other brokers by Income Shares during the fiscal year ended December 31, 2007 (representing commissions on transactions involving approximately \$1,903,090) was directed to those brokers at least partially on the basis of research services they provided. During the fiscal year ended December 31, 2007, Income Shares acquired securities of the following of its regular brokers or dealers: JP Morgan Chase, Bank of America, Morgan Stanley & Co., Inc., Credit Suisse, Merrill, Lynch, Fenner & Smith, Inc., Goldman Sachs & Co., Lehman Brothers, Citigroup, Deutsche Bank and First Union. At that date, Income Shares held the securities of its regular brokers or dealers with an aggregate value as follows: Bank of America, \$2,101,296.

During the fiscal period ended December 31, 2006, Credit Strategies Fund paid brokerage commissions of \$166,787, of which \$1,815 was paid to NexBank.

During the fiscal year ended December 31, 2007, Credit Strategies Fund paid brokerage commissions of \$99,535, of which \$26,414 was paid to NexBank. During the fiscal year ended December 31, 2007, transactions in which Credit Strategies Fund used NexBank as broker comprised 37.02% of the aggregate dollar amount of transactions involving the payment of commissions, and 26.54% of the aggregate brokerage commissions paid by Credit Strategies Fund. 100% of the \$73,121 paid to other brokers by Credit Strategies Fund during the fiscal year ended December 31, 2007 (representing commissions on transactions involving approximately \$67,868,965) was directed to those brokers at least partially on the basis of research services they provided. During the fiscal year ended December 31, 2007, Credit Strategies Fund acquired securities of the following of its regular brokers or dealers: Credit Suisse, Morgan Stanley, JP Morgan Chase, Goldman Sachs & Co., Bank of America, Deutsche Bank, Lehman Brothers, Citigroup, Merrill Lynch and BNP Paribas Securities. At that date, Credit Strategies Fund did not hold any securities of its regular brokers or dealers.

### TAX MATTERS

The following discussion summarizes certain material federal income and excise tax considerations affecting each Fund and the purchase, ownership and disposition of each Fund's common shares by shareholders that are "United States persons" (as defined for federal tax purposes) and hold those shares as capital assets. This discussion is based on current provisions of the Code and the regulations promulgated thereunder and existing judicial decisions and administrative pronouncements, all of which are subject to change or differing interpretations by the courts or the Internal Revenue Service ("IRS"), possibly with retroactive effect. No attempt is made to present a detailed and complete

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explanation of all federal tax concerns affecting the Funds and their shareholders (including shareholders owning large positions in a Fund) in light of their particular circumstances. Prospective investors should consult their own tax advisers with regard to the federal tax consequences of the purchase, ownership or disposition of common shares, as well as the tax consequences arising under the laws of any state, locality, foreign country or other taxing jurisdiction.

THE DISCUSSIONS SET FORTH HEREIN AND IN THE PROXY STATEMENT/PROSPECTUS DO NOT CONSTITUTE TAX ADVICE, AND YOU ARE URGED TO CONSULT YOUR OWN TAX ADVISOR TO DETERMINE THE SPECIFIC FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES TO YOU OF INVESTING IN A FUND AND OWNING OR DISPOSING OF COMMON SHARES THEREOF.

### TAXATION OF EACH FUND

Each Fund has elected to be, and has qualified annually to be treated as, a regulated investment company under Part I of Subchapter M of Chapter 1 of the Code ("RIC"). To continue to qualify as a RIC, each Fund must, among other things, annually meet the following requirements regarding the source of its income and the diversification of its assets:

(i) Each Fund must derive in each taxable year at least 90% of its gross income from the following sources: (a) dividends, interest (including tax-exempt 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 gain from options, futures and forward contracts) derived with respect to its business of investing in such stock, securities or foreign currencies; and (b) net income from an interest in a "qualified publicly traded partnership" (as defined below) ("QPTP") ("Income Requirement"); and

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(ii) Each Fund must diversify its holdings so that, at the end of each quarter of each taxable year, (a) at least 50% of the value of its total assets is represented by cash and cash items, U.S. government securities, the securities of other RICs 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 to not more than 10% of the issuer's outstanding voting securities (equity securities of QPTPs being considered voting securities for these purposes) and (b) not more than 25% of the value of its total assets is invested in (1) the securities (other than U.S. government securities and the securities of other RICs) of any one issuer, (2) the securities (other than the securities of other RICs) of two or more issuers that the Fund controls and are engaged in the same, similar or related trades or businesses or (3) the securities of one or more QPTPs.

A QPTP is defined as a publicly traded partnership (generally, a partnership the interests in which are "traded on an established securities market" or are "readily tradable on a secondary market (or the substantial equivalent thereof)") other than a partnership at least 90% of the gross income of which consists of income that satisfies the Income Requirement.

If a Fund qualifies as a RIC, it generally will not be subject to federal income tax on net income and gains that it distributes to its shareholders, provided that it distributes each taxable year at least the sum of (i) 90% of its investment company taxable income (generally consisting of net investment income, the excess of net short-term capital gain over net long-term capital loss ("short-term capital gain") and net gains and losses from certain foreign currency transactions, if any, reduced by deductible expenses), determined

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without regard to the deduction for dividends paid, plus (ii) 90% of its net tax-exempt interest (the excess of its gross tax-exempt interest over certain disallowed deductions) ("Distribution Requirement"). Each Fund intends to continue to distribute substantially all of such income and its net capital gain (i.e., the excess of net long-term capital gain over net short-term capital loss) each taxable year.

If for any taxable year a Fund does not qualify for treatment as a RIC, all of its taxable income (including its net capital gain) would be subject to tax at regular corporate rates without any deduction for distributions to its shareholders and the shareholders would treat all those distributions, including distributions of net capital gain, as dividends to the extent of the Fund's earnings and profits, taxable as ordinary income (except that, for individual shareholders, the part thereof that is "qualified dividend income" would be subject to federal income tax at the rate for net capital gain -- a maximum of 15%), and those dividends would be eligible for the dividends-received deduction available to corporations under certain circumstances. In addition, such a Fund could be required to recognize unrealized gains, pay substantial taxes and interest and make substantial distributions before requalifying for treatment as a RIC.

Each Fund will be subject to a nondeductible 4% federal excise tax ("Excise Tax") to the extent it fails to distribute by the end of any calendar year at least the sum of (i) 98% of its ordinary income for the calendar year, (ii) 98% of its capital gain net income (i.e., capital gain in excess of its capital loss, adjusted for certain ordinary losses) for a one-year period generally ending on October 31 of the calendar year (unless an election is made to use the Fund's fiscal year) plus (iii) 100% of any retained amount of either from the prior year. While each Fund intends to distribute its income and capital gain in the manner necessary to minimize imposition of the Excise Tax, there can be no assurance that each Fund will be able to do so. In that event, a Fund will be liable for the Excise Tax only on the amount by which it does not meet the foregoing distribution requirement.

The use of hedging strategies, such as writing (selling) and purchasing options and futures contracts and entering into forward contracts, involves complex rules that will determine for income tax purposes the amount, character and timing of recognition of the gains and losses a Fund realizes in connection therewith. Gains from the disposition of foreign currencies (except certain gains that may be excluded by future regulations), and gains from options, futures and forward contracts a Fund derives with respect to its business of investing in securities or foreign currencies, will be treated as qualifying income under the Income Requirement.

Certain of a Fund's investment practices are subject to special and complex federal income tax rules that may, among other things, (i) disallow, suspend or otherwise limit the allowance of certain losses or deductions, (ii) convert lower-taxed long-term capital gain to higher-taxed short-term capital gain or ordinary income, (iii) convert an ordinary loss or a deduction to a capital loss (the deductibility of which is more limited), (iv) cause the Fund to recognize income or gain without a corresponding receipt of cash, (v) adversely affect the time when a purchase or sale of securities is deemed to occur and (vi) adversely

alter the characterization of certain complex financial transactions. Each Fund will monitor its transactions and may make certain tax elections to mitigate the effect of these rules and prevent its disqualification as a RIC.

A Fund may invest in the stock of "passive foreign investment companies" ("PFICs"). A PFIC is any foreign corporation (with certain exceptions) that, in

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general, meets either of the following tests: (i) at least 75% of its gross income for the taxable year is passive or (ii) an average of at least 50% of its assets produce, or are held for the production of, passive income. Under certain circumstances, if a Fund holds stock of a PFIC, it will be subject to federal income tax on a portion of any "excess distribution" the Fund receives on the stock or of any gain on its disposition of the stock (collectively, "PFIC income"), plus interest thereon, even if the Fund distributes the PFIC income as a taxable dividend to its shareholders. (Certain elections may be available to a Fund to avoid such treatment.) The balance of a Fund's PFIC income will be included in the Fund's investment company taxable income and, accordingly, will not be taxable to it to the extent it distributes that income to its shareholders. Fund distributions attributable to PFIC income will not be eligible for the 15% maximum federal income tax rate on qualified dividend income mentioned above.

Interest, dividends and other income a Fund receives, and gains it realizes, on investments outside the United States may be subject to income, withholding and other taxes imposed by foreign countries and U.S. possessions that would reduce the total return on its securities. Tax treaties between the United States and certain other countries may reduce or eliminate such taxes, however, and many foreign countries do not impose taxes on capital gains in respect of investments by foreign investors. The Funds do not expect that any of them will be eligible to elect to treat any foreign taxes it pays as paid by its shareholders, who therefore will not be entitled to credits or deductions for such taxes on their own tax returns.

A Fund may acquire zero coupon or other securities that are issued with original issue discount ("OID"). As a holder of those securities, a Fund must include in its gross income the OID that accrues on them during the taxable year, even if it receives no corresponding payment on them during the year. Similarly, a Fund must include in its gross income securities it receives as "interest" on payment-in-kind securities. Because each Fund annually must distribute substantially all of its investment company taxable income, including any accrued OID and other non-cash income, to satisfy the Distribution Requirement and avoid imposition of the Excise Tax, it may be required in a particular year to distribute as a dividend an amount that is greater than the total amount of cash it actually receives. Those distributions will be made from a Fund's cash assets, from borrowings, or from the proceeds of sales of its portfolio securities, if necessary. A Fund may realize capital gains or losses from those sales, which would increase or decrease its investment company taxable income and/or net capital gain.

### TAXATION OF SHAREHOLDERS

As long as a Fund qualifies for treatment as a RIC, distributions it makes to you from its investment company taxable income will be taxable to you as ordinary income to the extent of its earnings and profits. Each Fund currently expects that most of the dividends it pays will not be eligible for the dividends-received deduction available to corporations or the 15% maximum federal income tax rate on "qualified dividend income" received by individuals. A Fund's distributions to you of net capital gain that it properly designates as such ("capital gain dividends") will be taxable to you as long-term capital gain, regardless of how long you have held the Fund's shares. Capital gain dividends a Fund pays to individuals with respect to net capital gain it recognizes on sales or exchanges of capital assets through October 31, 2011, will be subject to a maximum federal income tax rate of 15%.

A Fund may determine to retain for reinvestment all or part of its net capital gain. If a Fund does so, it may designate all or part of the retained amount as undistributed capital gains in a notice to its shareholders. If a Fund makes such a designation, it would be required to pay federal income tax at the rate of 35% on the undistributed gain ("Fund tax") and each shareholder subject

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to federal income tax (i) would be required to include in income, as long-term capital gain, his or her proportionate share of the designated gain (which would be taxed at the 15% rate mentioned above to the extent the Fund recognizes the designated gain on sales or exchanges of capital assets through December 31, 2010), (ii) would be entitled to credit his or her proportionate share of the Fund tax against his or her federal income tax liability, if any, and to claim a refund to the extent the credit exceeds that liability and (iii) would increase the basis in his or her Fund shares by the difference between the included income and such share of the Fund tax.

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Distributions to you on a Fund's common shares are generally subject to federal income tax as described above, even though those distributions may economically represent a return of your investment. Those distributions are likely to occur on a Fund's common shares purchased when their net asset value includes gains that are either unrealized or realized but not distributed or income that is not distributed. Those realized gains may be required to be distributed even when the common shares' net asset value reflects unrealized losses. A Fund's distributions are taxable to you even if they are paid from income or gains the Fund earned before you invested in its shares (and thus were reflected in the price you paid).

If a Fund makes a distribution to you in excess of its current and accumulated earnings and profits, the excess distribution will be treated as a "return of capital" to the extent of your basis in your Fund shares and thereafter as capital gain. A return of capital is not taxable, but it reduces your basis in your shares, thus reducing any loss or increasing any gain on a subsequent taxable disposition by you of the shares. Current earnings and profits will be, and accumulated earnings and profits may be, treated as first being used to pay distributions on an Acquired Fund's preferred stock, and only the remaining earnings and profits will be treated as being used to pay distributions on its common stock.

Dividends and other taxable distributions on a Fund's common shares are taxable to you even if they are reinvested in additional common shares of the Fund. Dividends and other distributions paid by a Fund are generally treated as received by you at the time the distribution is made. However, a distribution a Fund declares in the last quarter of any calendar year that is payable to shareholders of record on a date in that quarter will be deemed to have been paid by the Fund and received by those shareholders on December 31 of that year if the Fund pays the distribution during the following January. Accordingly, that distribution will be taxed to those shareholders for the taxable year in which that December 31 falls.

The price of common shares purchased at any time may reflect the amount of a forthcoming distribution. If you purchase common shares just prior to a distribution, you will receive a distribution that will be taxable to you even though it represents in part a return of your invested capital.

Each Fund will send you information after the end of each year setting forth the amount and tax status of any distributions it paid to you. Dividends may also be subject to state and local income taxes.

Each Fund generally is required to withhold and remit to the U.S. Treasury 28% (except as noted below) of all distributions (including capital gain dividends) and redemption proceeds, if any, otherwise payable to you (if you are an individual or certain other non-corporate shareholder) if you fail to properly furnish the Fund with a correct taxpayer identification number. Withholding at that rate also is required from all distributions by a Fund otherwise payable to such a shareholder who has under-reported dividend or

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interest income or who fails to certify to the Fund that he or she is not otherwise subject to that withholding (together with the withholding described in the preceding sentence, "backup withholding"). The backup withholding rate will increase to 31% for amounts paid after December 31, 2010, unless Congress enacts legislation providing otherwise. Backup withholding is not an additional tax, and any amounts withheld with respect to you may be credited against your federal income tax liability.

If you sell or otherwise dispose of common shares of a Fund, you will generally recognize a gain or loss in an amount equal to the difference between your basis in those shares and the amount you receive on the disposition. Any such gain or loss on common shares held as capital assets will be long-term capital gain or loss (and thus eligible, in the case of individuals, for the 15% maximum federal income tax rate on net capital gain described above) if you held those shares for more than one year; otherwise, any such gain or loss will be treated as short-term capital gain or loss. Any loss on the sale or exchange of common shares held for six months or less will be treated as long-term capital loss to the extent of any capital gain dividends you received (and amounts credited to you as undistributed capital gain) with respect to those shares. Any loss you realize on a disposition of common shares will be disallowed if you acquire other common shares within a 61-day period beginning 30 days before and ending 30 days after the disposition. In that case, your basis in the newly acquired shares will be adjusted to reflect the disallowed loss.

Dividends a Fund pays to a foreign shareholder, other than (i) dividends paid to a foreign shareholder whose ownership of shares is effectively connected with a U.S. trade or business the shareholder carries on and (ii) capital gain

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dividends paid to a nonresident alien individual who is physically present in the United States for no more than 182 days during the taxable year, generally will be subject to a federal withholding tax of 30% (or lower treaty rate). However, two categories of dividends, "interest-related dividends" and "short-term capital gain dividends," if properly designated by a Fund, will be exempt from that tax. "Interest-related dividends" are dividends that are attributable to "qualified net interest income" ("qualified interest income," which generally consists of certain original issue discount, interest on obligations "in registered form" and interest on deposits, less allocable deductions). "Short-term capital gain dividends" are dividends that are attributable to short-term capital gain, computed with certain adjustments. The exemption from withholding tax will apply to interest-related dividends and short-term capital gain dividends a Fund pays to foreign investors, with certain exceptions, only with respect to its current taxable year (ending October 31, 2008), unless Congress enacts legislation extending its applicability.

### ADDITIONAL INFORMATION

A registration statement on Form N-14, relating to the shares offered by the Prospectus/Proxy Statement (the "Registration Statement"), has been filed by the Acquiring Fund with the SEC. The Proxy Statement/Prospectus and this SAI 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 Acquiring Fund and the such shares, reference is made to the Registration Statement. Statements contained in the Proxy Statement/Prospectus and this SAI 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. A copy 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



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thereof may be obtained from the SEC upon the payment of certain fees prescribed by the SEC.

### PRO FORMA FINANCIAL STATEMENTS

Shown below are the financial statements for Highland Credit Strategies Fund and Prospect Street High Income Portfolio, PRO FORMA Highland Credit Strategies Fund financial statements including the proceeds of its rights offering and pro forma financial statements for the combined Fund. The PRO FORMA Combined Schedule of Investments and the PRO FORMA Combined Statement of Assets and Liabilities have been prepared as though the reorganization had been effective on December 31, 2007. The PRO FORMA Combined Statement of Operations reflects the results of Highland Credit Strategies Fund and Prospect Street High Income Portfolio for the twelve months ended December 31, 2007 as if the reorganization occurred on January 1, 2007.

The first table presents the Schedule of Investments for Highland Credit Strategies Fund and Prospect Street High Income Portfolio and PRO FORMA figures for the combined Fund. The second table presents the Statements of Assets and Liabilities for Highland Credit Strategies Fund and Prospect Street High Income Portfolio, PRO FORMA figures for Highland Credit Strategies Fund including the proceeds of its rights offering, and estimated PRO FORMA figures for the combined Fund. The third table presents the Statements of Operations for Highland Credit Strategies Fund and Prospect Street High Income Portfolio, PRO FORMA figures for Highland Credit Strategies Fund including the proceeds of its rights offering, and estimated PRO FORMA figures for the combined Fund. These tables are followed by the Notes to the PRO FORMA Financial Statements.

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HIGHLAND CREDIT STRATEGIES FUND (HCF) PRINCIPAL AMOUNT (\$)	PROSPECT STREET HIGH INCOME PORTFOLIO (PHY) PRINCIPAL AMOUNT (\$)	PRO FORMA COMBINED HIGHLAND CREDIT STRATEGIES FUND (HCF) PRINCIPAL AMOUNT (\$)	SECURITY
-----			
SENIOR LOANS (a) - 55.5%			
AEROSPACE - AEROSPACE/DEFENSE -			
0.9%			
2,022,750	-	2,022,750	AWAS Capital, Inc. Second Priority Term Loan, 11.25%, 03/15/13
2,969,697	-	2,969,697	IAP Worldwide Services, Inc. First Lien Term Loan, 11.50%, 12/30/12
2,000,000	-	2,000,000	Second Lien Term Loan, 17.00%, 06/30/13
356,888	-	356,888	Travelport LLC Synthetic Letter of Credit, 7.45%, 08/23/13
1,778,654	-	1,778,654	Tranche B Dollar Term Loan, 7.08%, 08/23/13
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AEROSPACE - AIRLINES			
- 1.5%			
8,281,894	-	8,281,894	Delta Airlines, Inc. Term Loan Equipment Notes, 8.63%, 09/29/12

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			Northwest Airlines, Inc.
6,930,000	-	6,930,000	Term Loan, 6.97%, 08/21/13
			US Airways Group, Inc.
	-	500,000	500,000 Term Loan, 7.28%, 03/23/14
AUTOMOBILE - 1.4%			
			Ford Motor Co.
14,850,000	-	14,850,000	Term Loan, 8.70%, 12/15/13
BROADCASTING - 2.4%			
			Bresnan Communications, LLC
	-	1,000,000	1,000,000 Additional Term Loan B, 06/30/13 (e)
			ComCorp Broadcasting, Inc.
622,034	-	622,034	Revolving Loan, 10.84%, 10/02/12 (b) (c)
11,309,712	-	11,309,712	Term Loan, 10.44%, 04/02/13 (b)
			Millennium Digital Media Systems, LLC
9,060,582	-	9,060,582	First Lien Term Loan, 8.98%, 06/30/11
1,238,322	-	1,238,322	Revolver, 8.43%, 06/30/11 (c)
CABLE - US CABLE - 0.2%			
			Charter Communications Operating, LLC
2,000,000	-	2,000,000	New Term Loan, 6.99%, 03/06/14
CHEMICALS - COMMODITY & FERTILIZER - 0.2%			
			Ferro Corp.
1,677,500	-	1,677,500	Term Loan, 7.06%, 06/06/12
CONSUMER DURABLES - 0.3%			
			Rexair LLC
2,559,468	-	2,559,468	First Lien Term Loan, 9.45%, 06/30/10
CONSUMER NON-DURABLES - 0.9%			
			Camelbak Products LLC
1,391,780	-	1,391,780	First Lien Term Loan, 9.18%, 08/04/11
			DS Waters of America, Inc.
1,980,000	-	1,980,000	Term Loan, 7.10%, 10/27/12
			Spectrum Brands, Inc.
4,008,292	-	4,008,292	Dollar Term B Loan, 9.31%, 03/30/13
201,369	-	201,369	Synthetic Letter of Credit, 4.57%, 03/30/13
			VNU Inc./Nielsen Finance LLC
1,970,056	-	1,970,056	Dollar Term Loan, 7.18%, 08/09/13
DIVERSIFIED MEDIA - 4.8%			
			Clarke American Corp.
1,990,000	-	1,990,000	Tranche B Term Loan, 7.70%, 06/30/14
			Endurance Business Media, Inc.
3,000,000	-	3,000,000	Second Lien Term Loan, 12.10%, 01/26/14
			Metro-Goldwyn-Mayer Holdings II, Inc.
10,333,487	-	10,333,487	Tranche B Term Loan, 8.61%, 04/08/12

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2,977,500	-	2,977,500	Tranche B-1 Term Loan, 8.45%, 04/08/12 Penton Media, Inc.
5,000,000	-	5,000,000	Second Lien Term Loan, 9.98%, 02/01/14 Tribune Co.
11,940,000	-	11,940,000	Initial Tranche B Advance, 7.91%, 05/19/14
7,466,667	-	7,466,667	Tranche X Advance, 7.74%, 05/18/09 Univision Communications, Inc.
-	110,738	110,738	Delayed Draw Term Loan, 09/29/14 (c) (e)
-	2,389,262	2,389,262	Initial Term Loan, 09/29/14 (e)
6,000,000	-	6,000,000	Initial Term Loan, 09/29/14 (e)
ENERGY - EXPLORATION & PRODUCTION - 1.1%			
11,262,205	-	11,262,205	ATP Oil & Gas Corp. First Lien Term Loan, 8.48%, 04/14/10
ENERGY - OTHER ENERGY - 0.5%			
218,889	-	218,889	Alon USA Energy, Inc. Edington Facility, 7.10%, 06/22/13
1,751,111	-	1,751,111	Paramount Facility, 7.10%, 06/22/13 Endeavour International Holding B.V.
3,000,000	-	3,000,000	Second Lien Term Loan, 11.91%, 11/01/11
FINANCIAL - 0.5%			
5,000,000	-	5,000,000	Concord Re Ltd. Term Loan, 9.61%, 02/29/12
FOOD/TOBACCO - BEVERAGES & BOTTLING - 0.2%			
1,888,356	-	1,888,356	PBM Holdings, Inc. Term Loan, 7.35%, 09/28/12
FOOD/TOBACCO - RESTAURANTS - 0.2%			
1,970,000	-	1,970,000	Restaurant Co., The Term Loan, 7.62%, 05/09/13
FOREST PRODUCTS - PAPER - 1.1%			
11,000,000	-	11,000,000	Verso Paper Financial Holding LLC Unsecured Loan, 11.16%, 02/01/13
GAMING/LEISURE - GAMING - 1.6%			
6,041,285	-	6,041,285	Drake Hotel Acquisition B Note 1, 12.90%, 04/01/08
10,000,000	-	10,000,000	Fontainebleu Florida Hotel LLC Tranche C Term Loan, 11.11%, 06/06/12
GAMING/LEISURE - OTHER LEISURE - 3.1%			
3,940,000	-	3,940,000	Cedar Fair L.P. US Term Loan, 6.82%, 08/30/12
5,954,660	-	5,954,660	Kuilima Resort Co. First Lien Term Loan, 11.50%, 09/30/10
9,000,000	-	9,000,000	Lake at Las Vegas Joint Venture Additional Term Loan, 12.50%, 01/24/08
2,407,407	-	2,407,407	Synthetic Revolver, 11.96%, 06/20/12 (d)
18,193,575	-	18,193,575	Term Loan, 16.35%, 06/20/12 (d)
1,995,000	-	1,995,000	Orbitz Worldwide, Inc. Term Loan, 7.84%, 07/25/14

HEALTHCARE - ACUTE CARE - 3%

8,795,180	-	8,795,180	Alliance Imaging, Inc. Tranche C Term Loan, 7.52%, 12/29/11
12,870,000	-	12,870,000	HCA, Inc. Tranche B Term Loan, 7.45%, 11/17/13
230,000	-	230,000	National Mentor Holdings, Inc. Institutional Line of Credit Facility, 5.32%, 06/29/13
3,713,450	-	3,713,450	Tranche B Term Loan, 7.20%, 06/29/13
4,500,000	-	4,500,000	Triumph Healthcare Second Holdings LLC Second Lien Term Loan, 12.90%, 07/28/14

HEALTHCARE - ALTERNATE SITE SERVICES - 0.3%

2,984,733	-	2,984,733	LifeCare Holdings Term Loan, 8.20%, 08/11/12
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HEALTHCARE - MEDICAL PRODUCTS - 3%

9,851,731	1,977,349	11,829,080	CCS Medical, Inc. First Lien Term Loan, 8.10%, 09/30/12
3,077,311	-	3,077,311	Danish Holdco A/S Mezzanine Facility, 12.73%, 05/01/17 PIK
2,500,000	-	2,500,000	Second Lien Term Facility D, 8.98%, 11/01/16
4,000,000	-	4,000,000	Golden Gate National Senior Care LLC Second Lien Term Loan, 12.56%, 09/14/11
2,946,052	-	2,946,052	HealthSouth Corp. Term Loan B, 7.75%, 03/11/13
3,500,000	-	3,500,000	Nyco Holdings 3 ApS Facility A, 12/29/13 (e)
1,682,626	-	1,682,626	Warner Chilcott Co., Inc. Tranche B Acquisition Date Term Loan, 7.36%, 01/18/12
578,754	-	578,754	Warner Chilcott Corp. Tranche C Acquisition Date Term Loan, 7.36%, 01/18/12

HOUSING - BUILDING MATERIALS - 2.8%

5,175,258	-	5,175,258	Custom Building Products, Inc. First Lien Term Loan, 6.98%, 10/20/11
1,625,000	-	1,625,000	Second Lien Term Loan, 10.20%, 04/20/12
-	1,574,920	1,574,920	Realogy Corp. Initial Term B Loan, 10/10/13 (e)
-	425,080	425,080	Synthetic Letter of Credit, 10/10/13 (e)
3,960,000	-	3,960,000	Roofing Supply Group LLC First Lien Term Loan, 9.20%, 08/31/13
3,000,000	-	3,000,000	Spirit Finance Corp. Term Loan, 7.91%, 08/01/13
6,000,000	-	6,000,000	WAICCS Las Vegas 3 LLC First Lien Term Loan, 8.19%, 07/30/08
7,000,000	-	7,000,000	Second Lien Term Loan, 14.25%, 07/30/08

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### HOUSING - REAL ESTATE DEVELOPMENT - 4%

			DESA LLC
418,880	-	418,880	Term Loan, 14.25%, 11/26/11
			Ginn LA Conduit Lender, Inc.
2,358,201	-	2,358,201	First Lien Tranche A Credit-Linked Deposit, 5.10%, 06/08/11
5,067,988	-	5,067,988	First Lien Tranche B Term Loan, 8.70%, 06/08/11
			LNR Property Corp.
10,000,000	-	10,000,000	Initial Tranche B Term Loan, 7.63%, 07/12/11
			MPH Mezzanine II, LLC
6,000,000	-	6,000,000	Mezzanine 2B, 8.27%, 02/09/08 (b)
			MPH Mezzanine III, LLC
4,000,000	-	4,000,000	Mezzanine 3, 9.27%, 02/09/08
			November 2005 Land Investors, LLC
2,500,000	-	2,500,000	Second Lien Term Loan, 11.81%, 05/09/12
			Westgate Investments LLC
7,757,893	-	7,757,893	Senior Secured Loan, 13.00%, 09/25/10 (f)
1,740,500	-	1,740,500	Senior Unsecured Loan, 18.00%, 09/25/12
			Weststate Land Partners LLC
	-	2,000,000	2,000,000 Second Lien Term Loan, 13.22%, 05/01/08

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### INFORMATION TECHNOLOGY - 2.8%

			DTN, Inc.
1,990,000	-	1,990,000	First Lien Tranche C Term Loan, 8.18%, 03/10/13
	-	3,840,302	3,840,302 Freescale Semiconductor, Inc.
			Term Loan, 7.33%, 11/29/13
			Infor Enterprise Solutions Holdings, Inc.
2,708,571	-	2,708,571	Delayed Draw Term Loan, 8.95%, 07/28/12
3,000,000	-	3,000,000	Dollar Tranche B-1, Second Lien Term Loan, 10.81%, 03/02/14
5,191,429	-	5,191,429	Initial US Term Facility, 9.11%, 07/28/12
2,566,667	-	2,566,667	Second Lien Delayed Draw Term Loan, 11.45%, 03/02/14
4,433,333	-	4,433,333	Second Lien Term Loan, 11.45%, 03/02/14
			Metrologic Instruments, Inc.
2,000,000	-	2,000,000	Second Lien Term Loan, 11.08%, 12/21/13
			Secure Computing Corp.
1,222,222	-	1,222,222	Term Loan, 8.45%, 08/31/13
			Serena Software, Inc.
1,840,000	-	1,840,000	Term Loan, 7.18%, 03/11/13

### MANUFACTURING - 2.4%

			Acument Global Technologies, Inc.
7,902,475	-	7,902,475	Term Loan, 8.33%, 08/11/13
			CST Industries, Inc.
2,962,500	-	2,962,500	Term Loan, 7.90%, 08/09/13
			Generac Acquisition Corp.
1,666,667	-	1,666,667	Second Lien Term Loan, 11.23%, 05/10/14
			Global Petroleum Inc.
5,900,101	-	5,900,101	Term Loan, 9.49%, 09/18/13

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1,000,000	-	1,000,000	Hunter Defense Technologies, Inc. First Lien Term B Loan, 8.08%, 08/13/14
2,250,000	-	2,250,000	Matinvest 2 SAS / Butterfly Wendal US, Inc. B-2 Facility, 7.40%, 06/22/14
2,250,000	-	2,250,000	C-2 Facility, 7.65%, 06/22/15
1,011,458	-	1,011,458	Matinvest 2 SAS / Deutsche Connector Mezz A USD Facility, 9.33%, 06/22/16

### METALS/MINERALS - OTHER METALS/MINERALS - 1.1%

1,326,316	-	1,326,316	Euramax International Holdings B.V. Second Lien European Loan, 13.36%, 06/29/13
2,753,611	-	2,753,611	Euramax International, Inc. First Lien Domestic Term Loan, 8.24%, 06/29/12
3,673,684	-	3,673,684	Second Lien Domestic Term Loan, 13.24%, 06/29/13
1,518,943	-	1,518,943	Oglebay Norton Co. Tranche B Term Loan, 7.50%, 07/31/12
1,615,602	-	1,615,602	United Central Industrial Supply Co., L.L.C. Term Loan, 7.91%, 03/31/12
1,455,231	-	1,455,231	Universal Buildings Products, Inc. Term Loan, 8.24%, 04/28/12

### RETAIL - 2.8%

2,352,062	-	2,352,062	Blockbuster, Inc. Tranche B Term Loan, 9.43%, 08/20/11
11,680,028	493,530	12,173,558	Burlington Coat Factory Warehouse Corp. Term Loan, 7.32%, 05/28/13
2,962,687	-	2,962,687	CSK Auto, Inc. Term Loan, 8.25%, 06/30/12
7,223,706	-	7,223,706	Home Interiors & Gifts, Inc. Initial Term Loan, 10.36%, 03/31/11
1,970,000	-	1,970,000	Sports Authority, Inc., The Term Loan B, 7.08%, 05/03/13
5,970,149	-	5,970,149	Toys "R" Us Tranche B Term Loan, 9.16%, 07/19/12

### SERVICE - ENVIRONMENTAL SERVICES - 0.8%

1,627,119	-	1,627,119	Safety-Kleen Systems, Inc. Synthetic Letter of Credit, 4.75%, 08/02/13
6,174,915	-	6,174,915	Term Loan B, 7.75%, 08/02/13

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### SERVICE - OTHER SERVICES - 2.1%

3,000,000	-	3,000,000	Cydcor, Inc. Second Lien Term Loan, 11.30%, 01/30/14
2,912,289	-	2,912,289	Education Management LLC Tranche C Term Loan, 6.63%, 06/01/13
7,765,705	-	7,765,705	NES Rentals Holdings, Inc. Second Lien Permanent Term Loan, 12.13%, 07/20/13

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			Sabre, Inc.
4,859,038	-	4,859,038	Initial Term Loan, 6.96%, 09/30/14
			Survey Sampling International LLC
1,315,028	-	1,315,028	Term Loan, 7.33%, 05/06/11
			United Rentals, Inc.
1,633,916	-	1,633,916	Initial Term Loan, 7.11%, 02/14/11
309,692	-	309,692	Tranche B Credit-Linked Deposit, 5.43%, 02/14/11
TELECOMMUNICATIONS - 1.1%			
			American Messaging Services, Inc.
2,300,901	-	2,300,901	Senior Secured Note, 11.38%, 09/03/08
			PaeTec Communications, Inc.
4,177,367	-	4,177,367	Initial Term Loan, 7.35%, 02/05/13
			Sorenson Communications, Inc.
1,824,792	-	1,824,792	Tranche C Term Loan, 8.00%, 02/28/13
			Stratos Global Corp./Stratos Funding LP
1,225,000	-	1,225,000	Term B Facility, 7.59%, 02/13/12
			Time Warner Telecom Holdings Inc.
990,000	-	990,000	Term Loan B, 6.85%, 01/07/13
TRANSPORTATION - AUTO - 2.1%			
			BST Safety Textiles Acquisition GMBH
2,662,000	-	2,662,000	Second Lien Facility, 12.49%, 06/30/09
			Dana Corp.
3,000,000	-	3,000,000	DIP Term Loan, 7.36%, 04/13/08
			Delphi Corp.
5,000,000	-	5,000,000	Tranche C Term Loan, 8.94%, 12/31/08
			Lear Corp.
4,940,090	-	4,940,090	First Lien Term Loan B, 7.79%, 04/25/12
			Motor Coach Industries International, Inc.
5,752,270	-	5,752,270	Second Lien Term Loan, 13.64%, 12/01/08
TRANSPORTATION - LAND - 0.6%			
			New Century Transportation, Inc.
1,973,842	-	1,973,842	Term Loan B, 8.08%, 08/14/12
			SIRVA Worldwide, Inc.
831,429	-	831,429	Revolver, 12.43%, 12/01/08 (c)
17,143	-	17,143	Revolver, 12.38%, 12/01/08 (c)
6,008,774	-	6,008,774	Tranche B Term Loan, 12.50%, 12/01/10
UTILITIES - 3.3%			
			ANP Funding I, LLC
4,888,889	-	4,888,889	Tranche A Term Loan, 8.73%, 07/29/10
			Calpine Construction Finance Company, L.P.
-	5,508	5,508	First Lien Term Loan, 11.34%, 08/26/09
			Coletto Creek Power, LP
5,465,915	-	5,465,915	First Lien Term Loan, 7.95%, 06/28/13
4,925,000	-	4,925,000	Second Lien Term Loan, 8.83%, 06/28/13
382,166	-	382,166	Synthetic Facility, 5.10%, 06/28/13
			Entegra TC LLC
6,198,643	-	6,198,643	Third Lien Term Loan, 11.20%, 04/19/14
			GBGH LLC (U S Energy)
5,128,912	-	5,128,912	First Lien Term Loan, 14.25%, 08/07/13

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5,478,811 - 5,478,811 Second Lien Term Loan, 7.89%, 08/07/14

WIRELESS - CELLULAR/PCS - 1.3%

1,970,000	-	1,970,000	Cricket Communications, Inc. Term Loan B, 7.83%, 06/16/13
8,000,000	-	8,000,000	Insight Midwest Holdings, LLC Term Loan B, 7.00%, 04/07/14
3,000,000	-	3,000,000	Level 3 Financing, Inc. New Term Loan, 7.49%, 03/13/14

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WIRELESS COMMUNICATIONS - 1%

9,975,000	-	9,975,000	Clearwire Corp. Term Loan, 11.15%, 07/03/12
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TOTAL SENIOR LOANS

FOREIGN DENOMINATED SENIOR LOANS

(a) - 10.3%

AUSTRALIA - 2%

AUD

22,940,476	-	22,940,476	Seven Media Group Facility A Term Loan, 12/22/13
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FRANCE - 2.1%

EUR

2,012,048	-	2,012,048	Ypso Holding SA Eur B Acq 1 Facility, 7.43%, 06/15/14
3,282,814	-	3,282,814	Eur B Acq 2 Facility, 7.43%, 06/15/14
5,213,674	-	5,213,674	Eur B Recap 1 Facility, 7.43%, 06/15/14
1,389,750	-	1,389,750	Eur C Acq Facility, 7.68%, 12/31/15
2,610,250	-	2,610,250	Eur C Recap Facility, 7.68%, 12/31/15

NETHERLANDS - 1%

EUR

2,500,000	-	2,500,000	Amsterdamse Beheer- En Consultingmaatschappij B.V. Casema Kabelcom B Term Loan, 6.67%, 09/12/14
2,500,000	-	2,500,000	Kabelcom C Term Loan, 7.17%, 09/12/15
1,500,000	-	1,500,000	Kabelcom D Term Loan Second Lien, 8.41%, 03/12/16

SWEDEN - 0.5%

SEK

15,333,333	-	15,333,333	Nordic Cable Acquisition Co., Sub-Holding AB Facility B2, 6.67%, 01/31/14
14,666,667	-	14,666,667	Facility C2, 6.79%, 01/31/15



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UNITED KINGDOM - 1.1%  
GBP

			Mobileserv Ltd.
2,764,925	-	2,764,925	Facility B , 8.82%, 09/22/14
3,250,000	-	3,250,000	Facility C, 9.32%, 09/22/15

TOTAL FOREIGN DENOMINATED SENIOR LOANS

ASSET-BACKED SECURITIES (g) - 0.5%

			Commercial Industrial Finance Corp.
1,000,000	-	1,000,000	Series 2006-1BA, Class B2L, 8.88%, 12/22/20
			Marquette US/European CLO, PLC
1,000,000	-	1,000,000	Series 2006-1A, Class D1, 6.99%, 07/15/20 (h)
			Ocean Trails CLO
1,000,000	-	1,000,000	Series 2006-1A, Class D, 9.00%, 10/12/20 (h)
			Venture CDO, Ltd.
2,000,000	-	2,000,000	Series 2007-9A, Class D, 9.27%, 10/12/21 (h)
			Westbrook CLO, Ltd.
1,000,000	-	1,000,000	Series 2006-1A, Class D, 6.63%, 12/20/20 (h)

TOTAL ASSET-BACKED SECURITIES

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FOREIGN ASSET-BACKED SECURITIES (g) - 0.6%

IRELAND - 0.6%  
EUR

			Static Loan Funding
2,000,000	-	2,000,000	Series 2007-1X, Class D, 07/31/17
2,000,000	-	2,000,000	Series 2007-1X, Class E, 07/31/17

TOTAL FOREIGN ASSET-BACKED SECURITIES

CORPORATE NOTES AND BONDS - 29.8%

AEROSPACE - AIRLINES - 0.2%

			Delta Airlines, Inc.
5,000,000	-	5,000,000	8.00%, 06/30/23 (d)
-	4,000,000	4,000,000	8.30%, 08/11/20 (d) (1)
			Northwest Airlines, Inc.
	-	1,899,659	1,899,659 Series 2002-1, Class C2, 9.06%, 05/20/12
	-	1,500,000	1,500,000 8.88%, 12/30/27 (d) (1)

BROADCASTING - 1%

			Univision Communications, Inc.
6,000,000	2,960,000	8,960,000	9.75%, 03/15/15 PIK (h)
	-	2,000,000	2,000,000 Young Broadcasting, Inc.
			10.00%, 03/01/11

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CABLE - US CABLE - 1.7%

			CCH I Holdings LLC
1,250,000	-	1,250,000	9.92%, 04/01/14
3,375,000	-	3,375,000	10.00%, 05/15/14
2,500,000	-	2,500,000	11.75%, 05/15/14
			CCH I LLC
8,358,000	4,861,000	13,219,000	11.00%, 10/01/15
			Charter Communications, Inc., Convertible
2,634,000	-	2,634,000	6.50%, 10/01/27

CONSUMER NON-DURABLES - 2.8%

			Ames True Temper, Inc.
3,000,000	2,000,000	5,000,000	9.24%, 01/15/12 (g)
1,500,000	1,375,000	2,875,000	10.00%, 07/15/12 (l)
			Outsourcing Services Group, Inc.
-	801,760	801,760	9.00%, 03/01/09 PIK (b)
			Spectrum Brands, Inc.
-	2,000,000	2,000,000	11.50%, 10/02/13 PIK (g) (l)
-	2,450,000	2,450,000	7.38%, 02/01/15 (l)
			Solo Cup Co.
11,875,000	8,300,000	20,175,000	8.50%, 02/15/14 (l)

DIVERSIFIED MEDIA - 0.6%

			Network Communications, Inc.
4,500,000	1,500,000	6,000,000	10.75%, 12/01/13

ELECTRONICS - 0.1%

			WII Components, Inc.
-	1,000,000	1,000,000	10.00%, 02/15/12

ENERGY - EXPLORATION & PRODUCTION - 0.2%

			McMoran Exploration Co.
-	1,800,000	1,800,000	11.88%, 11/15/14
			Opti Canada, Inc.
375,000	-	375,000	8.25%, 12/15/14 (h)

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ENERGY - OTHER ENERGY - 1.1%

			Energy XXI Gulf Coast, Inc.
6,000,000	1,750,000	7,750,000	10.00%, 06/15/13
			Helix Energy Solutions
2,000,000	1,100,000	3,100,000	9.50%, 01/15/16 (h)

FINANCIAL - 2.1%

			HUB International Holdings, Inc.
14,200,000	7,000,000	21,200,000	10.25%, 06/15/15 (h)
			Penhall International, Corp.
2,000,000	-	2,000,000	12.00%, 08/01/14 (h)

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FOOD AND DRUG - 0.1%				
441,291	-	441,291	Cinacalcet Royalty Sub LLC	8.00%, 03/30/17
FOOD/TOBACCO - 1.7%				
3,000,000	5,300,000	8,300,000	Chiquita Brands International, Inc.	7.50%, 11/01/14
5,000,000	-	5,000,000		8.88%, 12/01/15
	500,000	500,000	Land O' Lakes Capital Trust I	7.45%, 03/15/28 (h)
	500,000	500,000	Pinnacle Foods Group Inc.	9.25%, 04/01/15 (h)
	2,000,000	2,000,000		10.63%, 04/01/17 (h) (l)
	975,000	975,000	Select Medical Corporation	7.63%, 02/01/15
	1,162,000	1,162,000		11.26%, 09/15/15 (g) (l)
FOREST PRODUCTS - CONTAINERS - 0%				
	279,321	279,321	NewPage Corporation	11.82%, 11/01/13 PIK (g)
GAMING/LEISURE - OTHER LEISURE - 2%				
4,081,000	2,267,000	6,348,000	Six Flags, Inc.	4.50%, 05/15/15
4,500,000	2,000,000	6,500,000		8.88%, 02/01/10 (l)
6,525,000	8,000,000	14,525,000	Tropicana Entertainment LLC	9.63%, 12/15/14 (h) (l)
HEALTHCARE - ACUTE CARE - 3.1%				
9,803,340	3,640,494	13,443,834	Argatroban Royalty Sub LLC	18.50%, 09/21/14
	1,794,000	1,794,000	Eszopiclone Royalty Sub LLC	12.00%, 06/30/14
10,000,000	-	10,000,000	HCA, Inc.	6.30%, 10/01/12
	500,000	500,000		7.50%, 11/15/49
	500,000	500,000		7.69%, 06/15/25
3,000,000	-	3,000,000		8.36%, 04/15/24
	2,000,000	2,000,000	Risperidone Royalty Sub LLC	7.00%, 01/01/18
HEALTHCARE - ALTERNATE SITE SERVICES - 0.3%				
5,000,000	-	5,000,000	LifeCare Holdings	9.25%, 08/15/13
HOUSING - BUILDING MATERIALS - 2.2%				
	1,767,000	1,767,000	Associated Materials, Inc.	0.00%, 03/01/14 (l) (m)
4,000,000	250,000	4,250,000	Masonite Corp.	11.00%, 04/06/15 (l)
8,000,000	5,000,000	13,000,000	Realogy Corp.	10.50%, 04/15/14 (h) (l)
5,500,000	-	5,500,000		11.00%, 04/15/14 PIK (h)
4,000,000	570,000	4,570,000		12.38%, 04/15/15 (h) (l)

INFORMATION TECHNOLOGY - 2.7%

			Charys Holding Co., Inc.
-	2,500,000	2,500,000	8.75%, 02/16/12 (h)
			Freescale Semiconductor, Inc.
3,800,000	-	3,800,000	10.13%, 12/15/16
-	2,000,000	2,000,000	8.87%, 12/15/14 (g)
			MagnaChip Semiconductor
8,000,000	6,500,000	14,500,000	8.24%, 12/15/11 (g)
			NXP BV/NXP Funding LLC
2,000,000	-	2,000,000	7.99%, 10/15/13 (g)
			Spansion LLC
5,000,000	-	5,000,000	11.25%, 01/15/16 (h)

RETAIL - 2.6%

			Blockbuster, Inc.
11,500,000	8,000,000	19,500,000	9.00%, 09/01/12 (l)
			Dollar General Corp.
5,500,000	3,250,000	8,750,000	10.63%, 07/15/15 (h) (l)

TELECOMMUNICATIONS - 2.5%

			Digicel Group, Ltd.
12,454,260	6,537,854	18,992,114	9.13%, 01/15/15 PIK (h) (l)
-	2,000,000	2,000,000	14.00%, 04/01/11
			Intelsat Bermuda, Ltd.
-	4,500,000	4,500,000	11.25%, 06/15/16 (h)

TRANSPORTATION - 1.8%

			American Tire Distributors Holdings, Inc.
5,000,000	3,500,000	8,500,000	11.48%, 04/01/12 (g)
			Delphi Corp.
2,933,000	-	2,933,000	6.55%, 06/15/06 (d)
7,834,000	-	7,834,000	7.13%, 05/01/29 (d)
1,200,000	417,000	1,617,000	6.50%, 05/01/09 (d) (l)
200,000	-	200,000	6.50%, 08/15/13 (d)
			Federal-Mogul Corp.
1,579,000	-	1,579,000	7.50%, 01/15/09 (d)
1,000,000	-	1,000,000	7.75%, 07/01/06 (d)
			Motor Coach Industries International, Inc.
-	1,000,000	1,000,000	11.25%, 05/01/09
			Nordic Telephone Company Holdings
-	500,000	500,000	8.88%, 05/01/16 (h)

UTILITIES - 0%

			Enron Corp.
1,000,000	-	1,000,000	6.63%, 11/15/05 (d) (i)

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				USGen New England, Inc.
	-	56,303	56,303	01/02/15 (d) (h)
WIRELESS COMMUNICATIONS - 1.2%				
				SunCom Wireless Holdings, Inc.
	5,000,000	6,000,000	11,000,000	8.50%, 06/01/13
TOTAL CORPORATE NOTES AND BONDS				
CLAIMS - 0.1%				
AEROSPACE - AIRLINES - 0.1%				
				Delta Airlines, Inc.
	581,794	-	581,794	Delta ALPA Claim, 12/31/10 (d)
				Northwest Airlines, Inc.
	2,000,000	600,000	2,600,000	ALPA Trade Claim, 08/21/13 (d)
	3,551,000	1,065,300	4,616,300	Flight Attendant Claim, 08/21/13 (d)
	2,107,500	632,250	2,739,750	IAM Trade Claim, 08/21/13 (d)
	2,341,500	702,450	3,043,950	Retiree Claim, 08/21/13 (d)
TOTAL CLAIMS				
COMMON STOCKS - 6.9%				
AEROSPACE - AIRLINES - 1%				
	199,342	91,819	291,161	Delta Air Lines, Inc. (j)
	253,611	113,554	367,165	Northwest Airlines Corp. (j)
BROADCASTING - 0.4%				
	357,343	-	357,343	Gray Television, Inc.
	121,072	-	121,072	Gray Television, Inc., Class A
	-	1,184	1,184	Time Warner Cable, Inc. (j)
CONSUMER NON-DURABLES - 0%				
	-	24,015	24,015	Outsourcing Services Group, Inc. (b) (j)
DIVERSIFIED MEDIA - 0.1%				
	-	46,601	46,601	American Banknote Corp. (j)
FINANCIAL - 0%				
	-	555,258	555,258	Altiva Financial Corp. (j)
FOREST PRODUCTS - CONTAINERS - 0.4%				
	563,258	-	563,258	Graphic Packaging Corp. (j)
	100,067	-	100,067	Louisiana-Pacific Corp.
HOUSING - BUILDING MATERIALS - 0.3%				

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	150,285	-		150,285	
			Owens Corning, Inc. (j)		
HOUSING - REAL ESTATE DEVELOPMENT - 0%					
	8	-		8	Westgate Investments LLC (b)
INFORMATION TECHNOLOGY - 0%					
	-	303		303	Viatel Holding Bermuda, Ltd. (j)
SERVICE - ENVIRONMENTAL SERVICES - 0.3%					
	136,990	-		136,990	Safety-Kleen Systems, Inc. (j)
TELECOMMUNICATIONS - 0.5%					
	753,981	-		753,981	Communications Corp. of America (b) (j)
	-	232		232	Knology, Inc. (j)
TRANSPORTATION - 0.2%					
	1,544,148	-		1,544,148	Delphi Corp. (j)
	58,949	-		58,949	Federal-Mogul Corp., Class A (j)
UTILITIES - 0.5%					
	81,194	-		81,194	Entegra TC LLC
	59,600	-		59,600	NRG Energy, Inc. (j)
WIRELESS COMMUNICATIONS - 3.2%					
	225,000	853,905		1,078,905	ICO Global Communications Holding Ltd. (j) (1)
	1,037,196	-		1,037,196	SunCom Wireless Holdings, Inc., Class A (j)
TOTAL COMMON STOCKS					
WARRANTS - 0.0%					
	20,000	-		20,000	Clearwire Corp., expires 08/15/10 (j)
	-	5,000		5,000	XM Satellite Radio, Inc., expires 03/05/10 (j)
TOTAL WARRANTS					
TOTAL INVESTMENTS - 135.0%					

Investments sold short  
outstanding as of December 31,  
2007:

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HIGHLAND CREDIT STRATEGIES FUND (HCF)	PROSPECT STREET HIGH INCOME PORTFOLIO (PHY)	PRO FORMA COMBINED HIGHLAND CREDIT STRATEGIES FUND (HCF)	SECURITY	HIGHLAND CREDIT STRATEGIES FUND (HCF)
# OF SHARES	# OF SHARES	# OF SHARES		VALUE (\$)
19,593	-	19,593	Superior Industries International, Inc.	116,578
51,587	-	51,587	IndyMac Bancorp, Inc.	937,336

Forward foreign currency contracts outstanding as of December 31, 2007 were as follows:

CONTRACTS TO BUY OR TO SELL	CURRENCY	HIGHLAND CREDIT STRATEGIES FUND (HCF)	PROSPECT STREET HIGH INCOME PORTFOLIO (PHY)	PRO FORMA COMBINED HIGHLAND CREDIT STRATEGIES FUND (HCF)
		PRINCIPAL AMOUNT COVERED BY CONTRACTS	PRINCIPAL AMOUNT COVERED BY CONTRACTS	PRINCIPAL AMOUNT COVERED BY CONTRACTS
Sell	AUD	4,000,000	0	4,000,000
Sell	AUD	5,400,000	0	5,400,000
Sell	AUD	2,700,000	0	2,700,000
Sell	EUR	11,000,000	0	11,000,000
Sell	EUR	4,900,000	0	4,900,000
Sell	EUR	5,100,000	0	5,100,000
Sell	GBP	4,000,000	0	4,000,000
Sell	GBP	500,000	0	500,000
Sell	GBP	500,000	0	500,000

EXPIRATION	HIGHLAND CREDIT STRATEGIES FUND (HCF)	PROSPECT STREET HIGH INCOME PORTFOLIO (PHY)	PRO FORMA COMBINED HIGHLAND CREDIT STRATEGIES FUND (HCF)
	NET UNREALIZED APPRECIATION/ (DEPRECIATION)	NET UNREALIZED APPRECIATION/ (DEPRECIATION)	NET UNREALIZED APPRECIATION/ (DEPRECIATION)
02/28/2008	(\$236,992)	0	(\$236,992)
02/29/2008	-353,149	0	(\$353,149)
03/11/2008	-147,955	0	(\$147,955)
02/04/2008	-940,067	0	(\$940,067)
05/29/2008	108,967	0	\$108,967
05/30/2008	54,955	0	\$54,955
02/07/2008	169,210	0	\$169,210
05/29/2008	36,435	0	\$36,435
05/30/2008	33,338	0	\$33,338

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- (a) Senior loans in which the Fund invests generally pay interest at rates which are periodic by reference to a base lending rate plus a premium. (Unless otherwise identified by Note ( loans carry a variable rate interest.) These base lending rates are generally (i) the Prim one or more major United States banks, (ii) the lending rate offered by one or more Europe the London Inter-Bank Offered Rate ("LIBOR") or (iii) the Certificate of Deposit rate. Rat represents the weighted average rate at December 31, 2007. Senior loans, while exempt from under the Security Act of 1933, as amended (the "1933 Act"), contain certain restrictions cannot be sold publicly. Senior secured floating rate loans often require prepayments from or permit the borrower to repay at its election. The degree to which borrowers repay, whet contractual requirement or at their election, cannot be predicted with accuracy. As a resu remaining maturity may be substantially less than the stated maturities shown.
- (b) Represents fair value as determined in good faith under the direction of the Board.
- (c) Senior Loan Notes have additional unfunded loan commitments.
- (d) The issuer is in default of certain debt covenants. Income is not being accrued.
- (e) All or a portion of this position has not settled. Contract rates do not take effect until
- (f) Fixed Rate Senior Loan.
- (g) Floating rate security. The interest rate shown reflects the rate in effect at December 31
- (h) Securities exempt from registration pursuant to Rule 144A under the 1933 Act. These securi resold, in transactions exempt from registration, to qualified institutional buyers. Thes been determined by the Adviser to be liquid securities.
- (i) This issuer is under the protection of the U.S. federal bankruptcy court.
- (j) Non-income producing security.
- (l) Securities (or a portion of securities) on loan as of December 31, 2007.
- (m) Step Coupon. A bond that pays an initial coupon rate for the first period and then a highe the following periods until maturity.

AUD Australia Dollar  
 DIP Debtor in Possession  
 EUR Euro Currency  
 GBP Great Britian Pound  
 PIK Payment in Kind  
 SEK Swedish Krona

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STATEMENT OF ASSETS AND LIABILITIES

PRO FORMA COMBINED STATEMENT OF ASSETS AND LIABILITIES FOR HIGHLAND CREDIT STRATEGIES FUND AND PROSPECT STREET HIGH INCOME PORTFOLIO INC. AS OF DECEMBER 31, 2007 (UNAUDITED)

	HIGHLAND CREDIT STRATEGIES FUND (HCF)	RIGHTS OFFERING PRO FORMA ADJUSTMENTS	PRO FORMA INCLUDING RIGHTS OFFERING HIGHLAND CREDIT STRATEGIES FUND (HCF)	PROSPECT STREET HIGH INCOME PORTFOLIO (PHY)
	-----	-----	-----	-----
Assets:				
Investments, at value	838,189,541		838,189,541	131,681,117
Cash	2,837,166	143,563,458[3]	146,400,624	3,954,306
Restricted Cash	39,261,591		39,261,591	-
Net unrealized appreciation on forward currency				



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contracts	402,905		402,905	-
Receivable for:				
Investments Sold	22,028,985		22,028,985	2,180,241
Swap agreements	1,054,833		1,054,833	-
Dividends and interest receivables	13,150,972		13,150,972	2,526,024
Other assets	41,483		41,483	80,287
	<hr/>	<hr/>	<hr/>	<hr/>
Total assets	916,967,476	143,563,458	1,060,530,934	140,421,974
	<hr/>	<hr/>	<hr/>	<hr/>
LIABILITIES:				
Note payable	248,000,000		248,000,000	-
Securities sold short, at value	1,053,914		1,053,914	-
Net discount and unrealized depreciation on unfunded transactions	1,556,736		1,556,736	-
Net unrealized depreciation on forward currency contracts	1,678,163		1,678,163	-
Net unrealized depreciation on credit default swaps	29,158		29,158	-
Net unrealized depreciation on total return swaps	6,341,169		6,341,169	-
Payables for:				
Distributions	5,178,082		5,178,082	-
Investments purchased	29,734,707		29,734,707	3,841,806
Investment advisory fee payable	748,663		748,663	76,695
Preferred dividend payable	-		-	34,262
Administration fee	149,733		149,733	6,482
Interest Expense	1,278,012		1,278,012	-
Accrued expenses and other liabilities	140,978		140,978	105,414
	<hr/>	<hr/>	<hr/>	<hr/>
Total liabilities	295,889,315	-	295,889,315	4,064,658
	<hr/>	<hr/>	<hr/>	<hr/>
AUCTION RATE PREFERRED STOCK	-	-	-	40,000,000 [4]
NET ASSETS APPLICABLE TO COMMON SHARES:	621,078,161		764,641,619	96,357,317
COMPOSITION OF NET ASSETS:				
Par value of common shares	34,521	11,536 [3]	46,057	926,241
Paid-in capital in excess of par value of common shares	657,755,847	143,551,922 [3]	801,307,769	116,809,414
Undistributed net investment income	7,645,585		7,645,585	1,935,367
Accumulated net realized gain/(loss) from investments, swaps and foreign currency transactions	10,712,407		10,712,407	16,912
Net unrealized appreciation/ (depreciation) on investments, unfunded transactions, short				

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positions, forward currency contracts, swaps and translation of assets and liabilities denominated in foreign currency	(55,070,199)		(55,070,199)	(23,330,617)
NET ASSETS APPLICABLE TO COMMON SHARES	621,078,161	143,563,458	764,641,619	96,357,317
COMMON SHARES				
Net Assets	621,078,161		764,641,619	96,357,317
Shares outstanding (unlimited authorization)	34,520,550		46,056,165	30,874,699
Net asset value per share (net assets/ shares outstanding)	17.99		16.60	3.12

[1] Reflects adjustments for estimated reorganization expenses of \$561,950.

[2] Reflects adjustments to the number of shares outstanding due to the reorganization

[3] Reflects the proceeds received from the rights offering that closed on January 28, 2008

[4] Auction Rate Preferred Stock (1,000,000 shares authorized, and 1,600 shares issued at \$25,000)  
See Notes to Pro Forma Combined Financial Statements

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STATEMENT OF OPERATIONS

PRO FORMA COMBINED STATEMENT OF OPERATIONS FOR HIGHLAND CREDIT  
STRATEGIES FUND AND PROSPECT STREET HIGH INCOME PORTFOLIO INC.  
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2007 (UNAUDITED)

	HIGHLAND CREDIT STRATEGIES FUND (HCF)	RIGHTS OFFERING PRO FORMA ADJUSTMENTS (f)	PRO FORMA INCLUDING RIGHTS OFFERING HIGHLAND CREDIT STRATEGIES FUND (HCF)	PROSPECT STREET HIGH INCOME PORTFOLIO (PHY)
	-----	-----	-----	-----
INVESTMENT INCOME:				
Interest	85,031,062		85,031,062	12,132,742
Accretion of bond discount	-		-	678,083
Dividends	1,826,564		1,826,564	-
Securities lending income	7,479		7,479	163,872
Total investment income	86,865,105	-	86,865,105	12,974,697
EXPENSES:				
Investment advisory fees	9,368,976	1,967,689	11,336,665	947,447
Administration fees	1,873,796	393,538	2,267,334	33,406
Accounting service fees	449,908	38,470	488,378	33,406

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Transfer agent fees	34,147	-	34,147	29,371
Professional fees	332,701	-	332,701	64,245
Trustees' fees	32,295	-	32,295	46,036
Custodian fees	118,582	24,905	143,487	13,640
Registration fees	37,005	-	37,005	29,746
Preferred shares broker expense	-	-	-	102,437
Reports to shareholders	113,710	23,882	137,592	40,216
Other Expenses	413,714	19,696	433,410	82,223
	-----	-----	-----	-----
NET OPERATING EXPENSES	12,774,834	2,468,180	15,243,014	1,422,173
	-----	-----	-----	-----
Interest Expense	14,759,102		14,759,102	14,204
Dividends on securities sold short	226,480		226,480	-
	-----	-----	-----	-----
TOTAL EXPENSES	27,760,416	2,468,180	30,228,596	1,436,377
	-----	-----	-----	-----
Less: Fee waiver	-	-	-	-
	-----	-----	-----	-----
NET EXPENSE	27,760,416	2,468,180	30,228,596	1,436,377
	-----	-----	-----	-----
NET INVESTMENT INCOME	59,104,689	(2,468,180)	56,636,509	11,538,320
	-----	-----	-----	-----
NET REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS:				
Net realized gain/(loss) on investments	17,716,313		17,716,313	3,680,385
Net realized gain/(loss) on swaps	877,812		877,812	-
Net realized gain/(loss) on foreign currency transactions	(988,007)		(988,007)	76,789
Net change in unrealized appreciation/(depreciation) on investments	(72,891,311)		(72,891,311)	(14,923,803)
Net change in unrealized appreciation/(depreciation) on unfunded transactions	(1,205,082)		(1,205,082)	-
Net change in unrealized appreciation/(depreciation) on short positions	324,633		324,633	-
Net change in unrealized appreciation/(depreciation) on forward currency contracts	(1,275,258)		(1,275,258)	-
Net change in unrealized appreciation/(depreciation) on swaps	(6,370,327)		(6,370,327)	-
Net change in unrealized appreciation/(depreciation) on translation of assets and liabilities denominated in foreign currency	(55,214)		(55,214)	73,767
	-----	-----	-----	-----

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NET REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS	(63,866,441)	-	(63,866,441)	(11,092,863)
Distributions to Preferred Shareholders	-	-	-	(2,149,833)
NET (DECREASE)/INCREASE IN NET ASSETS, APPLICABLE TO COMMON SHAREHOLDERS, FROM OPERATIONS	(4,761,752)	(2,468,180)	(7,229,932)	(1,704,376)

See Notes to Pro Forma Combined Financial Statements

- (a) On historical financial statements the administration fee has included both accounting and administrative services payable to third party service providers.
- (b) Reflects the increase in the advisory fee due to the higher advisory fee of HCF relative to PHY and a higher administration fee for HCF relative to PHY.
- (c) Reflects the elimination of duplicative expenses and economies of scale due to the proposed merger.
- (d) Reflects the redemption of the preferred shares outstanding prior to the reorganization and thus elimination of related expenses.
- (e) Reflects the contractual fee waiver implemented upon shareholder approval of the reorganization.
- (f) Reflects adjustments due to proceeds received from the rights offering that closed on January 28, 2008.
- (g) Reflects adjustments due to incurring interest expense via a credit facility versus distributions to preferred shares.

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### PROSPECT STREET HIGH INCOME PORTFOLIO INC. MERGER WITH AND INTO HIGHLAND CREDIT STRATEGIES FUND

#### NOTES TO PRO FORMA COMBINED FINANCIAL STATEMENTS (UNAUDITED)

##### 1. BASIS OF COMBINATION:

The accompanying unaudited Pro Forma Combined Statement of Assets and Liabilities, the Pro Forma Combined Schedule of Investments at December 31, 2007 and the related Pro Forma Combined Statement of Operations ("Pro Forma Statements") for the twelve months ended December 31, 2007, reflect the accounts of Prospect Street High Income Portfolio Inc. ("Acquired Fund") and Highland Credit Strategies Fund ("Acquiring Fund"), each a "Fund." Following the reorganization, Highland Credit Strategies Fund will be the accounting survivor. The Pro Forma Statements assume the preferred shares of the Acquired Fund were redeemed prior the reorganization and a corresponding amount was borrowed under the credit facility of the Acquiring Fund. For the Acquiring Fund an adjustment has been made to the Pro Forma Statements to reflect the proceeds received from the rights offering that closed on January 28, 2008.

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Under the terms of the Agreement and Plan of Reorganization, the Reorganization is intended to qualify as a "reorganization" within the meaning of Section 368(a)(1) of the Internal Revenue Code of 1986, as amended. If the Reorganization so qualifies, in general, stockholders of the Acquired Fund will recognize no gain or loss upon the receipt solely of shares of the Acquiring Fund in connection with the Reorganization. Additionally, the Acquired Fund will recognize no gain or loss as a result of the Reorganization. Neither the Acquiring Fund nor its shareholders will recognize any gain or loss in connection with the Reorganization. However, stockholders of the Acquired Fund may recognize gain or loss with respect to cash such holders receive pursuant to the Agreement and Plan of Reorganization in lieu of fractional shares. The reorganization would be accomplished by an acquisition of the net assets of the Acquired Fund in exchange for shares of the Acquiring Fund at net asset value. The unaudited Pro Forma Combined Schedule of Investments and the unaudited Pro Forma Combined Statement of Assets and Liabilities have been prepared as though the combination had been effective on December 31, 2007. The unaudited Pro Forma Combined Statement of Operations reflects the results of the Funds for the twelve months ended December 31, 2007 as if the merger occurred on January 1, 2007. These pro forma statements have been derived from the books and records of the Funds utilized in calculating daily net asset values at the dates indicated above in conformity with U.S. generally accepted accounting principles. The historical cost of investment securities will be carried forward to the surviving entity. The fiscal year ends are October 31 for the Prospect Street High Income Portfolio Inc. and December 31 for the Highland Credit Strategies Fund. The Pro Forma Combined Financial Statements should be read in conjunction with the historical financial statements of each Fund, which are incorporated by reference in the Statement of Additional Information.

### 2. USE OF ESTIMATES:

The preparation of financial statements in conformity with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### 3. INVESTMENT VALUATION:

In computing the Fund's net assets attributable to Common Shares, securities with readily available market quotations use those quotations for valuation. When portfolio securities are traded on the relevant day of valuation, the valuation will be the last reported sale price on that day. If there are no such sales on that day, the security will be valued at the mean between the most recently quoted bid and asked prices provided by the principal market makers. If there is more than one such principal market maker, the value shall be the average of such means. Securities without a sale price or quotations from principal market makers on the valuation day will be valued by an independent pricing service. If securities do not have readily available market quotations or pricing service prices, including circumstances under which such are determined not to be accurate or current (including when events materially affect the value of securities occurring between the time when market price is determined and calculation of the Fund's net asset value), such

securities are valued at their fair value, as determined by Highland Capital Management, L.P. in good faith in accordance with procedures approved by the Fund's Board of Trustees. In these cases, the Fund's net asset value will reflect the affected portfolio securities' value as determined in the judgment of the Board of Trustees or its designee instead of being determined by the market. Using a fair value pricing methodology to value securities may result in

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a value that is different from a security's most recent sale price and from the prices used by other investment companies to calculate their net asset values. There can be no assurance that the Fund's valuation of a security will not differ from the amount that it realizes upon the sale of such security. Short-term investments, that is, those with a remaining maturity of 60 days or less, are valued at amortized cost. Repurchase agreements are valued at cost plus accrued interest. Foreign price quotations are converted to U.S. dollar equivalents using the 4 PM London Time Spot Rate.

#### 4. CAPITAL SHARES:

The unaudited pro forma net asset values per share assumes additional shares of capital stock of the Acquiring Fund were issued in connection with the proposed acquisition of the Acquired Fund as of December 31, 2007. The number of additional shares issued was calculated by dividing the net asset value of each class of the Acquired Fund by the respective class net asset value per share of the Acquiring Fund.

#### 5. PRO FORMA OPERATIONS:

In the Pro Forma Combined Statement of Operations certain expenses have been adjusted to reflect the expected expenses of the combined entity. The pro forma investment management fees of the combined entity are based on the fee schedules in effect for the Acquiring Fund's combined level of average net assets for the twelve months ended December 31, 2007.

#### 6. FEDERAL INCOME TAXES:

It is the policy of the Funds to comply with the federal income and excise tax requirements of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies. Accordingly, the Funds intend to distribute substantially all of their net investment income and net realized gains on investments, if any, to their shareholders. Therefore, no federal income tax provision is required.

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### APPENDIX A

#### RATINGS OF INVESTMENTS

Standard & Poor's--A brief description of the applicable rating symbols of Standard & Poor's and their meanings (as published by Standard & Poor's) follows:

#### 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

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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, are considered short-term. 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.

### LONG-TERM ISSUE CREDIT RATINGS

Issue credit ratings are based, in varying degrees, on the following considerations:

- o 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;
- o Nature of and provisions of the obligation; and
- o 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.

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.

### 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.

### A-1

### AA

An obligation rated "AA" differs from the highest-rated obligations only to a 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

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a weakened capacity of the obligor to meet its financial commitment on the obligation.

BB, B, CCC, CC, and C

Obligations rated "BB", "B", "CCC", "CC", and "C" are regarded as having significant speculative characteristics. "BB" indicates the least degree of speculation and "C" the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

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.

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.

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

A-2

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.

PLUS (+) OR MINUS (--)



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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.

NR

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.

### SHORT-TERM ISSUE CREDIT RATINGS

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.

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. Ratings of "B-1", "B-2", and "B-3" may be assigned to indicate finer distinctions within the "B" category. 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.

B-1

A short-term obligation rated "B-1" is regarded as having significant speculative characteristics, but the obligor has a relatively stronger capacity to meet its financial commitments over the short-term compared to other speculative-grade obligors.

B-2

A short-term obligation rated "B-2" is regarded as having significant speculative characteristics, and the obligor has an average speculative-grade capacity to meet its financial commitments over the short-term compared to other speculative-grade obligors.

A-3

B-3

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A short-term obligation rated "B-3" is regarded as having significant speculative characteristics, and the obligor has a relatively weaker capacity to meet its financial commitments over the short-term compared to other speculative-grade obligors.

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.

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.

ACTIVE QUALIFIERS (CURRENTLY APPLIED AND/OR OUTSTANDING)

i

This subscript is used for issues in which the credit factors, terms, or both, that determine the likelihood of receipt of payment of interest are different from the credit factors, terms or both that determine the likelihood of receipt of principal on the obligation. The "i" subscript indicates that the rating addresses the interest portion of the obligation only. The "i" subscript will always be used in conjunction with the "p" subscript, which addresses likelihood of receipt of principal. For example, a rated obligation could be assigned ratings of "AAAp NRi" indicating that the principal portion is rated "AAA" and the interest portion of the obligation is not rated.

L

Ratings qualified with "L" apply only to amounts invested up to federal deposit insurance limits.

P

This subscript is used for issues in which the credit factors, the terms, or both, that determine the likelihood of receipt of payment of principal are different from the credit factors, terms or both that determine the likelihood of receipt of interest on the obligation. The "p" subscript indicates that the rating addresses the principal portion of the obligation only. The "p" subscript will always be used in conjunction with the "i" subscript, which addresses likelihood of receipt of interest. For example, a rated obligation could be assigned ratings of "AAAp N.R.i" indicating that the principal portion is rated "AAA" and the interest portion of the obligation is not rated.

pi

Ratings with a "pi" subscript are based on an analysis of an issuer's published financial information, as well as additional information in the public domain. They do not, however, reflect in-depth meetings with an issuer's management and are therefore based on less comprehensive information than ratings without a "pi" subscript. Ratings with a "pi" subscript are reviewed annually based on a new year's financial statements, but may be reviewed on an interim basis if a major event occurs that may affect the issuer's credit quality.

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pr

The letters "pr" indicate that the rating is provisional. A provisional rating assumes the successful completion of the project financed by the debt being rated and indicates that payment of debt service requirements is largely or entirely dependent upon the successful, 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

A-4

upon failure of such completion. The investor should exercise his own judgment with respect to such likelihood and risk.

### PRELIMINARY

Preliminary ratings are assigned to issues, including financial programs, in the following circumstances.

- o Preliminary ratings may be assigned to obligations, most commonly structured and project finance issues, pending receipt of final documentation and legal opinions. Assignment of a final rating is conditional on the receipt and approval by Standard & Poor's of appropriate documentation. Changes in the information provided to Standard & Poor's could result in the assignment of a different rating. In addition, Standard & Poor's reserves the right not to issue a final rating.
- o Preliminary ratings are assigned to Rule 415 Shelf Registrations. As specific issues, with defined terms, are offered from the master registration, a final rating may be assigned to them in accordance with Standard & Poor's policies. The final rating may differ from the preliminary rating.

t

This symbol indicates termination structures that are designed to honor their contracts to full maturity or, should certain events occur, to terminate and cash settle all their contracts before their final maturity date.

### INACTIVE QUALIFIERS (NO LONGER APPLIED OR OUTSTANDING)

\*

This symbol indicated continuance of the ratings is contingent upon Standard & Poor's receipt of an executed copy of the escrow agreement or closing documentation confirming investments and cash flows. Discontinued use in August 1998.

c

This qualifier was used to provide additional information to investors that the bank may terminate its obligation to purchase tendered bonds if the long-term credit rating of the issuer is below an investment-grade level and/or the issuer's bonds are deemed taxable. Discontinued use in January 2001.

q

A "q" subscript indicates that the rating is based solely on quantitative analysis of publicly available information. Discontinued use in April 2001.

r

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The "r" modifier was assigned to securities containing extraordinary risks, particularly market risks, that are not covered in the credit rating. The absence of an "r" modifier should not be taken as an indication that an obligation will not exhibit extraordinary non-credit related risks. Standard & Poor's discontinued the use of the "r" modifier for most obligations in June 2000 and for the balance of obligations (mainly structured finance transactions) in November 2002.

A-5

MOODY'S INVESTORS SERVICE, INC.--A brief description of the applicable Moody's rating symbols and their meanings (as published by Moody's) follows:

### LONG-TERM OBLIGATION RATINGS

Moody's long-term obligation ratings are opinions of the relative credit risk of a fixed income obligations with an original maturity of one year or more. They address the possibility that a financial obligation will not be honored as promised. Such ratings reflect both the likelihood of default and any financial loss suffered in the event of default.

### MOODY'S LONG-TERM RATING DEFINITIONS:

#### Aaa

Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.

#### Aa

Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.

#### A

Obligations rated A are considered upper medium-grade and are subject to low credit risk.

#### Baa

Obligations rated Baa are subject to moderate credit risk. They are considered medium-grade and as such may possess certain speculative characteristics.

#### Ba

Obligations rated Ba are judged to have speculative elements and are subject to substantial credit risk.

#### B

Obligations rated B are considered speculative and are subject to high credit risk.

#### Caa

Obligations rated Caa are judged to be of poor standing and are subject to very high credit risk.

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Ca

Obligations rated Ca are highly speculative and are likely in, or very near, default, with some prospect of recovery of principal and interest.

C

Obligations rated C are the lowest rated class of bonds and are typically in default, with little prospect for recovery of principal or interest.

NOTE: Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa through Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category.

A-6

### MEDIUM-TERM NOTE RATINGS

Moody's assigns long-term ratings to individual debt securities issued from medium-term note (MTN) programs, in addition to indicating ratings to MTN programs themselves. Notes issued under MTN programs with such indicated ratings are rated at issuance at the rating applicable to all pari passu notes issued under the same program, at the program's relevant indicated rating, provided such notes do not exhibit any of the characteristics listed below:

- o Notes containing features that link interest or principal to the credit performance of any third party or parties (i.e., credit-linked notes);
- o Notes allowing for negative coupons, or negative principal
- o Notes containing any provision that could obligate the investor to make any additional payments
- o Notes containing provisions that subordinate the claim.

For notes with any of these characteristics, the rating of the individual note may differ from the indicated rating of the program.

For credit-linked securities, Moody's policy is to "look through" to the credit risk of the underlying obligor. Moody's policy with respect to non-credit linked obligations is to rate the issuer's ability to meet the contract as stated, regardless of potential losses to investors as a result of non-credit developments. In other words, as long as the obligation has debt standing in the event of bankruptcy, we will assign the appropriate debt class level rating to the instrument.

Market participants must determine whether any particular note is rated, and if so, at what rating level. Moody's encourages market participants to contact Moody's Ratings Desks or visit [www.moody.com](http://www.moody.com) directly if they have questions regarding ratings for specific notes issued under a medium-term note program. Unrated notes issued under an MTN program may be assigned an NR (not rated) symbol.

### SHORT-TERM RATINGS:

Moody's short-term ratings are opinions of the ability of issuers to honor short-term financial obligations. Ratings may be assigned to issuers, short-term programs or to individual short-term debt instruments. Such obligations

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generally have an original maturity not exceeding thirteen months, unless explicitly noted.

Moody's employs the following designations to indicate the relative repayment ability of rated issuers:

P-1

Issuers (or supporting institutions) rated Prime-1 have a superior ability to repay short-term debt obligations.

P-2

Issuers (or supporting institutions) rated Prime-2 have a strong ability to repay short-term debt obligations.

P-3

Issuers (or supporting institutions) rated Prime-3 have an acceptable ability to repay short-term obligations.

NP

Issuers (or supporting institutions) rated Not Prime do not fall within any of the Prime rating categories.

A-7

NOTE: Canadian issuers rated P-1 or P-2 have their short-term ratings enhanced by the senior most long-term rating of the issuer, its guarantor or support provider.

A-8

### APPENDIX B

#### HIGHLAND CAPITAL MANAGEMENT, L.P. PROXY VOTING POLICY

#### 1. Application; General Principles

1.1 This proxy voting policy (the "Policy") applies to securities held in Client accounts as to which the above-captioned investment adviser (the "Company") has voting authority, directly or indirectly. Indirect voting authority exists where the Company's voting authority is implied by a general delegation of investment authority without reservation of proxy voting authority.

1.2 The Company shall vote proxies in respect of securities owned by or on behalf of a Client in the Client's best economic interests and without regard to the interests of the Company or any other Client of the Company.

#### 2. Voting; Procedures

2.1 MONITORING. A settlement designee of the Company shall have responsibility for monitoring portfolios managed by the Company for securities subject to a proxy vote. Upon the receipt of a proxy notice related to a security held in a portfolio managed by the Company, the settlement designee shall forward all relevant information to the portfolio manager(s) with

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responsibility for the security.

### 2.2 Voting.

2.2.1. Upon receipt of notice from the settlement designee, the portfolio manager(s) with responsibility for purchasing the security subject to a proxy vote shall evaluate the subject matter of the proxy and cause the proxy to be voted on behalf of the Client. In determining how to vote a particular proxy, the portfolio manager (s) shall consider, among other things, the interests of each Client account as it relates to the subject matter of the proxy, any potential conflict of interest the Company may have in voting the proxy on behalf of the Client and the procedures set forth in this Policy.

2.2.2 If a proxy relates to a security held in a registered investment company or business development company ("Retail Fund") portfolio, the portfolio manager(s) shall notify the Compliance Department and a designee from the Retail Funds group. Proxies for securities held in the Retail Funds will be voted by the designee from the Retail Funds group in a manner consistent with the best interests of the applicable Retail Fund and a record of each vote will be reported to the Retail Fund's Board of Directors in accordance with the procedures set forth in Section 4 of this Policy.

2.3 CONFLICTS OF INTEREST. If the portfolio manager(s) determine that the Company may have a potential material conflict of interest (as defined in Section 3 of this Policy) in voting a particular proxy, the portfolio manager(s) shall contact the Company's Compliance Department prior to causing the proxy to be voted.

2.3.1. For a security held by a Retail Fund, the Company shall disclose the conflict and the determination of the manner in which it proposes to vote to the Retail Fund's Board of Directors. The Company's determination shall take into account only the interests of the Retail Fund, and the Compliance Department shall document the basis for the decision and furnish the documentation to the Board of Directors.

2.3.2. For a security held by an unregistered investment company, such as a hedge fund and structured products ("Non-Retail Funds"), where a material conflict of interest has been identified the Company may resolve the conflict by following the recommendation of a disinterested third party or by abstaining from voting.

B-1

2.4 NON-VOTES. The Company may determine not to vote proxies in respect of securities of any issuer if it determines it would be in its Client's overall best interests not to vote. Such determination may apply in respect of all Client holdings of the securities or only certain specified Clients, as the Company deems appropriate under the circumstances. As examples, the portfolio manager(s) may determine: (a) not to recall securities on loan if, in its judgment, the negative consequences to Clients of disrupting the securities lending program would outweigh the benefits of voting in the particular instance or (b) not to vote certain foreign securities positions if, in its judgment, the expense and administrative inconvenience outweighs the benefits to Clients of voting the securities.

2.5 RECORDKEEPING. Following the submission of a proxy vote, the applicable portfolio manager(s) shall submit a report of the vote to a settlement designee of the Company. Records of proxy votes by the Company shall be maintained in accordance with Section 4 of this Policy.

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2.6 CERTIFICATION. On a quarterly basis, each portfolio manager shall certify to the Compliance Department that they have complied with this Policy in connection with proxy votes during the period.

### 3. Conflicts of Interest

3.1 Voting the securities of an issuer where the following relationships or circumstances exist are deemed to give rise to a material conflict of interest for purposes of this Policy:

3.1.1 The issuer is a Client of the Company accounting for more than 5% of the Company's annual revenues.

3.1.2 The issuer is an entity that reasonably could be expected to pay the Company more than \$1 million through the end of the Company's next two full fiscal years.

3.1.3 The issuer is an entity in which a "Covered Person" (as defined in the Retail Funds' and the Company's Policies and Procedures Designed to Detect and Prevent Insider Trading and to Comply with Rule 17j-1 of the Investment Company Act of 1940, as amended (each, a "Code of Ethics")) has a beneficial interest contrary to the position held by the Company on behalf of Clients.

3.1.4 The issuer is an entity in which an officer or partner of the Company or a relative(1) of any such person is or was an officer, director or employee, or such person or relative otherwise has received more than \$150,000 in fees, compensation and other payment from the issuer during the Company's last three fiscal years; provided, however, that the Compliance Department may deem such a relationship not to be a material conflict of interest if the Company representative serves as an officer or director of the issuer at the direction of the Company for purposes of seeking control over the issuer.

3.1.5 The matter under consideration could reasonably be expected to result in a material financial benefit to the Company through the end of the Company's next two full fiscal years (for example, a vote to increase an investment advisory fee for a Retail Fund advised by the Company or an affiliate).

3.1.6 Another Client or prospective Client of the Company, directly or indirectly, conditions future engagement of the Company on voting proxies in respect of any Client's securities on a particular matter in a particular way.

3.1.7 The Company holds various classes and types of equity and debt securities of the same issuer contemporaneously in different Client portfolios.

3.1.8 Any other circumstance where the Company's duty to serve its Clients' interests, typically referred to as its "duty of loyalty," could be compromised.

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(1) For the purposes of this Policy, "relative" includes the following family members: spouse, minor children or stepchildren or children or stepchildren sharing the person's home.



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3.2 Notwithstanding the foregoing, a conflict of interest described in Section 3.1 shall not be considered material for the purposes of this Policy in respect of a specific vote or circumstance if:

3.2.1 The securities in respect of which the Company has the power to vote account for less than 1% of the issuer's outstanding voting securities, but only if: (i) such securities do not represent one of the 10 largest holdings of such issuer's outstanding voting securities and (ii) such securities do not represent more than 2% of the Client's holdings with the Company.

3.2.2 The matter to be voted on relates to a restructuring of the terms of existing securities or the issuance of new securities or a similar matter arising out of the holding of securities, other than common equity, in the context of a bankruptcy or threatened bankruptcy of the issuer.

### 4. Recordkeeping and Retention

4.1 The Company shall retain records relating to the voting of proxies, including:

4.1.1 Copies of this Policy and any amendments thereto.

4.1.2 A copy of each proxy statement that the Company receives regarding Client securities.

4.1.3 Records of each vote cast by the Company on behalf of Clients.

4.1.4 A copy of any documents created by the Company that were material to making a decision how to vote or that memorializes the basis for that decision.

4.1.5 A copy of each written request for information on how the Company voted proxies on behalf of the Client, and a copy of any written response by the Company to any (oral or written) request for information on how the Company voted.

4.2 These records shall be maintained and preserved in an easily accessible place for a period of not less than five years from the end of the Company's fiscal year during which the last entry was made in the records, the first two years in an appropriate office of the Company.

4.3 The Company may rely on proxy statements filed on the SEC's EDGAR system or on proxy statements and records of votes cast by the Company maintained by a third party, such as a proxy voting service (provided the Company had obtained an undertaking from the third party to provide a copy of the proxy statement or record promptly on request).

4.4 Records relating to the voting of proxies for securities held by the Retail Funds will be reported periodically to the Retail Funds' Boards of Directors/Trustees/Managers and, with respect to Retail Funds other than business development companies, to the SEC on an annual basis pursuant to Form N-PX.

Revised: February 22, 2007

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B-3

PROSPECT STREET (R)  
HIGH INCOME PORTFOLIO INC.

Using a BLACK INK pen, mark your votes with an X as shown in this example. /x/  
Please do not write outside the designated areas.

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ANNUAL MEETING PROXY CARD COMMON SHARES  
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PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE  
ENCLOSED ENVELOPE.

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A. PROPOSALS - THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSAL 1 AND FOR  
THE NOMINEE LISTED.

1. To approve an Agreement and Plan of Reorganization between Prospect Street High Income Portfolio Inc. and Highland Credit Strategies Fund, as more fully described in the proxy statement.	FOR / /	AGAINST / /	ABSTAIN / /
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2. Nominee: 01 - Mr. Scott F. Kavanaugh	FOR / /	WITHHOLD / /
--	------------	-----------------

3. In their discretion, on such matters as may properly come before  
the Annual Meeting and any Adjournment Thereof.

B. NON-VOTING ITEMS

CHANGE OF ADDRESS -- Please print new address below.

COMMENTS -- Please print your

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C. AUTHORIZED SIGNATURES -- THIS SECTION MUST BE COMPLETED FOR YOUR VOTE TO BE  
COUNTED. -- DATE AND SIGN BELOW

Please sign exactly as names appear on this proxy. If shares are held jointly,  
each holder should sign. If signing as an attorney, trustee, executor,  
administrator, custodian, guardian or corporate officer, please give full title.

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Date (mm/dd/yyyy) -- Please print  
date below.

Signature 1 -- Please keep  
signature within the box.

Signature 2  
signature wi

/ /

PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE  
ENCLOSED ENVELOPE.

PROXY -- PROSPECT STREET(R) HIGH INCOME PORTFOLIO INC.

ANNUAL MEETING OF STOCKHOLDERS -- JUNE 6, 2008 COMMON STOCK PROXY SOLICITED ON  
BEHALF OF BOARD OF DIRECTORS

The undersigned holder of shares of Common Stock of Prospect Street (R) High  
Income Portfolio Inc., a Maryland corporation ("PHY"), hereby appoints Mark K.  
Okada, Michael Colvin and M. Jason Blackburn, and each of them, with full power  
of substitution and revocation, as proxies to represent the undersigned at the  
Annual Meeting of Stockholders of PHY to be held at Galleria Tower I, 13355 Noel  
Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6,  
2008, at 8:00 a.m. Central Time, and at any and all adjournments thereof (the  
"Annual Meeting"), and thereat to vote all Common Stock of PHY which the  
undersigned would be entitled to vote, with all powers the undersigned would  
possess if personally present, in accordance with the instructions on this  
proxy.

THIS PROXY IS SOLICITED BY PHY'S BOARD OF DIRECTORS AND WILL BE VOTED FOR THE  
PROPOSALS UNLESS OTHERWISE INDICATED. BY SIGNING THIS PROXY CARD, RECEIPT OF THE  
ACCOMPANYING NOTICE OF ANNUAL MEETING AND COMBINED PROXY STATEMENT AND  
PROSPECTUS IS ACKNOWLEDGED.

PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED  
ENVELOPE.

PROSPECT STREET(R)  
HIGH INCOME PORTFOLIO INC.

Using a BLACK INK pen, mark your votes with an X as shown in this example. /x/  
Please do not write outside the designated areas.

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ANNUAL MEETING PROXY CARD

PREFERRED SHARES

PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

A. PROPOSALS - THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSAL 1 AND FOR THE NOMINEE LISTED.

1. To approve an Agreement and Plan of Reorganization between Prospect Street High Income Portfolio Inc. and Highland Credit Strategies Fund, as more fully described in the proxy statement.	FOR / /	AGAINST / /	ABSTAIN / /
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2. Nominee: 01 - Mr. Timothy K. Hui	FOR / /	WITHHOLD / /
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3. In their discretion, on such matters as may properly come before the Annual Meeting and any adjournment thereof.

B. NON-VOTING ITEMS

CHANGE OF ADDRESS -- Please print new address below.

COMMENTS -- Please print your

C. AUTHORIZED SIGNATURES -- THIS SECTION MUST BE COMPLETED FOR YOUR VOTE TO BE COUNTED. -- DATE AND SIGN BELOW

Please sign exactly as names appear on this proxy. If shares are held jointly, each holder should sign. If signing as an attorney, trustee, executor, administrator, custodian, guardian or corporate officer, please give full title.

Date (mm/dd/yyyy) -- Please print date below.

Signature 1 -- Please keep signature within the box.

Signature 2 -- Please keep signature within the box.

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PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE

Edgar Filing: Highland Credit Strategies Fund - Form N-14 8C/A

ENCLOSED ENVELOPE.

PROXY -- PROSPECT STREET(R) HIGH INCOME PORTFOLIO INC.

ANNUAL MEETING OF STOCKHOLDERS -- JUNE 6, 2008 PREFERRED STOCK PROXY SOLICITED ON BEHALF OF BOARD OF DIRECTORS

The undersigned holder of shares of Preferred Stock of Prospect Street(R) High Income Portfolio Inc., a Maryland corporation ("PHY"), hereby appoints Mark K. Okada, Michael Colvin and M. Jason Blackburn, and each of them, with full power of substitution and revocation, as proxies to represent the undersigned at the Annual Meeting of Stockholders of PHY to be held at Galleria Tower I, 13355 Noel Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6, 2008, at 8:00 a.m. Central Time, and at any and all adjournments thereof (the "Annual Meeting"), and thereat to vote all Preferred Shares of PHY which the undersigned would be entitled to vote, with all powers the undersigned would possess if personally present, in accordance with the instructions on this proxy.

THIS PROXY IS SOLICITED BY PHY'S BOARD OF DIRECTORS AND WILL BE VOTED FOR THE PROPOSALS UNLESS OTHERWISE INDICATED. BY SIGNING THIS PROXY CARD, RECEIPT OF THE ACCOMPANYING NOTICE OF ANNUAL MEETING AND COMBINED PROXY STATEMENT AND PROSPECTUS IS ACKNOWLEDGED.

PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.

PROSPECT STREET(R) INCOME SHARES INC.

Using a BLACK INK pen, mark your votes with an X as shown in this example. /x/ Please do not write outside the designated areas.

ANNUAL MEETING PROXY CARD COMMON SHARES

PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

A. PROPOSALS - THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSAL 1 AND FOR THE NOMINEE LISTED.

1. To approve an Agreement and Plan of Reorganization between Prospect Street High Income Portfolio Inc. and Highland Credit Strategies	FOR	AGAINST	ABSTAIN
	/ /	/ /	/ /

Edgar Filing: Highland Credit Strategies Fund - Form N-14 8C/A

Fund, as more fully described in the proxy statement.

2. Nominee: 01 - Mr. R. Joseph Dougherty FOR WITHHOLD / / / /

3. In their discretion, on such matters as may properly come before the Annual Meeting and any adjournment thereof.

B. NON-VOTING ITEMS

CHANGE OF ADDRESS -- Please print new address below.

COMMENTS -- Please print your

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C. AUTHORIZED SIGNATURES -- THIS SECTION MUST BE COMPLETED FOR YOUR VOTE TO BE COUNTED. -- DATE AND SIGN BELOW

Please sign exactly as names appear on this proxy. If shares are held jointly, each holder should sign. If signing as an attorney, trustee, executor, administrator, custodian, guardian or corporate officer, please give full title.

Date (mm/dd/yyyy) -- Please print date below.

Signature 1 -- Please keep signature within the box.

Signature 2 signature wi

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PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

PROXY -- PROSPECT STREET(R) INCOME SHARES INC.

ANNUAL MEETING OF STOCKHOLDERS -- JUNE 6, 2008 COMMON STOCK PROXY SOLICITED ON BEHALF OF BOARD OF DIRECTORS

The undersigned holder of shares of Common Stock of Prospect Street (R) Income Shares Inc., a Maryland corporation ("CNN"), hereby appoints Mark K. Okada, Michael Colvin and M. Jason Blackburn, and each of them, with full power of substitution and revocation, as proxies to represent the undersigned at the Annual Meeting of Stockholders of CNN to be held at Galleria Tower I, 13355 Noel Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6, 2008, at 8:00 a.m. Central Time, and at any and all adjournments thereof (the "Annual Meeting"), and thereat to vote all Common Stock of CNN which the

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undersigned would be entitled to vote, with all powers the undersigned would possess if personally present, in accordance with the instructions on this proxy.

THIS PROXY IS SOLICITED BY CNN'S BOARD OF DIRECTORS AND WILL BE VOTED FOR THE PROPOSALS UNLESS OTHERWISE INDICATED. BY SIGNING THIS PROXY CARD, RECEIPT OF THE ACCOMPANYING NOTICE OF ANNUAL MEETING AND COMBINED PROXY STATEMENT AND PROSPECTUS IS ACKNOWLEDGED.

PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.

PROSPECT STREET(R) INCOME  
SHARES INC.

Using a BLACK INK pen, mark your votes with an X as shown in this example. /x/  
Please do not write outside the designated areas.

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ANNUAL MEETING PROXY CARD PREFERRED SHARES  
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PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.  
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A. PROPOSALS - THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSAL 1 AND FOR THE NOMINEE LISTED.

1. To approve an Agreement and Plan of Reorganization between Prospect Street High Income Portfolio Inc. and Highland Credit Strategies Fund, as more fully described in the proxy statement.	FOR / /	AGAINST / /	ABSTAIN / /
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2. Nominee: 01 - Mr. R. Joseph Dougherty	FOR / /	WITHHOLD / /
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3. In their discretion, on such matters as may properly come before the Annual Meeting and any adjournment thereof.

B. NON-VOTING ITEMS

CHANGE OF ADDRESS -- Please print new address below.  
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COMMENTS -- Please print your  
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C. AUTHORIZED SIGNATURES -- THIS SECTION MUST BE COMPLETED FOR YOUR VOTE TO BE COUNTED. -- DATE AND SIGN BELOW

Please sign exactly as names appear on this proxy. If shares are held jointly, each holder should sign. If signing as an attorney, trustee, executor, administrator, custodian, guardian or corporate officer, please give full title.

Date (mm/dd/yyyy) -- Please print date below.

Signature 1 -- Please keep signature within the box.

Signature 2  
signature wi

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PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.

PROXY -- PROSPECT STREET(R) INCOME SHARES INC.

ANNUAL MEETING OF STOCKHOLDERS -- JUNE 6, 2008 PREFERRED STOCK PROXY SOLICITED ON BEHALF OF BOARD OF DIRECTORS

The undersigned holder of shares of Preferred Stock of Prospect Street(R) Income Shares Inc., a Maryland corporation ("CNN"), hereby appoints Mark K. Okada, Michael Colvin and M. Jason Blackburn, and each of them, with full power of substitution and revocation, as proxies to represent the undersigned at the Annual Meeting of Stockholders of CNN to be held at Galleria Tower I, 13355 Noel Road, Suite 275 - The Chicago Room, Dallas, Texas 75240, on Friday, June 6, 2008, at 8:00 a.m. Central Time, and at any and all adjournments thereof (the "Annual Meeting"), and thereat to vote all Preferred Shares of CNN which the undersigned would be entitled to vote, with all powers the undersigned would possess if personally present, in accordance with the instructions on this proxy.

THIS PROXY IS SOLICITED BY CNN'S BOARD OF DIRECTORS AND WILL BE VOTED FOR THE PROPOSALS UNLESS OTHERWISE INDICATED. BY SIGNING THIS PROXY CARD, RECEIPT OF THE ACCOMPANYING NOTICE OF ANNUAL MEETING AND COMBINED PROXY STATEMENT AND PROSPECTUS IS ACKNOWLEDGED.

PLEASE VOTE, DATE AND SIGN ON REVERSE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.

PART C



## Edgar Filing: Highland Credit Strategies Fund - Form N-14 8C/A

### OTHER INFORMATION

#### ITEM 15. INDEMNIFICATION

Article V of the Registrant's Agreement and Declaration of Trust provides as follows:

5.1 No Personal Liability of Shareholders, Trustees, etc. No Shareholder of the Trust shall be subject in such capacity to any personal liability whatsoever to any Person in connection with Trust Property or the acts, obligations or affairs of the Trust. Shareholders shall have the same limitation of personal liability as is extended to stockholders of a private corporation for profit incorporated under the Delaware General Corporation Law. No trustee or officer of the Trust shall be subject in such capacity to any personal liability whatsoever to any Person, save only liability to the Trust or its Shareholders arising from bad faith, willful misfeasance, gross negligence or reckless disregard for his duty to such Person; and, subject to the foregoing exception, all such Persons shall look solely to the Trust Property for satisfaction of claims of any nature arising in connection with the affairs of the Trust. If any Shareholder, trustee or officer, as such, of the Trust, is made a party to any suit or proceeding to enforce any such liability, subject to the foregoing exception, he shall not, on account thereof, be held to any personal liability. Any repeal or modification of this Section 5.1 shall not adversely affect any right or protection of a trustee or officer of the Trust existing at the time of such repeal or modification with respect to acts or omissions occurring prior to such repeal or modification.

5.2 Mandatory Indemnification. (a) The Trust hereby agrees to indemnify each person who at any time serves as a trustee or officer of the Trust (each such person being an "indemnitee") against any liabilities and expenses, including amounts paid in satisfaction of judgments, in compromise or as fines and penalties, and reasonable counsel fees reasonably incurred by such indemnitee in connection with the defense or disposition of any action, suit or other proceeding, whether civil or criminal, before any court or administrative or investigative body in which he may be or may have been involved as a party or otherwise or with which he may be or may have been threatened, while acting in any capacity set forth in this Article V by reason of his having acted in any such capacity, except with respect to any matter as to which he shall not have acted in good faith in the reasonable belief that his action was in the best interest of the Trust or, in the case of any criminal proceeding, as to which he shall have had reasonable cause to believe that the conduct was unlawful, provided, however, that no indemnitee shall be indemnified hereunder against any liability to any person or any expense of such indemnitee arising by reason of (i) willful misfeasance, (ii) bad faith, (iii) gross negligence, or (iv) reckless disregard of the duties involved in the conduct of his position (the conduct referred to in such clauses (i) through (iv) being sometimes referred to herein as "disabling conduct"). Notwithstanding the foregoing, with respect to any action, suit or other proceeding voluntarily prosecuted by any indemnitee as plaintiff, indemnification shall be mandatory only if the prosecution of such action, suit or other proceeding by such indemnitee (1) was authorized by a majority of the trustees or (2) was instituted by the indemnitee to enforce his or her rights to indemnification hereunder in a case in which the indemnitee is found to be entitled to such indemnification. The rights to indemnification set forth in this Declaration shall continue as to a person who has ceased to be a trustee or officer of the Trust and shall inure to the benefit of his or her heirs, executors and personal and legal representatives. No amendment or

restatement of this Declaration or repeal of any of its provisions shall limit or eliminate any of the benefits provided to any person who at any time is or was a trustee or officer of the Trust or otherwise entitled to indemnification

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hereunder in respect of any act or omission that occurred prior to such amendment, restatement or repeal.

(b) Notwithstanding the foregoing, no indemnification shall be made hereunder unless there has been a determination (i) by a final decision on the merits by a court or other body of competent jurisdiction before whom the issue of entitlement to indemnification hereunder was brought that such indemnitee is entitled to indemnification hereunder or, (ii) in the absence of such a decision, by (1) a majority vote of a quorum of those trustees who are neither "interested persons" of the Trust (as defined in Section 2(a)(19) of the Investment Company Act) nor parties to the proceeding ("Disinterested Non-Party Trustees"), that the indemnitee is entitled to indemnification hereunder, or (2) if such quorum is not obtainable or even if obtainable, if such majority so directs, independent legal counsel in a written opinion concludes that the indemnitee should be entitled to indemnification hereunder. All determinations to make advance payments in connection with the expense of defending any proceeding shall be authorized and made in accordance with the immediately succeeding paragraph (c) below.

(c) The Trust shall make advance payments in connection with the expenses of defending any action with respect to which indemnification might be sought hereunder if the Trust receives a written affirmation by the indemnitee of the indemnitee's good faith belief that the standards of conduct necessary for indemnification have been met and a written undertaking to reimburse the Trust unless it is subsequently determined that the indemnitee is entitled to such indemnification and if a majority of the trustees determine that the applicable standards of conduct necessary for indemnification appear to have been met. In addition, at least one of the following conditions must be met: (i) the indemnitee shall provide adequate security for his undertaking, (ii) the Trust shall be insured against losses arising by reason of any lawful advances, or (iii) a majority of a quorum of the Disinterested Non-Party Trustees, or if a majority vote of such quorum so direct, independent legal counsel in a written opinion, shall conclude, based on a review of readily available facts (as opposed to a full trial-type inquiry), that there is substantial reason to believe that the indemnitee ultimately will be found entitled to indemnification.

(d) The rights accruing to any indemnitee under these provisions shall not exclude any other right which any person may have or hereafter acquire under this Declaration, the By-Laws of the Trust, any statute, agreement, vote of stockholders or trustees who are "disinterested persons" (as defined in Section 2(a)(19) the Investment Company Act) or any other right to which he or she may be lawfully entitled.

(e) Subject to any limitations provided by the Investment Company Act and this Declaration, the Trust shall have the power and authority to indemnify and provide for the advance payment of expenses to employees, agents and other Persons providing services to the Trust or serving in any capacity at the request of the Trust to the full extent corporations organized under the Delaware General Corporation Law may indemnify or provide for the advance payment of expenses for such Persons, provided that such indemnification has been approved by a majority of the trustees.

5.3 No Bond Required of Trustees. No trustee shall, as such, be obligated to give any bond or other security for the performance of any of his duties hereunder.

5.4 No Duty of Investigation; Notice in Trust Instruments, etc. No purchaser, lender, transfer agent or other person dealing with the trustees or with any officer, employee or agent of the Trust shall be bound to make any inquiry

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concerning the validity of any transaction purporting to be made by the trustees or by said officer, employee or agent or be liable for the application of money or property paid, loaned, or delivered to or on the order of the trustees or of said officer, employee or agent. Every obligation, contract, undertaking, instrument, certificate, Share, other security of the Trust, and every other act or thing whatsoever executed in connection with the Trust shall be conclusively taken to have been executed or done by the executors thereof only in their capacity as trustees under this Declaration or in their capacity as officers, employees or agents of the Trust. The trustees may maintain insurance for the protection of the Trust Property, its Shareholders, trustees, officers, employees and agents in such amount as the trustees shall deem adequate to cover possible tort liability, and such other insurance as the trustees in their sole judgment shall deem advisable or is required by the Investment Company Act.

5.5 Reliance on Experts, etc. Each trustee and officer or employee of the Trust shall, in the performance of its duties, be fully and completely justified and protected with regard to any act or any failure to act resulting from reliance in good faith upon the books of account or other records of the Trust, upon an opinion of counsel, or upon reports made to the Trust by any of the Trust's officers or employees or by any advisor, administrator, manager, distributor, selected dealer, accountant, appraiser or other expert or consultant selected with reasonable care by the trustees, officers or employees of the Trust, regardless of whether such counsel or expert may also be a trustee.

Insofar as indemnification for liabilities arising under the Securities Act of 1933, may be permitted to trustees, officers and controlling persons of the Trust, pursuant to the foregoing provisions or otherwise, the Trust has been advised that in the opinion of the Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the Trust of expenses incurred or paid by a trustee, officer or controlling person of the Trust in the successful defense of any action, suit or proceeding) is asserted by such trustee, officer or controlling person in connection with the securities being registered, the Trust will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue. Reference is made to Section 8 of the underwriting agreement attached as Exhibit (h), which is incorporated herein by reference and discusses the rights, responsibilities and limitations with respect to indemnity and contribution.

### ITEM 16. EXHIBITS

- (1) Agreement and Declaration of Trust (Incorporated by reference to Pre-Effective Amendment No. 4 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 9, 2006)
- (2) By-laws (Incorporated by reference to Pre-Effective Amendment No. 4 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 9, 2006)
- (3) Voting Trust Agreement. (Not Applicable)
- (4) Form of Agreement and Plan of Reorganization. (Filed herewith as Appendix A to the Proxy Statement/Prospectus)
- (5) Provisions of instruments defining the rights of holders of

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securities are contained in the Registrant's Agreement and Declaration of Trust and By-laws.

- (6) Investment Advisory Agreement. (Incorporated by reference to Pre-Effective Amendment No. 5 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 21, 2006)
- (7) (a) Underwriting Agreement. (Incorporated by reference to Pre-Effective Amendment No. 5 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 21, 2006)
- (b) Dealer Manager Agreement with respect to rights offering. (Incorporated by reference to Pre-Effective Amendment No. 2 to the Registrant's Registration Statement, File Nos. 333-147121 and 811-21421, filed on December 14, 2007)
- (8) Bonus, profit sharing or pension contracts. (Not applicable)
- (9) Custodian Services Agreement. (Incorporated by reference to Pre-Effective Amendment No. 4 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 9, 2006)
- (10) 12b-1 of 18f-3 Plans. (Not applicable)
- (11) Opinion and Consent of Counsel as to the legality of shares being registered. (Incorporated by reference to the Registrant's Registration Statement on Form N-14, File Nos. 333-149424 and 811-21869, filed on February 28, 2008)
- (12) Opinion and Consent of Counsel regarding certain tax matters and consequences to shareholders discussed in the Proxy Statement/ Prospectus. (To be filed by post effective amendment)
- (13) (a) Administration Services Agreement. (Incorporated by reference to Pre-Effective Amendment No. 5 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 21, 2006)
- (b) Sub-administration Services Agreement. (Incorporated by reference to Pre-Effective Amendment No. 4 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 9, 2006)
- (c) Transfer Agency Services Agreement. (Incorporated by reference to Pre-Effective Amendment No. 4 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 9, 2006)
- (d) Accounting Services Agreement. (Incorporated by reference to Pre-Effective Amendment No. 4 to the Registrant's Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 9, 2006)
- (e) Marketing and Structuring Fee Agreement. (Incorporated by reference to Pre-Effective Amendment No. 5 to the Registrant's

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Registration Statement, File Nos. 333-132436 and 811-21869, filed on June 21, 2006)

- (14) (a) Consent of Independent Registered Public Accounting Firm. (Filed herewith)
- (b) Consent of Independent Registered Public Accounting Firm. (Filed herewith)
- (15) Omitted Financial Statements. (Not applicable)
- (16) Powers of Attorney. (Incorporated by reference to to the Registrant's Registration Statement on Form N-14, File Nos. 333-149424 and 811-21869, filed on February 28, 2008)
- (17) Contractual Fee Waiver Agreement. (Filed herewith)

### ITEM 17. UNDERTAKINGS

- (1) The undersigned registrant agrees that prior to any public reoffering of the securities registered through the use of a prospectus which is a part of this registration statement by any person or party who is deemed to be an underwriter within the meaning of Rule 145(c) of the Securities Act of 1933 ("1933 Act"), the reoffering prospectus will contain the information called for by the applicable registration form for the reofferings by persons who may be deemed underwriters, in addition to the information called for by the other items of the applicable form.
- (2) The undersigned registrant agrees that every prospectus that is filed under paragraph (1) above will be filed as a part of an amendment to the registration statement and will not be used until the amendment is effective, and that, in determining any liability under the 1933 Act, each post-effective amendment shall be deemed a new registration statement for the securities offered therein, and the offering of the securities at that time shall be deemed the initial bona fide offering of them.
- (3) The undersigned registrant agrees to file by post-effective amendment, an opinion of counsel supporting the tax consequences of the proposed reorganization within a reasonable time after receipt of such opinion.

### SIGNATURES

As required by the Securities Act of 1933, as amended (the "1933 Act"), the Registrant has duly caused this Pre-Effective Amendment No. 1 to the Registration Statement on Form N-14 to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Dallas and State of Texas,

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on the 16th day of April, 2008.

/s/ James D. Dondero  
-----  
James D. Dondero\*  
Chief Executive Officer and President

Pursuant to the requirements of the 1933 Act, this Registration Statement has been signed below by the following persons in the capacities and on the dates indicated.

NAME -----	TITLE -----
/s/ R. Joseph Dougherty ----- R. Joseph Dougherty*	Trustee
/s/ Timothy Hui ----- Timothy Hui*	Trustee
/s/ Scott Kavanaugh ----- Scott Kavanaugh*	Trustee
/s/ James Leary ----- James Leary*	Trustee
/s/ Bryan Ward ----- Bryan Ward*	Trustee
/s/ James D. Dondero ----- James D. Dondero*	Chief Executive Officer and President
/s/ M. Jason Blackburn ----- M. Jason Blackburn	Chief Financial Officer (Principal Accounting Officer), Treasurer and Secretary

\*By: /s/ M. Jason Blackburn  
-----  
M. Jason Blackburn  
Attorney-in-Fact  
April 16, 2008