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VAN KAMPEN SENIOR INCOME TRUST  
Form N-2/A  
February 11, 2004

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON FEBRUARY 11, 2004

1933 ACT FILE NO. 333-111002

1940 ACT FILE NO. 811-08743

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
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FORM N-2

REGISTRATION STATEMENT  
UNDER THE SECURITIES ACT OF 1933

Pre-Effective Amendment No. 1  
 Post-Effective Amendment No. \_\_\_\_\_

(Check appropriate box or boxes)  
-----

VAN KAMPEN SENIOR INCOME TRUST  
(Exact Name of Registrant as Specified in Agreement and Declaration of Trust)

1 PARKVIEW PLAZA, P.O. BOX 5555, OAKBROOK TERRACE, ILLINOIS 60181-5555  
(Address of Principal Executive Offices)  
TELEPHONE NUMBER: (630) 684-6000  
(Area Code and Telephone Number)

A. THOMAS SMITH III, ESQ.  
MANAGING DIRECTOR AND GENERAL COUNSEL  
VAN KAMPEN INVESTMENTS INC.  
1221 AVENUE OF THE AMERICAS  
NEW YORK, NEW YORK 10020  
(212) 762-5260  
(Name and Address of Agent for Service)  
-----

COPIES TO:

WAYNE W. WHALEN, ESQ.  
CHARLES B. TAYLOR, ESQ.  
SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP  
333 WEST WACKER DRIVE

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CHICAGO, ILLINOIS 60606  
(312) 407-0700

NEW YORK, NEW YORK 10017  
(212) 455-2000

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

If any securities being registered on this form will be offered on a delayed or continuous basis in reliance on Rule 415 under the Securities Act of 1933, other than securities offered in connection with a dividend reinvestment plan, check the following box. [ ]

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933:

TITLE OF SECURITIES BEING REGISTERED	AMOUNT BEING REGISTERED	PROPOSED MAXIMUM OFFERING PRICE PER UNIT	PROPOSED MAXIMUM AGGREGATE OFFERING PRICE
Shares of Auction Rate Cumulative Preferred Shares, par value \$0.01 per share.....	28,000	\$25,000	\$700,000,000

(1) \$80.90 of which has been paid previously.

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, as amended, or until the registration statement shall become effective on such date as the Securities Exchange Commission, acting pursuant to Section 8(a) of the Securities Act of 1933, as amended, may determine.

THE INFORMATION IN THIS PROSPECTUS IS NOT COMPLETE AND MAY BE CHANGED. WE MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SECURITIES AND EXCHANGE COMMISSION IS EFFECTIVE. THIS PROSPECTUS IS NOT AN OFFER TO SELL THESE SECURITIES AND IT IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION, DATED FEBRUARY 11, 2004

PRELIMINARY PROSPECTUS

\$700,000,000

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VAN KAMPEN SENIOR INCOME TRUST

AUCTION RATE CUMULATIVE PREFERRED SHARES

5,600 SHARES, SERIES M  
 5,600 SHARES, SERIES T  
 5,600 SHARES, SERIES W  
 5,600 SHARES, SERIES TH  
 5,600 SHARES, SERIES F

LIQUIDATION PREFERENCE \$25,000 PER SHARE  
 -----

Van Kampen Senior Income Trust (the "Fund") is a non-diversified, closed-end management investment company. The Fund's investment objective is to provide a high level of current income, consistent with preservation of capital. The Fund seeks to achieve its objective by investing primarily in a professionally managed portfolio of interests in floating or variable rate senior loans ("Senior Loans") to corporations, partnerships and other entities ("Borrowers") which operate in a variety of industries and geographical regions. The Fund's investment adviser is Van Kampen Asset Management (the "Adviser").

The Fund is offering 5,600 Series M, 5,600 Series T, 5,600 Series W, 5,600 Series TH and 5,600 Series F Auction Rate Cumulative Preferred Shares (collectively, the "Preferred Shares"). The minimum purchase amount for Preferred Shares is \$25,000.

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AN INVESTMENT IN THE PREFERRED SHARES MAY NOT BE APPROPRIATE FOR ALL INVESTORS AND THERE IS NO ASSURANCE THAT THE FUND WILL ACHIEVE ITS INVESTMENT OBJECTIVE. SEE RISK FACTORS OF THE FUND DESCRIBED IN THE SECTION "RISK FACTORS" BEGINNING ON PAGE 24 OF THIS PROSPECTUS.

Neither the Securities and Exchange Commission ("SEC") nor any state securities commission has approved or disapproved of these securities or determined that this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

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	Per Share -----	Total -----
Public Offering Price(1)	\$25,000	\$700,000,000
Sales Load	\$	\$
Proceeds to Fund (before expenses) (2)	\$	\$

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 (1) The public offering price per share will be increased by the amount of dividends, if any, that have accumulated from the date the Preferred Shares

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are first issued.

(2) Not including offering expenses incurred by the Fund, estimated to be \$ .

The underwriters are offering the Preferred Shares subject to various conditions. The underwriters expect to deliver the Preferred Shares to an investor's broker-dealer, in book-entry form through The Depository Trust Company, on or about February , 2004.

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CITIGROUP

MERRILL LYNCH & CO.

A.G. EDWARDS & SONS, INC.

LEHMAN BROTHERS

WACHOVIA SECURITIES

February , 2004

Senior Loans in which the Fund invests generally pay interest at rates which are periodically redetermined by reference to a base lending rate plus a premium. These base lending rates are generally the prime rate offered by one or more major United States banks, the London Inter-Bank Offered Rate, the Certificate of Deposit rate or other base lending rates used by commercial lenders. Senior Loans generally hold the most senior position in the capital structure of the Borrowers and generally are secured with specific collateral, which may include guarantees, although the Fund may also invest in Senior Loans that are not secured by any collateral. The terms of Senior Loans typically include various restrictive covenants which are designed to limit certain activities of the Borrowers. It is anticipated that the proceeds of the Senior Loans in which the Fund acquires interests will be used primarily to finance leveraged buyouts, recapitalizations, mergers, acquisitions and stock repurchases and, to a lesser extent, to finance internal growth and for other corporate purposes of Borrowers.

Senior Loans in which the Fund invests generally have a claim on the assets of an issuer senior to that of subordinated debt, preferred stock and common stock of such issuer. Senior Loans in which the Fund may invest generally are not registered with the SEC or listed on any national securities exchange, and there is no express limitation on the percentage of the Fund's assets that may be invested in illiquid securities or the percentage of the Fund's assets that may be invested in below investment grade Senior Loans, which are considered speculative by rating agencies (and which are often referred to as "junk securities").

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Investors in Preferred Shares will be entitled to receive cash dividends at an annual rate that may vary for the successive dividend periods for such shares. The dividend rate on the Series M Preferred Shares for the initial dividend period from and including the date of issue to but excluding \_\_\_\_\_, 2004 will be \_\_\_\_%. The dividend rate on the Series T Preferred Shares for the initial dividend period from and including the date of issue to but excluding \_\_\_\_\_, 2004 will be \_\_\_\_%. The dividend rate on the Series W Preferred Shares for the initial dividend period from and including the date of issue to but excluding \_\_\_\_\_, 2004 will be \_\_\_\_%. The dividend rate on the Series TH Preferred Shares for the initial dividend period from and including the date of issue to but excluding \_\_\_\_\_, 2004 will be \_\_\_\_%. The dividend rate on the Series F Preferred Shares for the initial dividend period from and including the date of issue to but excluding \_\_\_\_\_, 2004 will be \_\_\_\_%. For each subsequent dividend period, the auction agent will determine the dividend rate for a particular period by an auction conducted on the business day prior to that period.

The Preferred Shares are not listed on an exchange. Investors in Preferred Shares may participate in auctions through broker-dealers that have entered into an agreement with the auction agent and the Fund in accordance with the procedures specified herein. Broker-dealers are not required to maintain a secondary market in Preferred Shares, and there can be no assurance that a secondary market will develop, or if it does develop a secondary market may not provide you with liquidity. The Fund may redeem Preferred Shares as described under "Description of Preferred Shares."

The Preferred Shares will be senior to the Fund's outstanding common shares, par value \$0.01 per share. The Fund's common shares are traded on the New York Stock Exchange ("NYSE") under the symbol "VVR." It is a condition of closing this offering that the Preferred Shares be offered with a rating of "Aaa" from Moody's Investors Service, Inc. ("Moody's") and "AAA" from Fitch Ratings ("Fitch").

This Prospectus sets forth concisely the information that prospective investors should know before investing in Preferred Shares, including information about risks. Investors should read this Prospectus before investing and keep the Prospectus for future reference. The Fund's Statement of Additional Information ("SAI") dated February \_\_\_\_\_, 2004, contains additional information about the Fund and is incorporated by reference into this Prospectus. You may obtain a copy of the SAI without charge by calling (800) 847-2424 (or (800) 421-2833 for the hearing impaired) or by writing to the Fund at 1 Parkview Plaza, P.O. Box 5555, Oakbrook Terrace, Illinois 60181-5555. A table of contents to the SAI is located at page 53 of this Prospectus. The SAI has been filed with the SEC and is available along with other Fund-related materials at the SEC's internet site (<http://www.sec.gov>).

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

YOU SHOULD RELY ONLY ON THE INFORMATION CONTAINED OR INCORPORATED BY

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REFERENCE INTO THIS PROSPECTUS. THE FUND HAS NOT, AND THE UNDERWRITERS HAVE NOT, AUTHORIZED ANYONE TO PROVIDE YOU WITH DIFFERENT INFORMATION. IF ANYONE PROVIDES YOU WITH DIFFERENT OR INCONSISTENT INFORMATION YOU SHOULD NOT RELY ON IT. THE FUND IS NOT, AND THE UNDERWRITERS ARE NOT, MAKING AN OFFER OF THESE SECURITIES IN ANY STATE WHERE THE OFFER IS NOT PERMITTED. THE FUND'S BUSINESS, FINANCIAL CONDITION, RESULTS OF OPERATION AND PROSPECTS MAY HAVE CHANGED SINCE THE DATE OF THIS PROSPECTUS.

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### PROSPECTUS SUMMARY

This summary highlights selected information from this Prospectus. It may not contain all of the information that is important to you. To understand the offering of the Preferred Shares fully, you should read this entire Prospectus carefully, including the risk factors. The following summary is qualified in its entirety by reference to the more detailed information included elsewhere in this Prospectus, the SAI and the Fund's Certificate of Vote (the "Certificate") attached as Appendix B to the SAI.

The Fund..... Van Kampen Senior Income Trust is a non-diversified, closed-end management investment company. The Fund was organized as a Massachusetts

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business trust on April 8, 1998, and is registered under the Investment Company Act of 1940, as amended (the "1940 Act").

The Fund commenced investment operations on June 23, 1998 upon the closing of an initial public offering of its common shares of beneficial interest, par value \$0.01 per share. The Fund's common shares are traded on the NYSE under the symbol "VVR." As of December 31, 2003, the Fund had total assets of approximately \$2.2 billion and net assets of approximately \$1.5 billion.

The Offering..... The Fund is offering 5,600 Series M Preferred Shares, 5,600 Series T Preferred Shares, 5,600 Series W Preferred Shares, 5,600 Series TH Preferred Shares and 5,600 Series F Preferred Shares, each series with a par value of \$0.01 at a purchase price of \$25,000 per share plus dividends, if any, that have accumulated from the commencement date of the dividend period during which the Fund first issues the Preferred Shares. The Fund is offering the Preferred Shares through a group of underwriters led by Citigroup Global Markets Inc. See "Underwriting."

The Preferred Shares of the Fund will entitle their holders to receive cash dividends at an annual rate that may vary for the successive dividend periods for such shares. In general, except as described under "Description of Preferred Shares -- Dividends and Dividend Periods," the dividend period for each series will be seven days. The auction agent will determine the dividend rate for a particular dividend period by an auction conducted on the business day immediately prior to the start of that dividend period. See "Description of Preferred Shares -- Summary of Auction Procedures."

The Preferred Shares are not listed on an exchange. Investors and potential investors in Preferred Shares may participate in auctions for the Preferred Shares through broker-dealers that have entered into an agreement with the auction agent and the Fund. Generally, an investor in Preferred Shares will not receive certificates representing ownership of his or her shares. The securities depository (The Depository Trust Company or any successor) or its nominee for the account of the investor's broker-dealer will maintain record ownership of the Preferred Shares in book-entry form. An investor's broker-dealer, in turn, will maintain records of that investor's beneficial ownership of Preferred Shares.

The Fund will not issue Preferred Shares unless such shares have a rating of "Aaa" from Moody's and "AAA" from Fitch. A rating is not a financial guarantee and can change. The Fund may at some future

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time seek to have the Preferred Shares rated by another rating agency. See "Description of Preferred Shares."

Use of Proceeds..... The Fund will use all of the net proceeds of the offering to (i) pay down amounts borrowed by the Fund under its commercial paper program by approximately \$640 million and (ii) invest the remaining proceeds in accordance with the Fund's investment objective and policies as soon as practicable following the offering.

Investment Objective and Investment Policies..... The Fund's investment objective is to provide a high level of current income, consistent with preservation of capital. The Fund seeks to achieve its objective by investing primarily in a professionally managed portfolio of interests in Senior Loans to Borrowers which operate in a variety of industries and geographical regions (including domestic and foreign entities). Senior Loans in which the Fund invests generally pay interest at rates which are periodically redetermined by reference to a base lending rate plus a premium. These base lending rates are generally the prime rate offered by one or more major United States banks ("Prime Rate"), the London Inter-Bank Offered Rate ("LIBOR"), the Certificate of Deposit ("CD") rate or other base lending rates used by commercial lenders. The value of the Fund's portfolio may be affected by changes in the credit quality of Borrowers with respect to Senior Loan interests in which the Fund invests. No assurance can be given that the Fund will achieve its investment objective.

Senior Loans generally hold the most senior position in the capital structure of the Borrowers and generally are secured with specific collateral, which may include guarantees, although the Fund may also invest in Senior Loans that are not secured by any collateral. The terms of Senior Loans typically include various restrictive covenants which are designed to limit certain activities of the Borrowers. Senior Loans generally are arranged through private negotiations between a Borrower and several financial institutions ("Lenders")

represented in each case by one or more such Lenders acting as agent ("Agent") of the several Lenders. On behalf of the several Lenders, the Agent will be primarily responsible for negotiating the loan agreement ("Loan Agreement") that establishes the relative terms and conditions of the Senior Loan and rights of the Borrower and the several Lenders. The Fund may invest in participations ("Participations") in Senior Loans, may purchase assignments ("Assignments") of portions of Senior Loans from third parties and may act as one of the group of Lenders originating a Senior Loan (an "Original Lender"). The Fund will purchase an Assignment or act as Original Lender with respect to a syndicated Senior Loan only where the Agent with respect to the Senior Loan at the time of investment has outstanding debt or deposit obligations rated investment grade (BBB or A-3 or higher by Standard & Poor's Ratings Group ("S&P") or Baa or P-3 or higher by Moody's) or determined by the Adviser to be of comparable quality.

Under normal market conditions, at least 80% of the Fund's total assets are invested in Senior Loans (either as an Original Lender or as a purchaser of an Assignment or Participation) of domestic Borrowers or foreign Borrowers (so long as Senior Loans to such foreign Borrowers are U.S. dollar denominated and payments of interest and

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repayments of principal pursuant to such Senior Loans are required to be made in U.S. dollars). It is anticipated that the proceeds of the Senior Loans in which the Fund acquires interests will be used primarily to finance leveraged buyouts, recapitalizations, mergers, acquisitions and stock repurchases and, to a lesser extent, to finance internal growth and for other corporate purposes of Borrowers. Senior Loans generally have the most senior position in a Borrower's capital structure, although some Senior Loans may hold an equal ranking with other senior securities of the Borrower. Senior Loans generally are secured by specific collateral, which may include guarantees. Such guaranteed Senior Loans may be guaranteed by, or fully secured by assets of, shareholders, owners or affiliated entities of the Borrower, even if the Senior Loans are not otherwise collateralized by assets of the Borrower. The Fund may invest up to 20% of its total assets in interests in Senior Loans which are not secured by any collateral. Senior loans which are not secured by specific collateral generally pose a greater risk of non-payment of interest or loss of principal than do collateralized Senior Loans. The Fund may also

acquire warrants, equity securities and, in limited circumstances, junior debt securities in connection with its investments in Senior Loans. Such equity securities and junior debt securities will not be treated by the Fund as Senior Loans. Investments in Senior Loans which are not secured by specific collateral and in warrants, equity securities and junior debt securities entail certain risks in addition to those associated with investments in collateralized Senior Loans.

The Fund is not subject to any restrictions with respect to the maturity of Senior Loans held in its portfolio. The Fund's assets invested in Senior Loans generally consist of Senior Loans with stated maturities of between three and ten years, and with rates of interest which are redetermined either daily, monthly, quarterly or semi-annually; provided, however, that the Fund may invest up to 5% of its total assets in Senior Loans which permit the Borrower to select an interest rate redetermination period of up to one year. Investments in Senior Loans with longer interest rate redetermination periods may increase fluctuations in the value of the Fund's portfolio as a result of changes in interest rates. The Senior Loans in the Fund's portfolio will at all times have a dollar-weighted average time until next interest rate redetermination of 90 days or less. Because of prepayment provisions, the actual remaining maturity of Senior Loans may vary substantially from the stated maturity of such loans. The Fund estimates that the actual maturities of Senior Loans in the portfolio generally range between 18 and 24 months.

The Adviser generally relies on its own credit analyses of Borrowers and not on analyses prepared by ratings agencies or other independent parties. There is no minimum rating or other independent evaluation of a Borrower or its securities limiting the Fund's investments. Although a Senior Loan may not be rated by any rating agency at the time the Fund purchases the Senior Loan, rating agencies have become more active in rating Senior Loans, and at any given time a substantial portion of the Senior Loans in the Fund's portfolio may be rated. The lack of a rating does not necessarily imply that a Senior Loan is of lesser investment quality. There is no limit on the

percentage of the Fund's assets that may be invested in Senior Loans that are rated below

investment grade or that are unrated but of comparable quality, which are commonly referred to as "junk securities." The Fund invests only in those Senior Loans with respect to which the Borrower, in the opinion of the Adviser, demonstrates one or more of the following characteristics: sufficient cash flow to service debt; adequate liquidity; successful operating history; strong competitive position; experienced management; and, with respect to collateralized Senior Loans, adequate collateral coverage of the Senior Loans. In addition, the Adviser may consider, and may rely in part, on analyses performed by Lenders other than the Fund.

Under normal market conditions, the Fund may invest up to 20% of its total assets in (i) high quality, short-term debt securities with remaining maturities of one year or less and (ii) warrants, equity securities and, in limited circumstances, junior debt securities acquired in connection with the Fund's investments in Senior Loans. If the Adviser determines that market conditions temporarily warrant a defensive investment policy, the Fund may, subject to its ability to liquidate its relatively illiquid portfolio of Senior Loans, invest up to 100% of its assets in cash and such high quality, short-term securities. The Fund may also lend its portfolio securities to other parties and may enter into repurchase and reverse repurchase agreements for securities, subject to certain restrictions. For further discussion of the Fund's investment objective and policies and its investment practices and the associated considerations, see "Investment Objective and Investment Policies" and "Other Investment Practices."

Use of Leverage..... The Fund uses financial leverage for investment purposes. Including the proceeds of the offering of the Preferred Shares, it is currently anticipated that the amount of leverage will represent approximately 32% (and in no event will it exceed 50%) of the Fund's total assets. As discussed below, in addition to issuing Preferred Shares, the Fund borrows money through a commercial paper program. See "Use of Leverage." The Fund's obligations under the commercial paper program are senior to the Preferred Shares. Payments to holders of Preferred Shares (the "Preferred Shareholders") in liquidation or otherwise will be subject to the prior payment of all outstanding indebtedness, including the Fund's obligations under the commercial paper program. There can be no assurance that the commercial paper will remain outstanding or that the Fund will continue such borrowing.

The issuance of Preferred Shares and the use of borrowing for investment purposes are forms of financial leverage and as such pose certain risks. The Fund generally will not utilize financial leverage if it anticipates that it would result in a lower return to common shareholders over time. Use of financial leverage creates an opportunity for increased income for common shareholders but, at the same time, creates the possibility for greater loss (including the likelihood of greater volatility of net asset value and market price of the common shares and of dividends), and, under certain circumstances, the Fund's use of financial leverage may impair the ability of the Fund to maintain its qualification, for federal income tax purposes, as a regulated investment company. There can be no assurance that a

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leveraging strategy will be successful during any period in which it is employed. The fees paid to the Adviser and the Administrator (as defined below) are calculated on the basis of the Fund's managed assets, and those fees will be higher when leverage is utilized.

The Fund currently has a fundamental investment restriction that the Fund may not issue senior securities (including borrowing money or entering into reverse repurchase agreements) in excess of 33 1/3% of its total assets (including the amount of senior securities issued but excluding any liabilities and indebtedness not constituting senior securities) except that the Fund may borrow up to an additional 5% of its total assets for temporary purposes, or pledge its assets other than to secure such issuance or in connection with hedging transactions, when-issued and delayed delivery transactions and similar investment strategies. The Fund has filed a proxy statement seeking a shareholder vote to amend the aforementioned investment restriction regarding the Fund's use of financial leverage to allow the Fund to utilize financial leverage to the maximum extent allowable under the 1940 Act. The Fund expects to hold a shareholder meeting to vote on this proposal on April 8, 2004. For a description of the limitations on financial leverage under the 1940 Act, see "Use of Leverage."

Principal Investment

Risks..... Risk is inherent in all investing. The primary risks of investing in Preferred Shares are:

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- the Fund will not be permitted to declare dividends or other distributions with respect to the Preferred Shares or redeem the Preferred Shares unless the Fund meets certain asset coverage requirements and is not in default under the terms of any senior indebtedness;
- in extraordinary circumstances, the Fund may not earn sufficient income from its investments to pay dividends on the Preferred Shares;
- senior indebtedness of the Fund may also constitute a substantial lien and burden on the common shares and the Preferred Shares by reason of its prior claim against the income of the Fund and against the net assets of the Fund in liquidation;
- if a Preferred Share auction fails, investors may not be able to sell any or all of their Preferred Shares;
- because of the nature of the market for Preferred Shares, investors may receive less than the price paid for their Preferred Shares if sold outside of the auction, especially when market interest rates are rising;
- although broker-dealers may maintain a secondary market in the Preferred Shares, they are not obligated to do so and no secondary market may develop or exist at any time;
- a rating agency or agencies could downgrade the ratings assigned to the Preferred Shares, which could affect liquidity; and
- the Fund may be forced to redeem the Preferred Shares to meet regulatory or rating agency requirements or may voluntarily redeem the Preferred Shares in certain circumstances.

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The primary risks of investing in the Fund are:

- borrowers under Senior Loans may default on obligations to pay principal or interest when

due;

- although, with respect to collateralized Senior Loans, the Fund generally will invest only in Senior Loans that the Adviser believes are secured by specific collateral, which may include guarantees, the value of which exceeds the principal amount of the Senior Loan at the time of initial investment, there can be no assurance that the liquidation of any such collateral 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; moreover, to the extent that a Senior Loan is collateralized by stock in the borrower or its subsidiaries, such stock may lose all or substantially all of its value in the event of bankruptcy of the Borrower;
- although it is growing, the secondary market for Senior Loans is currently limited and Senior Loans generally are not listed on any national securities exchange or automated quotation system and no active trading market may exist for many of the Senior Loans in which the Fund will invest; accordingly, Senior Loans are generally less liquid than many other types of investments and the Fund may be restricted in its ability to sell its Senior Loans in a timely fashion and at a fair price;
- interest rates are near historical lows and it is likely that they will rise, and if long-term rates rise, the value of the Fund's investment portfolio may decline thereby reducing asset coverage for the Preferred Shares, although such risk may be reduced by the floating or variable rate nature of Senior Loans held by the Fund;
- the Fund's use of financial leverage will result in greater volatility in the net asset value of the Fund's common shares;
- in certain circumstances, the Fund may not earn sufficient income from its investments to pay interest on the Fund's indebtedness or dividends;
- to the extent the Fund invests in non-U.S. issuers, the Fund may be subject to special risks; and

- the Fund is a non-diversified Fund and to the extent the Fund invests a relatively high percentage of its assets in obligation of a limited number of issuers, the Fund may be more susceptible than a diversified company to any single corporate, economic, political or regulatory occurrence.

For further discussion of the risks of investing in the Preferred Shares and the Fund, see "Risk Factors."

Investment Adviser and  
Administrator.....

Van Kampen Asset Management is the Fund's investment adviser. The Adviser is a wholly owned subsidiary of Van Kampen Investments Inc. ("Van Kampen Investments"). Van Kampen Investments is the Fund's administrator (in such capacity, the "Administrator"). Van Kampen Investments is a diversified asset management company

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that administers more than three million retail investor accounts, has extensive capabilities for managing institutional portfolios and has more than \$84 billion under management or supervision as of December 31, 2003. Van Kampen Investments has more than 50 open-end funds, more than 30 closed-end funds and more than 2,700 unit investment trusts that are distributed by authorized dealers nationwide.

The Fund pays the Adviser a monthly fee (accrued daily and paid monthly) computed based upon an annual rate of 0.85% applied to the average daily managed assets of the Fund (which, for purposes of determining such fee, shall mean the average daily gross asset value of the Fund minus the sum of accrued liabilities other than the aggregate amount of any borrowings undertaken by the Fund). The Fund pays the Administrator a monthly fee (accrued daily and paid monthly) computed based upon an annual rate of 0.20% applied to the average daily managed assets of the Fund (as defined above). Because leverage will increase the amount of the Fund's total assets, the Fund will pay a greater amount of advisory and administrative fees when leverage is utilized.

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Dividends and Dividend

Periods..... The table below shows the dividend rates for the initial dividend periods for each series of the Preferred Shares offered in this Prospectus. For subsequent dividend periods, the Preferred Shares will pay dividends based on a rate set at auctions, normally held every 7 days. In most instances, dividends are also payable every 7 days, on the first business day following the end of the dividend period. See "Description of Preferred Shares."

The table below also shows the date from which dividends on the Preferred Shares will accumulate at the initial rate, the dividend payment date for the initial dividend period and the day on which dividends will normally be paid. If the day on which dividends otherwise would be paid is not a business day, then dividends will be paid on the first business day that falls after that day.

Finally, the table below shows the number of days of the initial dividend periods for the Preferred Shares. Subsequent dividend periods generally will be 7 days. The dividend payment date for special dividend periods of more than 7 days will be set out in the notice designating a special dividend period. See "Description of Preferred Shares -- Designation of Special Dividend Periods."

PREFERRED SHARES	INITIAL DIVIDEND RATE	DATE OF ACCUMULATION OF INITIAL RATE	DIVIDEND PAYMENT DATE FOR INITIAL DIVIDEND PERIOD	S	P
-----	-----	-----	-----		
Series M....					
Series T....					
Series W....					
Series TH...					
Series F....					

Asset Maintenance..... The Fund's Certificate, attached as Appendix B to the SAI, establishes and fixes the rights and preferences of the Preferred Shares. The Certificate provides that the Fund must maintain:

- asset coverage of the Preferred Shares as

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required by the rating agency or agencies rating the Preferred Shares, and

- asset coverage of the Preferred Shares as required by the 1940 Act (which currently requires asset coverage of at least 200%).

Based on the Fund's assets and liabilities as of December 31, 2003, the asset coverage of the Preferred Shares as measured pursuant to the 1940 Act would be approximately 310% if the Fund were to issue all of the Preferred Shares offered in this Prospectus and apply the proceeds as set forth under "Use of Proceeds" below.

In addition, under the commercial paper program, the Fund may not permit the Fund's asset coverage ratio (as defined separately by related credit agreements) to fall below 300% at any time without causing an event of default under the credit agreements.

Redemption..... Although the Fund ordinarily does not expect to redeem Preferred Shares, it may be required to redeem Preferred Shares if, for example, the Fund does not correct a failure to meet an asset coverage ratio required by law or a rating agency guideline in a timely manner. The Fund may also voluntarily redeem Preferred Shares under certain conditions. See "Description of Preferred Shares -- Redemption."

Liquidation Preference..... The liquidation preference (that is, the amount the Fund must pay to Preferred Shareholders if the Fund is liquidated) for Preferred Shares will be \$25,000 per share plus accumulated but unpaid dividends, if any, whether or not earned or declared. See "Description of Preferred Shares -- Liquidation Preference."

Voting Rights..... The 1940 Act requires that the Preferred Shareholders, and the holders of any other series of preferred shares of the Fund, voting as a separate class, have the right to:

- elect at least two trustees at all times, and
- elect a majority of the trustees at any time when dividends on any series of the Preferred Shares, or any other series of preferred shares of the Fund, are unpaid for two full years, and they

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will continue to be so represented until all dividends in arrears shall have been paid or otherwise provided for.

The holders of common shares will elect the remaining trustees. The Preferred Shareholders, and the holders of any other series of preferred shares of the Fund, will vote as a separate class or series on other matters as required under the Fund's Agreement and Declaration of Trust, as amended (the "Declaration of Trust"), the Certificate, the 1940 Act and Massachusetts law. Each common share, each Preferred Share and each share of any other series of preferred shares of the Fund is entitled to one vote per share. See "Description of Preferred Shares -- Voting Rights."

Secondary Market Trading... The Preferred Shares are not listed on an exchange. Instead, you may buy or sell Preferred Shares at an auction that is normally held every

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7 days by submitting orders to a broker-dealer that has entered into an agreement with the auction agent and the Fund (a "Broker-Dealer") or to a broker-dealer that has entered into a separate agreement with a Broker-Dealer. Broker-dealers may, but are not obligated to, maintain a secondary market in Preferred Shares outside of auctions. There can be no assurance that a secondary market will develop or, if it does develop, that it will provide owners with liquidity of investment. Preferred Shares may be transferred outside of auctions only to or through a broker-dealer.

Federal Income Taxes..... The distributions with respect to Preferred Shares (other than distributions in redemption of Preferred Shares subject to Section 302(b) of the Internal Revenue Code of 1986, as amended (the "Code")) will constitute dividends to the extent of the Fund's current or accumulated earnings and profits, as calculated for federal income tax purposes. Such dividends generally will be taxable as ordinary income to holders. Because the Fund's portfolio income will consist principally of interest income, corporate investors in the Preferred Shares generally will not be entitled to the dividends received deduction and individual investors generally will not be entitled to the reduced rates of taxation available for "qualified dividend income." Distributions to holders of net capital gain (the excess of net long-term capital

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gain over net short-term capital loss) that are designated by the Fund as capital gain dividends will be treated as long-term capital gains in the hands of such holders. The Internal Revenue Service currently requires that a regulated investment company that has two or more classes of stock allocate to each such class proportionate amounts of each type of its income (such as ordinary income and capital gains). Accordingly, the Fund intends to designate distributions of net capital gain made with respect to Preferred Shares as capital gain dividends in proportion to the Preferred Shares' share of total dividends paid during the year.

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FINANCIAL HIGHLIGHTS

The table below sets forth selected financial information for a single common share of beneficial interest of the Fund outstanding throughout the periods presented. The financial highlights for the fiscal years ended July 31, 2003, 2002, 2001 and 2000 have been audited by Deloitte & Touche LLP, independent auditors, whose report, along with the Fund's most recent financial statements, are included in the SAI. The information for the fiscal year ended July 31, 1999 and for the fiscal period ended July 31, 1998 was audited by the Fund's former independent auditors.

	YEAR ENDED JULY 31,				
	2003	2002 (E)	2001	2000	1999
Net Asset Value, Beginning of the Period(a).....	\$ 7.94	\$ 8.51	\$ 9.65	\$ 10.08	\$ 10.07
Net Investment Income.....	.46	.49	.79	.81	.77
Net Realized and Unrealized Gain/Loss.....	.14	(.55)	(1.10)	(.42)	-0-
Total from Investment Operations.....	.60	(.06)	(.31)	.39	.77
Less:					
Distributions from Net Investment Income.....	.44	.51	.83	.81	.76
Distributions from Net Realized Gain.....	-0-	-0-	-0-	.01	-0-
Total Distributions.....	.44	.51	.83	.82	.76
Net Asset Value, End of the Period.....	\$ 8.10	\$ 7.94	\$ 8.51	\$ 9.65	\$ 10.08
Common Share Market Price at End of the Period.....	\$ 7.84	\$ 6.67	\$ 7.79	\$ 8.75	\$ 9.56

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Total Return(b) .....	25.06%	-8.05%	-1.42%	.61%	2.98%
Net Assets at End of the Period (In millions).....	\$1,458.6	\$1,430.0	\$1,532.7	\$1,736.5	\$1,815.1
Ratio of Operating Expenses to Average Net Assets excluding Borrowings*.....	1.59%	1.48%	1.63%	1.75%	1.66%
Ratio of Interest Expense to Average Net Assets excluding Borrowings.....	.62%	.53%	2.15%	2.49%	2.37%
Ratio of Gross Expense to Average Net Assets excluding Borrowings*.....	2.21%	2.01%	3.78%	4.24%	4.03%
Ratio of Net Investment Income to Average Net Assets excluding Borrowings*.....	5.98%	6.02%	8.90%	8.19%	7.72%
Portfolio Turnover(c).....	78%	65%	55%	57%	28%
Supplemental Ratios:					
Ratio of Operating Expenses to Average Net Assets including Borrowings*.....	1.19%	1.22%	1.20%	1.24%	1.18%
Ratio of Interest Expense to Average Net Assets including Borrowings.....	.46%	.44%	1.58%	1.77%	1.67%
Ratio of Gross Expense to Average Net Assets including Borrowings*.....	1.65%	1.66%	2.78%	3.01%	2.85%
Ratio of Net Investment Income to Average Net Assets including Borrowings*.....	4.47%	4.95%	6.55%	5.83%	5.46%
Senior Indebtedness:					
Total Borrowing Outstanding (In thousands).....	\$401,000	\$370,159	\$375,000	\$700,000	\$800,000
Asset Coverage Per \$1,000 Unit of Senior Indebtedness(d).....	4,637	4,863	5,087	3,481	3,269

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\* If certain expenses had not been voluntarily assumed by the Adviser, total return would have been lower and the Ratio of Operating Expenses to Average Net Assets and the Ratio of Net Investment Income to Average Net Assets would have been 1.21% and 6.90% for the period ended July 31, 1998.

\*\* Non-Annualized

(a) Net asset value on June 24, 1998 of \$10.00 is adjusted for common share offering costs of \$.013.

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(b) Total return based on common share market price assumes an investment at the common share market price at the beginning of the period indicated, reinvestment of all distributions for the period in accordance with the Fund's dividend reinvestment plan, and sale of all shares at the closing common share market price at the end of the period indicated.

(c) Calculation includes the proceeds from principal repayments and sales of

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variable rate senior loan interest.

(d) Calculated by subtracting the Fund's total liabilities (not including the Borrowings) from the Fund's total assets and dividing by the total number of senior indebtedness units, where one unit equals \$1,000 of senior indebtedness.

(e) As required, effective August 1, 2001, the Fund has adopted the provisions of the AICPA Audit and Accounting Guide for Investment Companies and began amortizing premium on fixed income securities. The effect of this change for the year ended July 31, 2002 was to decrease the ratio of net investment income to average net asset applicable to common shares by .01%. Net investment income per share and net realized and unrealized gains and losses per share were unaffected by the adjustments. Per share, ratios and supplemental data for the periods prior to July 31, 2002 have not been restated to reflect this change in presentation.

NA--Not Applicable

SENIOR SECURITIES

FISCAL YEAR ENDED -----	AMOUNT OF DEBT OUTSTANDING AT END OF YEAR ----- (IN THOUSANDS)	AVERAGE DAILY BALANCE OF DEBT OUTSTANDING DURING YEAR ----- (IN THOUSANDS)	ASSET COVERAGE PER \$1,000 OF INDEBTEDNESS -----	AVERAGE DAILY	-----
				BALANCE OF SHARES OUTSTANDING DURING YEAR ----- (IN THOUSANDS)	
July 31, 2000.....	\$737,000	\$718,075	\$3,481	180,010	
July 31, 2001.....	375,000	578,000	5,087	180,010	
July 31, 2002.....	370,159	334,000	4,863	180,010	
July 31, 2003.....	401,000	472,687	4,637	180,010	

THE FUND

The Fund is a non-diversified, closed-end management investment company. The Fund was organized as a Massachusetts business trust on April 8, 1998, and is registered under the 1940 Act. The Fund commenced investment operations on June 23, 1998 upon the closing of an initial public offering of its common shares of beneficial interest. As of December 31, 2003, the Fund had total assets of approximately \$1.5 billion and net assets of approximately \$2.2 billion. On December 31, 2003, the Fund had outstanding 180,010,000 common shares. The Fund's principal office is located at 1 Parkview Plaza, PO Box 5555, Oakbrook Terrace, Illinois 60181-5555, and its telephone number is (630) 684-6000.

USE OF PROCEEDS

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The estimated net proceeds of this offering will be \$693,150,000 after payment of offering expenses and the sales load. The Fund will use all of the net proceeds of the offering to (i) pay down amounts borrowed by the Fund under its commercial paper program by approximately \$640 million and (ii) invest the remaining proceeds in accordance with the Fund's investment objective and policies as soon as practicable, but in no event, under normal market conditions, later than three months after the receipt thereof. Pending such investment, the proceeds may be invested in high-quality, short-term securities.

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### CAPITALIZATION

The following table sets forth the unaudited capitalization of the Fund as of December 31, 2003, and as adjusted to give effect to the issuance of the Preferred Shares offered hereby and repayments of the commercial paper program (including estimated offering expenses and sales load of \$6,850,000).

	AS OF DECEMBER 31, 2003	
	ACTUAL	AS ADJUSTED
Shareholders' equity		
Preferred Shares, par value \$0.01 per share (no shares issued; shares issued, as adjusted, at \$25,000 per share liquidation preference).....	\$ --	\$ 700,000,000
Common shares, par value \$0.01 per share, 180,010,000 shares outstanding.....	\$ 1,800,100	\$ 1,800,100
Capital in excess of par value.....	\$1,795,669,290	\$1,788,819,290
Undistributed net investment income.....	\$ 3,177,328	\$ 3,177,328
Net accumulated realized gain (loss) from investment transactions.....	\$ (253,937,719)	\$ (253,937,719)
Net unrealized depreciation of investments.....	\$ (24,602,696)	\$ (24,602,696)
Total net assets less liquidation value of Preferred Shares.....	\$1,522,106,303	\$1,515,256,303

### PORTFOLIO COMPOSITION

The following tables set forth the unaudited portfolio characteristics, top ten Senior Loan industries as a percentage of assets, the top ten Senior Loans as a percentage of assets and the ratings of Senior Loans held by the Fund, in each case as of December 31, 2003.

#### PORTFOLIO CHARACTERISTICS

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Net assets.....	\$1,522,106,303
Total assets.....	\$2,190,055,917
Assets invested in Senior Loans and other loans.....	\$2,026,119,717
Average amount outstanding per loan.....	\$ 6,720,000
Total number of industries.....	46
Weighted average days to next interest rate reset.....	56.9
Assets invested in other debt obligations.....	\$ 29,967,375

### TOP 10 SENIOR LOAN INDUSTRIES AS A PERCENTAGE OF ASSETS ON DECEMBER 31, 2003

	DECEMBER 31, 2003
	-----
Beverage, Food and Tobacco.....	7.88%
Printing and Publishing.....	7.81%
Medical Products/Supplies.....	6.44%
Broadcasting -- Cable.....	6.39%
Hotel/Motel/Inn/Gaming.....	5.19%
Health Care Providers.....	4.64%
Chemicals, Plastics & Rubber.....	4.58%
Automotive.....	3.64%
Leisure and Entertainment.....	3.56%
Telecommunications-Wireless.....	3.53%

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### TOP 10 SENIOR LOANS AS A PERCENTAGE OF ASSETS ON DECEMBER 31, 2003

Allied Waste North America.....	2.4%
Rite Aid Corporation.....	2.0
Charter Communications.....	1.9
Community Health Systems.....	1.7
Davita, Inc.....	1.6
Aladdin Gaming LLC.....	1.5
Federal-Mogul Corporation.....	1.4
Ispat Inland, L.P.....	1.3
Dex Media West LLC.....	1.2
Aurora Foods, Inc.....	1.2

### SECURITIES RATINGS

The table below reflects the ratings of Senior Loans only, representing

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approximately 90% of the Fund's total assets as of December 31, 2003.

S&P*	MOODY'S*	NUMBER OF ISSUES	VALUE  (IN THOUSANDS)	PERCENTAGE OF TOTAL ASSETS
-----	-----	-----	-----	-----
AAA	Aaa	0	\$ 0	0%
AA	Aa	0	0	0
A	A	0	0	0
BBB	Baa	11	71,880	3.5
BB	Ba	139	846,777	41.2
B	B	134	639,294	31.1
CCC	Caa	13	30,551	1.5
Unrated		110	467,585	22.7
		---	-----	-----
Total		407	\$2,056,087	100.0%

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\* Ratings: Using the higher of S&P's or Moody's ratings. S&P rating categories may be modified further by a plus (+) or minus (-) in the AA, A, BBB, BB, B and CCC ratings. Moody's rating categories may be modified further by a 1, 2, or 3 in the Aa, A, Baa, Ba, B and Caa ratings.

+ Senior Loans that are not rated by S&P or Moody's. Such Senior Loans may be rated by nationally recognized statistical rating organizations other than S&P or Moody's, or may not be rated by any such organization. With respect to the percentage of the Fund's assets invested in such Senior Loans, the Adviser believes that these are of comparable quality to rated Senior Loans in which the Fund may invest. This determination is based on the Adviser's own internal evaluation and does not necessarily reflect how such Senior Loans would be rated by S&P or Moody's if either were to rate the securities.

### INVESTMENT OBJECTIVE AND INVESTMENT POLICIES

#### INVESTMENT OBJECTIVE

The Fund's investment objective is to provide a high level of current income, consistent with preservation of capital.

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#### INVESTMENT POLICIES

The Fund seeks to achieve its objective by investing primarily in a professionally managed portfolio of Senior Loans to Borrowers which operate in a variety of industries and geographical regions (including domestic and foreign entities). Although the Fund's net asset value per common share ("NAV") will

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vary, the Fund's policy of acquiring interests in floating or variable rate Senior Loans is expected to minimize fluctuations in the Fund's NAV as a result of changes in interest rates. No assurance can be given that the Fund will achieve its investment objective.

Senior Loans generally are arranged through private negotiations between a Borrower and Lenders represented in each case by one or more such Lenders acting as Agent of the several Lenders. On behalf of the several Lenders, the Agent, which is frequently the commercial bank or other entity that originates the Senior Loan and the person that invites other parties to join the lending syndicate, will be primarily responsible for negotiating the Loan Agreement(s) that establish the relative terms, conditions and rights of the Borrower and the several Lenders. In larger transactions it is common to have several Agents; however, generally only one such Agent has primary responsibility for documentation and administration of the Senior Loan. Agents are typically paid a fee or fees by the Borrower for their services.

The Fund may invest in Participations in Senior Loans, may purchase Assignments of portions of Senior Loans from third parties and may act as one of the group of Original Lenders. Under normal market conditions, at least 80% of the Fund's total assets are invested in Senior Loans (either as an Original Lender or as a purchaser of an Assignment or Participation) of domestic Borrowers or foreign Borrowers (so long as Senior Loans to foreign Borrowers are U.S. dollar denominated and payments of interest and repayments of principal pursuant to such Senior Loans are required to be made in U.S. dollars).

It is anticipated that the proceeds of the Senior Loans in which the Fund will acquire interests primarily will be used to finance leveraged buyouts, recapitalizations, mergers, acquisitions, stock repurchases, and, to a lesser extent, to finance internal growth and for other corporate purposes of Borrowers. Senior Loans have the most senior position in a Borrower's capital structure, although some Senior Loans may hold an equal ranking with other senior securities of the Borrower. The capital structure of a Borrower may include Senior Loans, senior and junior subordinated debt (which may include "junk bonds"), preferred stock and common stock issued by the Borrower, typically in descending order of seniority with respect to claims on the Borrower's assets. Senior Loans generally are secured by specific collateral, which may include guarantees. Such guaranteed Senior Loans may be guaranteed by, or fully secured by assets of, shareholders, owners or affiliated entities of the Borrower, even if the Senior Loans are not otherwise collateralized by assets of the Borrower. The Fund may invest up to 20% of its total assets in Senior Loans which are not secured by any collateral. Senior Loans that are not secured by specific collateral generally pose a greater risk of non-payment of interest or loss of principal than do collateralized Senior Loans.

As discussed below, the Fund may also acquire warrants, equity securities and junior debt securities issued by a Borrower or its affiliates as part of a package of investments in the Borrower or its affiliates. Warrants, equity securities and junior debt securities will not be treated as Senior Loans and thus assets invested in such securities will not count toward the 80% of the Fund's total assets that normally will be invested in Senior Loans. The Fund will acquire such interests in warrants, equity securities and junior debt securities only as an incident to the intended purchase of interests in Senior Loans. In order to borrow money pursuant to collateralized Senior Loans, a Borrower will frequently, for the term of the Senior Loan, pledge as collateral assets, including but not limited to trademarks, accounts receivable, inventory,

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buildings, real estate, franchises and common and preferred stock in its subsidiaries. In addition, in the case of some Senior Loans, there may be additional collateral pledged in the form of guarantees or other credit support by and/or securities of affiliates of the Borrowers. In certain instances, a collateralized Senior Loan may be secured only by stock in the Borrower or its subsidiaries. Collateral may consist of assets that may not be readily liquidated, and there is no assurance that the liquidation of such assets would satisfy fully a Borrower's obligations under a Senior Loan.

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Loan Agreements may include various restrictive covenants designed to limit the activities of the Borrower in an effort to protect the right of the Lenders to receive timely payments of interest on and repayment of principal of the Senior Loans. Restrictive covenants may include mandatory prepayment provisions arising from excess cash flows and typically include restrictions on dividend payments, specific mandatory minimum financial ratios, limits on total debt and other financial tests. Breach of such covenants, if not waived by the Lenders, is generally an event of default under the applicable Loan Agreement and may give the Lenders the right to accelerate principal and interest payments. The Adviser will consider the terms of such restrictive covenants in deciding whether to invest in Senior Loans for the Fund's portfolio. When the Fund holds a Participation in a Senior Loan, it may not have the right to vote to waive enforcement of any restrictive covenant breached by a Borrower. Lenders voting in connection with a potential waiver of a restrictive covenant may have interests different from those of the Fund, and such Lenders may not consider the interests of the Fund in connection with their votes.

Senior Loans in which the Fund invests generally pay interest at rates which are periodically redetermined by reference to a base lending rate plus a premium. These base lending rates generally are the Prime Rate, LIBOR, the CD rate or other base lending rates used by commercial lenders. The Prime Rate quoted by a major U.S. bank is generally the interest rate at which such bank is willing to lend U.S. dollars to its most creditworthy borrowers, although it may not be the bank's lowest available rate. LIBOR, as provided for in Loan Agreements, is generally an average of the interest rates quoted by several designated banks as the rates at which such banks would offer to pay interest to major financial institutional depositors in the London interbank market on U.S. dollar denominated deposits for a specified period of time. The CD rate, as provided for in Loan Agreements, is generally the average rate paid on large certificates of deposit traded in the secondary market.

The Fund may invest in the Senior Loans of non-U.S. issuers. Investment in the Senior Loans of non-U.S. issuers involves special risks, including that non-U.S. issuers may be subject to less rigorous accounting and reporting requirements than U.S. issuers, less rigorous regulatory requirements, differing legal systems and laws relating to creditors' rights, the potential inability to enforce legal judgments and foreclose on collateral, possible restrictions on expatriation and repatriation of capital and the potential for political, social and economic adversity.

The Fund is not subject to any restrictions with respect to the maturity of Senior Loans held in its portfolio. The Fund's assets invested in Senior Loans

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generally consist of Senior Loans with stated maturities of between three and ten years, and with rates of interest which are redetermined either daily, monthly, quarterly or semi-annually; provided, however, that the Fund may invest up to 5% of its total assets in Senior Loans which permit the Borrower to select an interest rate redetermination period of up to one year. Investment in Senior Loans with longer interest rate redetermination periods may increase fluctuations in the Fund's NAV as a result of changes in interest rates. The Senior Loans in the Fund's portfolio will at all times have a dollar-weighted average time until the next interest rate redetermination of 90 days or less. As a result, as short-term interest rates increase, interest payable to the Fund from its investments in Senior Loans should increase, and as short-term interest rates decrease, interest payable to the Fund from its investments in Senior Loans should decrease. The amount of time required to pass before the Fund will realize the effects of changing short-term market interest rates on its portfolio will vary with the dollar-weighted average time until the next interest rate redetermination on the Senior Loans in the Fund's portfolio. The Fund may utilize certain investment practices to, among other things, shorten the effective interest rate redetermination period of Senior Loans in its portfolio. In such event, the Fund will consider such shortened period to be the interest rate redetermination period of the Senior Loan; provided, however, that the Fund will not invest in Senior Loans which permit the Borrower to select an interest rate redetermination period in excess of one year. Because most Senior Loans in the Fund's portfolio will be subject to mandatory and/or optional prepayment and there may be significant economic incentives for a Borrower to prepay its loans, prepayments of Senior Loans in the Fund's portfolio may occur. Accordingly, the actual remaining maturity of the Fund's portfolio invested in Senior Loans may vary substantially from the average stated maturity of the Senior Loans held in the Fund's portfolio. As a result of expected prepayments from time to time of Senior Loans in the Fund's portfolio, the Fund

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estimates that the actual maturities of Senior Loans held in its portfolio generally range between 18 and 24 months.

When interest rates decline, the value of a portfolio invested in fixed-rate obligations can be expected to rise. Conversely, when interest rates rise, the value of a portfolio invested in fixed-rate obligations can be expected to decline. Although the Fund's NAV will vary, the Fund's management expects the Fund's policy of acquiring interests in floating or variable rate Senior Loans to minimize fluctuations in NAV as a result of changes in interest rates. Accordingly, the Fund's management expects the value of the Fund's portfolio to fluctuate less than a portfolio of fixed-rate, longer term obligations as a result of interest rate changes. However, changes in prevailing interest rates can be expected to cause some fluctuation in the Fund's NAV. In addition to changes in interest rates, changes in the credit quality of Borrowers will also affect the Fund's NAV. Further, a serious deterioration in the credit quality of a Borrower could cause a prolonged or permanent decrease in the Fund's NAV. Fluctuations in NAV may be magnified as a result of the Fund's use of leverage.

The Fund may purchase and retain in its portfolio Senior Loan interests in Borrowers which have filed for protection under the federal bankruptcy laws or have had an involuntary bankruptcy petition filed against them by their creditors. The values of such Senior Loan interests, if any, will reflect, among other things, of the likelihood that the Fund ultimately will receive full repayment of the principal amount of such Senior Loan interests, the likely

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duration, if any, of a lapse in the scheduled repayment of principal and prevailing interest rates. At times, in connection with the restructuring of a Senior Loan either outside of bankruptcy court or in the context of bankruptcy court proceedings, the Fund may determine or be required to accept equity securities or junior debt securities in exchange for all or a portion of a Senior Loan interest. Depending upon, among other things, the Adviser's evaluation of the potential value of such securities in relation to the price that could be obtained by the Fund at any given time upon sale thereof, the Fund may determine to hold such securities in its portfolio. Any equity securities and junior debt securities held by the Fund will not be treated as Senior Loans and thus will not count toward the 80% of the Fund's total assets that normally will be invested in Senior Loans.

Senior Loans historically have not been rated by nationally recognized statistical rating organizations. Because of the senior capital structure position of Senior Loans and the collateralized or guaranteed nature of most Senior Loans, the Fund and the Adviser believe that ratings of other securities issued by a Borrower do not necessarily reflect adequately the relative quality of a Borrower's Senior Loans. Therefore, although the Adviser may consider such ratings in determining whether to invest in a particular Senior Loan, the Adviser is not required to consider such ratings and such ratings will not be the determinative factor in the Adviser's analysis. The Fund may invest a substantial portion of its assets in Senior Loans, the Borrowers with respect to which have outstanding debt securities which are rated below investment grade by a nationally recognized statistical rating organization or are unrated but determined by the Adviser to be of comparable quality to such securities. Debt securities rated below investment grade or unrated but of comparable quality commonly are referred to as "junk bonds." The Fund will invest only in those Senior Loans with respect to which the Borrower, in the opinion of the Adviser, demonstrates one or more of the following characteristics: sufficient cash flow to service debt; adequate liquidity; successful operating history; strong competitive position; experienced management; and, with respect to collateralized Senior Loans, collateral coverage that equals or exceeds the outstanding principal amount of the Senior Loan. In addition, the Adviser will consider, and may rely in part, on the analyses performed by the Agent and other Lenders, including such persons' determinations with respect to collateral securing a Senior Loan.

The Fund may invest up to 100% of its assets in Participations. The selling Lenders and other persons interpositioned between such Lenders and the Fund with respect to such Participations will likely conduct their principal business activities in the banking, finance and financial services industries. Although, as discussed below, the Fund has taken measures which it believes reduce its exposure to any risks incident to such policy, the Fund may be more susceptible than an investment company without such a policy to any single economic, political or regulatory occurrence affecting such industries. Persons engaged in such industries may be more susceptible than are persons engaged in some other industry to, among other

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things, fluctuations in interest rates, changes in the Federal Open Market Committee's monetary policy, governmental regulations concerning such industries and concerning capital raising activities generally and fluctuations in the financial markets generally.

Participations by the Fund in a Lender's portion of a Senior Loan typically will result in the Fund having a contractual relationship only with such Lender,

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not with the Borrower. As a result, the Fund may have the right to receive payments of principal, interest and any fees to which it is entitled only from the Lender selling the Participation and only upon receipt by such Lender of such payments from the Borrower. In connection with purchasing Participations, the Fund generally will have no right to enforce compliance by the Borrower with the terms of the Loan Agreement, nor any rights with respect to any funds acquired by other Lenders through set-off against the Borrower, and the Fund may not directly benefit from the collateral supporting the Senior Loan in which it has purchased the Participation. As a result, the Fund may assume the credit risk of both the Borrower and the Lender selling the Participation. In the event of the insolvency of the Lender selling a Participation, the Fund may be treated as a general creditor of such Lender. The Fund has taken the following measures in an effort to minimize such risks. The Fund will only acquire Participations if the Lender selling the Participation, and any other persons interpositioned between the Fund and the Lender, (i) at the time of investment has outstanding debt or deposit obligations rated investment grade (BBB or A-3 or higher by S&P or Baa or P-3 or higher by Moody's) or determined by the Adviser to be of comparable quality and (ii) has entered into an agreement which provides for the holding of assets in safekeeping for, or the prompt disbursement of assets to, the Fund. Long-term debt rated BBB by S&P is regarded by S&P as having adequate capacity to pay interest and repay principal, and debt rated Baa by Moody's is regarded by Moody's as a medium grade obligation, i.e., it is neither highly protected nor poorly secured. Commercial paper rated A-3 by S&P indicates that S&P believes such obligations exhibit adequate protection parameters but that 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, and issues of commercial paper rated P-3 by Moody's are considered by Moody's to have an acceptable ability for repayment of short-term debt obligations but the effect of industry characteristics and market compositions may be more pronounced. The Fund ordinarily will purchase a Participation only if, at the time of such purchase, the Fund believes that the party from whom it is purchasing such Participation is retaining an interest in the underlying Senior Loan. In the event that the Fund does not so believe, it will only purchase such a Participation if, in addition to the requirements set forth above, the party from whom the Fund is purchasing such Participation (i) is a bank, a member of a national securities exchange or other entity designated in the 1940 Act, as qualified to serve as a custodian for a registered investment company and (ii) has been approved as a custodian by the Board of Trustees of the Fund (a "Designated Custodian").

The Fund may also purchase Assignments from Lenders. The purchaser of an Assignment typically succeeds to all the rights and obligations under the Loan Agreement of the assigning Lender and becomes a Lender under the Loan Agreement with the same rights and obligations as the assigning Lender. Assignments may, however, be arranged through private negotiations between potential assignees and potential assignors, and the rights and obligations acquired by the purchaser of an Assignment may differ from, and be more limited than, those held by the assigning Lender.

When the Fund is an Original Lender originating a Senior Loan it may share in a fee paid to the Original Lenders. The Fund will never act as the Agent or principal negotiator or administrator of a Senior Loan. When the Fund is a Lender, it will have a direct contractual relationship with the Borrower, may enforce compliance by the Borrower with the terms of the Loan Agreement and may have rights with respect to any funds acquired by other Lenders through set-off. Lenders also have full voting and consent rights under the applicable Loan Agreement. Action subject to Lender vote or consent generally requires the vote or consent of the holders of some specified percentage of the outstanding principal amount of the Senior Loan. Certain decisions, such as reducing the amount or increasing the time for payment of interest on or repayment of principal of a Senior Loan, or releasing collateral therefor, frequently require

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the unanimous vote or consent of all Lenders affected.

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The Fund will purchase an Assignment or act as a Lender with respect to a syndicated Senior Loan only where the Agent with respect to such Senior Loan at the time of investment has outstanding debt or deposit obligations rated investment grade (BBB or A-3 or higher by S&P or Baa or P-3 or higher by Moody's) or determined by the Adviser to be of comparable quality. Further, the Fund will not purchase interests in Senior Loans unless such Agent, Lender or interpositioned person has entered into an agreement which provides for the holding of assets in safekeeping for, or the prompt disbursement of assets to, the Fund.

Loan Agreements typically provide for the termination of the Agent's agency status in the event that it fails to act as required under the relevant Loan Agreement, becomes insolvent, enters Federal Deposit Insurance Corporation ("FDIC") receivership or, if not FDIC insured, enters into bankruptcy. Should such an Agent, Lender or assignor with respect to an Assignment interpositioned between the Fund and the Borrower become insolvent or enter FDIC receivership or bankruptcy, any interest in the Senior Loan of such person and any loan payment held by such person for the benefit of the Fund should not be included in such person's estate. If, however, any such amount were included in such person's estate, the Fund would incur certain costs and delays in realizing payment or could suffer a loss of principal or interest. In such event, the Fund could experience a decrease in NAV.

The Fund may be required to pay and may receive various fees and commissions in connection with purchasing, selling and holding interests in Senior Loans. The fees normally paid by Borrowers may include three types: facility fees, commitment fees and prepayment penalties. Facility fees are paid to Lenders upon origination of a Senior Loan. Commitment fees are paid to Lenders on an ongoing basis based upon the undrawn portion committed by the Lenders of the underlying Senior Loan. Lenders may receive prepayment penalties when a Borrower prepays all or part of a Senior Loan. The Fund will receive these fees directly from the Borrower if the Fund is an Original Lender, or, in the case of commitment fees and prepayment penalties, if the Fund acquires an interest in a Senior Loan by way of Assignment. Whether or not the Fund receives a facility fee from the Lender in the case of an Assignment, or any fees in the case of a Participation, depends upon negotiations between the Fund and the Lender selling such interests. When the Fund is an assignee, it may be required to pay a fee, or forgo a portion of interest and any fees payable to it, to the Lender selling the Assignment. Occasionally, the assignor will pay a fee to the assignee based on the portion of the principal amount of the Senior Loan which is being assigned. A Lender selling a Participation to the Fund may deduct a portion of the interest and any fees payable to the Fund as an administrative fee prior to payment thereof to the Fund. The Fund may be required to pay over or pass along to a purchaser of an interest in a Senior Loan from the Fund a portion of any fees that the Fund would otherwise be entitled to.

Pursuant to the relevant Loan Agreement, a Borrower may be required in certain circumstances, and may have the option at any time, to prepay the principal amount of a Senior Loan, often without incurring a prepayment penalty. Because the interest rates on Senior Loans are periodically redetermined at relatively short intervals, the Fund and the Adviser believe that the prepayment of, and subsequent reinvestment by the Fund in, Senior Loans will not have a materially adverse impact on the yield on the Fund's portfolio and may have a beneficial impact on income due to receipt of prepayment penalties, if any, and any facility fees earned in connection with reinvestment.

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A Lender may have certain obligations pursuant to a Loan Agreement, which may include the obligation to make additional loans in certain circumstances. The Fund currently intends to reserve against such contingent obligations by segregating cash, liquid securities and/or liquid Senior Loans sufficient to cover such commitments. The Fund will not purchase interests in Senior Loans that would require the Fund to make any such additional loans if such additional loan commitments in the aggregate would exceed 20% of the Fund's total assets or would cause the Fund to fail to meet the diversification requirements set forth under the heading "Investment Restrictions" in the SAI.

Under normal market conditions, the Fund may invest up to 20% of its total assets (including assets maintained by the Fund as a reserve against any additional loan commitments) in (i) high quality, short-term debt securities with remaining maturities of one year or less and (ii) warrants, equity securities and

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junior debt securities acquired in connection with the Fund's investments in Senior Loans. Such high quality, short-term securities may include commercial paper rated at least in the top two rating categories of either S&P or Moody's, or unrated commercial paper considered by the Adviser to be of similar quality, interests in short-term loans of Borrowers having short-term debt obligations rated or a short-term credit rating at least in such top two rating categories or having no such rating but determined by the Adviser to be of comparable quality, certificates of deposit and bankers' acceptances and securities issued or guaranteed by the U.S. government, its agencies or instrumentalities. Such high quality, short-term securities may pay interest at rates which are periodically redetermined or may pay interest at fixed rates. If the Adviser determines that market conditions temporarily warrant a defensive investment policy, the Fund may invest, subject to its ability to liquidate its relatively illiquid portfolio of Senior Loans, up to 100% of its assets in cash and such high quality, short-term debt securities. The Fund will acquire such warrants, equity and junior debt securities only as an incident to the purchase or intended purchase of interests in collateralized Senior Loans. Although the Fund generally will acquire interests in warrants, equity and junior debt securities only when the Adviser believes that the relative value being given by the Fund in exchange for such interests is substantially outweighed by the potential value of such instruments, investment in warrants, equity and junior debt securities entail certain risks in addition to those associated with investments in Senior Loans. Warrants and equity securities have a subordinate claim on a Borrower's assets as compared with debt securities, and junior debt securities have a subordinate claim on such assets as compared with Senior Loans. As such, the values of warrants and equity securities generally are more dependent on the financial condition of the Borrower and less dependent on fluctuations in interest rates than are the values of many debt securities. The values of warrants, equity securities and junior debt securities may be more volatile than those of Senior Loans.

The Fund also may invest up to 5% of its total assets in structured notes with rates of return determined by reference to the total rate of return on one or more loans referenced in such notes. The rate of return on the structured note may be determined by applying a multiplier to the rate of total return on the referenced loan or loans. Application of a multiplier is comparable to the

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use of financial leverage, a speculative technique. Leverage magnifies the potential for gain and the risk of loss; as a result, a relatively small decline in the value of a referenced note could result in a relatively large loss in the value of a structured note. Structured notes will be treated as Senior Loans for purposes of the Fund's policy of normally investing at least 80% of its assets in Senior Loans.

### USE OF LEVERAGE

The Fund uses financial leverage for investment purposes. The Fund has authority to do so through borrowings, including the issuance of debt securities, or the issuance of preferred shares, or through the use of certain other transactions which have the effect of financial leverage.

Including the proceeds of the offering of the Preferred Shares, it is currently anticipated that the amount of leverage will represent approximately 32% (and in no event will it exceed 50%) of the Fund's total assets. In addition to issuing Preferred Shares, the Fund borrows money through a commercial paper program. The Fund's obligations under the commercial paper program are senior to the Preferred Shares. Payments to Preferred Shareholders in liquidation or otherwise will be subject to the prior payment of all outstanding indebtedness, including the Fund's obligations under the commercial paper program. There can be no assurance that the commercial paper will remain outstanding or that the Fund will continue such borrowing.

The Fund currently has a fundamental investment restriction that the Fund may not issue senior securities (including borrowing money or entering into reverse repurchase agreements) in excess of 33 1/3% of its total assets (including the amount of senior securities issued but excluding any liabilities and indebtedness not constituting senior securities), except that the Fund may borrow up to an additional 5% of its total assets for temporary purposes, or pledge its assets other than to secure such issuance or in connection with hedging transactions, when-issued and delayed delivery transactions and similar investment strategies. The Fund has filed a proxy statement seeking a shareholder vote to amend the aforementioned

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investment restriction regarding the Fund's use of financial leverage to allow the Fund to utilize financial leverage to the maximum extent allowable under the 1940 Act (see the 1940 Act limitations described below). Until the Fund receives shareholder approval to amend its fundamental investment restriction regarding the use of financial leverage, the Fund may issue senior securities (which includes the Preferred Shares and any borrowing under its existing commercial paper program) up to the current limitation (i.e. 33% of its total assets) and, upon receiving such approval, may increase its use of senior securities (by maintaining the Preferred Shares and increasing borrowing under the commercial paper program) up to the leverage limitations under the 1940 Act. See "Description of Commercial Paper Program." The Fund expects to hold a shareholder meeting to vote on this proposal on April 8, 2004.

Under the 1940 Act, the Fund is not permitted to incur indebtedness unless

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immediately after such incurrence the Fund has an asset coverage of at least 300% of the aggregate outstanding principal balance of indebtedness (i.e., such indebtedness may not exceed 33 1/3% of the Fund's total assets). Additionally, under the 1940 Act, the Fund may not declare any dividend or other distribution upon any class of its capital shares, or purchase any such capital shares, unless the aggregate indebtedness of the Fund has, at the time of the declaration of any such dividend or distribution or at the time of any such purchase, an asset coverage of at least 300% after deducting the amount of such dividend, distribution, or purchase price, as the case may be. Under the 1940 Act, the Fund is not permitted to issue preferred shares unless immediately after such issuance the net asset value of the Fund's portfolio is at least 200% of the liquidation value of the outstanding preferred shares (i.e., such liquidation value may not exceed 50% of the Fund's total assets). In addition, the Fund is not permitted to declare any cash dividend or other distribution on its common shares unless, at the time of such declaration, the net asset value of the Fund's portfolio (determined after deducting the amount of such dividend or other distribution) is at least 200% of such liquidation value.

The use of financial leverage creates the opportunity for increased net income and NAV appreciation for the Fund's common shares. The concept of leveraging is based on the premise that the return on the underlying portfolio assets (including assets obtained from the leverage) will exceed the costs related to such leverage. As the difference between the return on the underlying assets and costs of leverage narrow, the return provided by leverage is reduced and a decline in the value of portfolio assets may completely offset any benefits of leverage. Leverage creates risks for common shareholders, including the likelihood of greater volatility of NAV and market price of the common shares and the possibility that fluctuations in interest rates on borrowings and short-term debt or in the dividend rates on any preferred shares may affect the return to common shareholders. To the extent the income or capital growth derived from securities purchased with funds received from leverage exceeds the cost of leverage, the Fund's return will be greater than if leverage had not been used. Conversely, if the income or capital growth from the securities purchased with such funds is not sufficient to cover the cost of leverage, the Fund's return will be less than if leverage had not been used, and therefore the amount available for distribution to common shareholders as dividends and other distributions will be reduced. The Fund generally will not utilize financial leverage if it anticipates that it would result in a lower return to common shareholders over time. As discussed under "Management of the Fund," the fees paid to the Adviser and the Administrator are calculated on the basis of the Fund's average daily managed assets, including proceeds from borrowings for leverage and the issuance of preferred shares, and thus those fees will be higher when leverage is utilized.

Certain types of borrowings, including borrowings under the Fund's commercial paper program, may result in the Fund being subject to covenants in credit agreements, including those relating to asset coverage and portfolio composition requirements. The Fund may be subject to certain restrictions on investments imposed by guidelines of one or more rating agencies which may issue ratings for corporate debt securities or any additional series of preferred shares issued by the Fund. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act. It is not anticipated that these covenants or guidelines will impede the Adviser from managing the Fund's portfolio in accordance with the Fund's investment objective and policies. See "Description of Commercial Paper Program" and "Description of Preferred Shares."

The Fund's willingness to borrow money and issue new securities for investment purposes, and the amount the Fund will borrow or issue, will depend on many factors, the most important of which are investment outlook, market conditions and interest rates. Successful use of a leveraging strategy depends on the Adviser's ability to predict correctly interest rates and market movements, and there is no assurance that a leveraging strategy will be successful during any period in which it is employed.

The amount of outstanding leverage may vary with prevailing market or economic conditions.

#### OTHER INVESTMENT PRACTICES

In connection with the investment objective and policies described above, the Fund may engage in interest rate and other hedging transactions, lend portfolio holdings, purchase and sell interests in Senior Loans and other portfolio debt securities on a "when issued" or "delayed delivery" basis and enter into repurchase and reverse repurchase agreements. These investment practices involve certain special risk considerations. The Adviser may use some or all of the following investment practices when, in the opinion of the Adviser, their use is appropriate. Although the Adviser believes that these investment practices may further the Fund's investment objective, no assurance can be given that these investment practices will achieve this result.

Interest Rate and Other Hedging Transactions. The Fund may enter into various interest rate hedging and risk management transactions. Certain of these interest rate hedging and risk management transactions may be considered to involve derivative instruments. A derivative is a financial instrument whose performance is derived at least in part from the performance of an underlying index, security or asset. The values of certain derivatives can be affected dramatically by even small market movements, sometimes in ways that are difficult to predict. There are many different types of derivatives, with many different uses. The Fund expects to enter into these transactions primarily to seek to preserve a return on a particular investment or portion of its portfolio, and may also enter into such transactions to seek to protect against decreases in the anticipated rate of return on floating or variable rate financial instruments the Fund owns or anticipates purchasing at a later date, or for other risk management strategies such as managing the effective dollar-weighted average duration of the Fund's portfolio. In addition, the Fund may also engage in hedging transactions to seek to protect the value of its portfolio against declines in NAV resulting from changes in interest rates or other market changes. The Fund does not intend to engage in such transactions to enhance the yield on its portfolio or to increase income available for distributions. Market conditions will determine whether and in what circumstances the Fund would employ any of the hedging and risk management techniques described below. The Fund will not engage in any of the transactions for speculative purposes and will use them only as a means to hedge or manage the risks associated with assets held in, or anticipated to be purchased for, the Fund's portfolio or obligations incurred by the Fund. The successful utilization of hedging and risk management transactions requires skills different from those needed in the selection of the Fund's portfolio securities. The Fund believes that the Adviser possesses the skills necessary for the successful utilization of hedging and risk management transactions. The Fund

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will incur brokerage and other costs in connection with its hedging transactions.

The Fund may enter into interest rate swaps or purchase or sell interest rate caps or floors. The Fund will not sell interest rate caps or floors that it does not own. Interest rate swaps involve the exchange by the Fund with another party of their respective obligations to pay or receive interest, e.g., an exchange of an obligation to make floating rate payments for an obligation to make fixed rate payments. For example, the Fund may seek to shorten the effective interest rate redetermination period of a Senior Loan in its portfolio the Borrower of which has selected an interest rate redetermination period of one year. The Fund could exchange the Borrower's obligation to make fixed rate payments for one year for an obligation to make payments that readjust monthly. In such event, the Fund would consider the interest rate redetermination period of such Senior Loan to be the shorter period.

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 at the difference of the index and the predetermined rate on a notional principal amount (the reference amount with respect to which

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interest obligations are determined although no actual exchange of principal occurs) 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 at the difference of the index and the predetermined rate on a notional principal amount from the party selling such interest rate floor. The Fund will not enter into swaps, caps or floors if, on a net basis, the aggregate notional principal amount with respect to such agreements exceeds the net assets of the Fund.

In circumstances in which the Adviser anticipates that interest rates will decline, the Fund might, for example, enter into an interest rate swap as the floating rate payor or, alternatively, purchase an interest rate floor. In the case of purchasing an interest rate floor, if interest rates declined below the floor rate, the Fund would receive payments from its counterparty which would wholly or partially offset the decrease in the payments it would receive in respect of the portfolio assets being hedged. In the case where the Fund purchases an interest rate swap, if the floating rate payments fell below the level of the fixed rate payment set in the swap agreement, the Fund's counterparty would pay the Fund amounts equal to interest computed at the difference between the fixed and floating rates over the notional principal amount. Such payments would offset or partially offset the decrease in the payments the Fund would receive in respect of floating rate portfolio assets being hedged.

The successful use of swaps, caps and floors to preserve the rate of return on a portfolio of financial instruments depends on the Adviser's ability to predict correctly the direction and extent of movements in interest rates. Although the Fund believes that use of the hedging and risk management techniques described above will benefit the Fund, if the Adviser's judgment about the direction or extent of the movement in interest rates is incorrect, the Fund's overall performance would be worse than if it had not entered into any such transactions. For example, if the Fund had purchased an interest rate swap or an interest rate floor to hedge against its expectation that interest rates would decline but instead interest rates rose, the Fund would lose part or all of the benefit of the increased payments it would receive as a result of the

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rising interest rates because it would have to pay amounts to its counterparty under the swap agreement or would have paid the purchase price of the interest rate floor.

Inasmuch as these hedging transactions are entered into for good-faith risk management purposes, the Adviser and the Fund believe such obligations do not constitute senior securities. The Fund will usually enter into interest rate swaps on a net basis, i.e., where the two parties make net payments with the Fund receiving or paying, as the case may be, only the net amount of the two payments. The net amount of the excess, if any, of the Fund's obligations over its entitlements with respect to each interest rate swap will be accrued and the Fund will segregate an amount of cash or liquid assets having an aggregate NAV at least equal to the accrued excess. If the Fund enters into a swap on other than a net basis, the Fund will segregate an amount of cash or liquid assets equal to the full amount of the Fund's obligations under such swap. Accordingly, the Fund does not treat swaps as senior securities. The Fund may enter into swaps, caps and floors with member banks of the Federal Reserve System, members of the NYSE or other entities determined by the Adviser, pursuant to procedures adopted and reviewed on an ongoing basis by the Board of Trustees, to be creditworthy. If a default occurs by the other party to such transaction, the Fund will have contractual remedies pursuant to the agreements related to the transaction, but such remedies may be subject to bankruptcy and insolvency laws which could affect the Fund's rights as a creditor. The swap market has grown substantially in recent years with a large number of banks and financial services firms acting both as principals and as agents utilizing standardized swap documentation. As a result, the swap market has become relatively liquid. Caps and floors are more recent innovations and they are less liquid than swaps. There can be no assurance, however, that the Fund will be able to enter into interest rate swaps or to purchase interest rate caps or floors at prices or on terms the Adviser believes are advantageous to the Fund. In addition, although the terms of interest rate swaps, caps and floors may provide for termination, there can be no assurance that the Fund will be able to terminate an interest rate swap or to sell or offset interest rate caps or floors that it has purchased.

New financial products continue to be developed and the Fund may invest in any such products as may be developed to the extent consistent with its investment objective and the regulatory and federal tax requirements applicable to investment companies.

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**Lending of Portfolio Holdings.** The Fund may seek to increase its income by lending financial instruments in its portfolio in accordance with present regulatory policies, including those of the Board of Governors of the Federal Reserve System and the SEC. Such loans may be made, without limit, to brokers, dealers, banks or other recognized institutional borrowers of financial instruments and would be required to be secured continuously by collateral, including cash, cash equivalents or U.S. Treasury bills maintained on a current basis at an amount at least equal to the market value of the financial instruments loaned. The Fund would have the right to call a loan and obtain the financial instruments loaned at any time on five days' notice. For the duration of a loan, the Fund would continue to receive the equivalent of the interest paid by the issuer on the financial instruments loaned and also may receive compensation from the investment of the collateral.

The Fund would not have the right to vote any financial instruments having voting rights during the existence of the loan, but the Fund could call the loan in anticipation of an important vote to be taken among holders of the financial instruments or in anticipation of the giving or withholding of their consent on

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a material matter affecting the financial instruments. As with other extensions of credit, risks of delay in recovery or even loss of rights in the collateral exist should the borrower of the financial instruments fail financially. However, the loans would be made only to firms deemed by the Adviser to be of good standing and when, in the judgment of the Adviser, the consideration which can be earned currently from loans of this type justifies the attendant risk. The creditworthiness of firms to which the Fund lends its portfolio holdings will be monitored on an ongoing basis by the Adviser pursuant to procedures adopted and reviewed, on an ongoing basis, by the Board of Trustees of the Fund. No specific limitation exists as to the percentage of the Fund's assets which the Fund may lend.

"When Issued" and "Delayed Delivery" Transactions. The Fund may also purchase and sell interests in Senior Loans and other portfolio securities on a "when issued" and "delayed delivery" basis. No income accrues to the Fund on such interests or securities in connection with such purchase transactions prior to the date the Fund actually takes delivery of such interests or securities. These transactions are subject to market fluctuation; the value of the interests in Senior Loans and other portfolio debt securities at delivery may be more or less than their purchase price, and yields generally available on such interests or securities when delivery occurs may be higher or lower than yields on the interests or securities obtained pursuant to such transactions. Because the Fund relies on the buyer or seller, as the case may be, to consummate the transaction, failure by the other party to complete the transaction may result in the Fund missing the opportunity of obtaining a price or yield considered to be advantageous. When the Fund is the buyer in such a transaction, however, it will segregate cash and/or liquid assets having an aggregate value equal to the amount of such purchase commitments until payment is made. The Fund will make commitments to purchase such interests or securities on such basis only with the intention of actually acquiring these interests or securities, but the Fund may sell such interests or securities prior to the settlement date if such sale is considered to be advisable. To the extent the Fund engages in "when issued" and "delayed delivery" transactions, it will do so for the purpose of acquiring interests or securities for the Fund's portfolio consistent with the Fund's investment objective and policies and not for the purpose of investment leverage. No specific limitation exists as to the percentage of the Fund's assets which may be used to acquire securities on a "when issued" or "delayed delivery" basis.

Repurchase Agreements. The Fund may enter into repurchase agreements (a purchase of, and a simultaneous commitment to resell, a financial instrument at an agreed upon price on an agreed upon date) only with member banks of the Federal Reserve System and member firms of the NYSE. When participating in repurchase agreements, the Fund buys securities from a vendor, e.g., a bank or brokerage firm, with the agreement that the vendor will repurchase the securities at a higher price at a later date. Such transactions afford an opportunity for the Fund to earn a return on available cash at minimal market risk, although the Fund may be subject to various delays and risks of loss if the vendor is unable to meet its obligation to repurchase. Under the 1940 Act, repurchase agreements are deemed to be collateralized loans of money by the Fund to the seller. In evaluating whether to enter into a repurchase agreement, the Adviser will consider carefully the creditworthiness of the vendor. If the member bank or member firm that is the party to the repurchase agreement petitions for bankruptcy or otherwise becomes subject to the

U.S. Bankruptcy Code, the law regarding the rights of the Fund is unsettled. The securities underlying a repurchase agreement will be marked to market every

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business day so that the value of the collateral is at least equal to the value of the loan, including the accrued interest thereon, and the Adviser will monitor the value of the collateral. No specific limitation exists as to the percentage of the Fund's assets which may be used to participate in repurchase agreements.

**Reverse Repurchase Agreements.** The Fund may enter into reverse repurchase agreements with respect to debt obligations which could otherwise be sold by the Fund. A reverse repurchase agreement is an instrument under which the Fund may sell an underlying debt instrument and simultaneously obtain the commitment of the purchaser (a commercial bank or a broker or dealer) to sell the security back to the Fund at an agreed upon price on an agreed upon date. The Fund will segregate an amount of cash or liquid assets at least equal to its obligations with respect to reverse repurchase agreements. The Fund receives payment for such securities only upon physical delivery or evidence of book entry transfer by its custodian. Regulations of the SEC require either that securities sold by the Fund under a reverse repurchase agreement be segregated pending repurchase or that the proceeds be segregated on the Fund's books and records pending repurchase. Reverse repurchase agreements could involve certain risks in the event of default or insolvency of the other party, including possible delays or restrictions upon the Fund's ability to dispose of the underlying securities. An additional risk is that the market value of securities sold by the Fund under a reverse repurchase agreement could decline below the price at which the Fund is obligated to repurchase them. Reverse repurchase agreements will be considered borrowings by the Fund and as such would be subject to the restrictions on borrowing as described herein and in the SAI under "Investment Restrictions." The Fund will not hold more than 5% of the value of its total assets in reverse repurchase agreements.

### RISK FACTORS

Risk is inherent in all investing. Before investing you should consider carefully the following risks that you assume when you invest in Preferred Shares.

**Payment and Redemption Restrictions.** Under the terms of the credit agreement governing the commercial paper program, the Fund is not permitted to declare dividends or other distributions, including dividends and distributions with respect to Preferred Shares, or purchase or redeem shares, including Preferred Shares, unless (i) at the time thereof the Fund meets the Credit Agreement Asset Coverage Test (as defined herein) and (ii) there is no event of default under the credit facility program. See "Description of Commercial Paper Program."

**Leverage Risk.** The Fund uses financial leverage for investment purposes by employing leverage instruments (e.g., borrowing, issuing commercial paper or notes and preferred shares of beneficial interest). The amount of leverage represented by the commercial paper program as of December 31, 2003 was approximately 29% of the Fund's total assets. It is currently anticipated that, after issuing the Preferred Shares offered in this Prospectus and paying down a portion of the commercial paper program with the proceeds, the amount of leverage will represent approximately 32% (and in no event will it exceed 50%) of the Fund's total assets. If the proposal to amend the Fund's fundamental investment restriction on senior securities is approved by shareholders, the Fund may increase its leverage ratio to the maximum amount allowed under the 1940 Act. Under the requirements of the 1940 Act, the value of the Fund's total assets, less all liabilities and indebtedness of the Fund not represented by

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senior securities, must be at least equal, immediately after any borrowing, to 300% of the aggregate value of borrowings represented by senior securities. Any lender with respect to borrowings by the Fund may require additional asset coverage provisions as well as restrictions on the Fund's investment practices. Under the requirements of the 1940 Act, the value of the Fund's total assets, less all liabilities and indebtedness of the Fund not represented by senior securities, must at least be equal, immediately after the issuance of any preferred shares, to 200% of the aggregate liquidation value of the preferred shares plus the aggregate amount of senior securities representing indebtedness.

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The liquidation value of the Preferred Shares offered hereby is equal their aggregate original purchase price plus a redemption premium, if any, together with any accrued and unpaid dividends thereon (on a cumulative basis), whether or not earned or declared. The Fund seeks an "Aaa" rating by Moody's and an "AAA" rating from Fitch for the Preferred Shares, and to obtain such ratings, asset coverage provisions in addition to and more stringent than those required by the 1940 Act have been imposed. In addition, restrictions have been imposed on certain investment practices in which the Fund may otherwise engage. The rating agency requirements impose certain minimum issue size, issuer geographical diversification and other requirements for determining portfolio assets that are eligible for computing compliance with their asset coverage requirements. A rating of the Preferred Shares does not reflect a direct assessment of the credit quality of the Fund's portfolio and is not an assessment of the investment characteristics of the Preferred Shares. If the Fund's ratings on the Preferred Shares are subsequently lowered or withdrawn, the Fund would likely be required to pay higher dividends on the Preferred Shares. See "Description of Preferred Shares."

The Fund's leveraged capital structure creates special risks not associated with unleveraged funds having similar investment objectives and policies. Borrowed funds pursuant to any credit facility constitute a substantial lien and burden on the Preferred Shares by reason of their prior claim against the income of the Fund and against the total assets of the Fund in liquidation. In the event of a default under the commercial paper program, the lenders have the right to cause a liquidation of the collateral (i.e., sell Senior Loans and other assets of the Fund), and if any such default is not cured within five days of written notice by the lenders, the lenders can control the liquidation as well.

Investors should note that there are risks associated with issuing Preferred Shares or borrowing in an effort to increase the yield on the common shares, including higher volatility of both the NAV and the market value of the common shares, and that fluctuations in the dividend rates on the Preferred Shares or interest rates on the borrowing may affect the yield to common shareholders. So long as the Fund is able to realize a higher return after expenses on its investment of the proceeds of the Preferred Shares offering or of any borrowing than the then current dividend rates on the Preferred Shares or interest rates on the borrowing, the effect of the leverage will be to cause the common shareholders to realize a higher current rate of return than if the Fund were not so leveraged. On the other hand, to the extent that the then current dividend rates on the Preferred Shares or interest rates on the borrowing approaches the return on such proceeds after expenses or the value of portfolio securities otherwise declines, the benefit of leverage to the common

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shareholders may be reduced or eliminated and could even result in a lower rate of return to the common shareholders than if the Fund were not leveraged. Since any decline in the net asset value of the Fund's investments is borne entirely by the common shareholders, the effect of leverage in a declining market would result in a greater decrease in net asset value to the common shareholders than if the Fund were not so leveraged. Any such decrease would likely be reflected in a decline in the market price for common shares. The floating or variable rate nature of Senior Loans in which the Fund invests helps mitigate against the risks of increased dividend or interest costs as a result of increasing interest rates. The Adviser may also seek to manage certain of the risks of financial leverage in anticipation of changes in interest rates in a number of ways, including extending the length of the dividend period on the Preferred Shares or the interest rate period on any borrowing so as to fix a dividend or an interest rate for a period of time, "deleveraging" the Fund by redeeming all or a portion of the outstanding Preferred Shares or repaying all or a portion of any outstanding borrowing, entering into certain transactions in an effort to hedge against changes in interest rates and purchasing securities the terms of which have elements of, or are similar in effect to, certain hedging transactions in which the Fund may engage. There can be no assurance that the Adviser can successfully manage the risks of leverage.

The issuance of the Preferred Shares or borrowing by the Fund entails certain initial costs and expenses and certain ongoing administrative and accounting expenses. These costs and expenses will be borne by the Fund and will reduce the income or net assets available to common shareholders. If the Fund's current investment income were not sufficient to meet dividend requirements on the Preferred Shares or interest expenses on any borrowing, the Fund might have to liquidate certain of its investments in order to meet required dividend or interest payments, thereby reducing the net asset value attributable

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to the Fund's common shares. In addition, the Fund is not permitted to declare any cash dividend or other distribution on its common shares unless, at the time of such declaration, the Fund meets certain asset coverage requirements (determined after deducting the amount of such dividend or distribution). Such prohibition on the payment of dividends or other distributions might impair the ability of the Fund to maintain its qualification, for federal income tax purposes, as a regulated investment company. The Fund intends, however, to the extent possible, to purchase or redeem Preferred Shares from time to time or to repay borrowing, which may involve the payment by the Fund of a premium and the sale by the Fund of portfolio securities at a time when it may be disadvantageous to do so, to maintain such asset coverage requirements. Subject to the restrictions of the 1940 Act, the Fund may "releverage" through the reissuance of preferred shares or incurrence of new borrowing, and in connection with which the Fund, and indirectly the common shareholders, would incur the expenses of such releveraging.

If there are no preferred shares issued and outstanding, common shareholders elect all of the trustees of the Fund. If there are preferred shares issued and outstanding, holders of any preferred shares, including the Preferred Shares, elect two trustees. Under the 1940 Act, upon failure by the Fund to pay dividends on the preferred shares in an amount equal to two full years' dividends arrearage, the holders of preferred shares, including the Preferred Shares, are entitled to elect a majority of the Board of Trustees

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until all such dividends arrearage has been paid or provided for. The lenders with respect to any borrowing by the Fund may be entitled to elect a majority of the Board of Trustees if certain asset coverage requirements are not maintained.

Restrictions imposed on the declaration and payment of dividends or other distributions to the holders of the Fund's common shares and preferred shares, both by the 1940 Act and by reason of requirements imposed by lenders and rating agencies, might impair the Fund's ability to maintain its qualification as a regulated investment company for federal income tax purposes. While the Fund intends to pay down borrowings and redeem Preferred Shares in order to permit the Fund to distribute its income as required to maintain its qualification as a regulated investment company under the Code, there can be no assurance that such actions can be effected in time to meet Code requirements. See "Federal Taxation."

Because the fees paid to the Adviser and the Administrator will be calculated on the basis of the Fund's average daily managed assets, those fees are higher when leverage is utilized, giving the Adviser an incentive to utilize leverage.

**Auction Risk.** You may not be able to sell your Preferred Shares at an auction if the auction fails, that is, if there are more Preferred Shares offered for sale than there are buyers for those shares. Also, if you place hold orders (orders to retain Preferred Shares) at an auction only at a specified rate, and that bid rate exceeds the rate set at the auction, you will not retain your Preferred Shares. Finally, if you buy Preferred Shares or elect to retain Preferred Shares without specifying a rate below which you would not wish to continue to hold those shares, and the auction sets a below-market rate, you may receive a lower rate of return on your Preferred Shares than the market rate.

**Secondary Market Risk.** Preferred Shares will not be listed on a stock exchange or the NASDAQ Stock Market. Broker-dealers may maintain a secondary trading market in Preferred Shares outside of auctions, but may discontinue this activity any time. You may transfer Preferred Shares outside of auctions only to or through a broker-dealer or such other persons who may be permitted by the Fund. If you try to sell your Preferred Shares between auctions, you may not be able to sell any or all of your shares, or you may not be able to sell them for \$25,000 per share or \$25,000 per share plus accumulated dividends. If the Fund has designated a special dividend period (a dividend period of more than 7 days), changes in interest rates could affect the price you would receive if you sold your shares in the secondary market. Broker-dealers that maintain a secondary trading market for Preferred Shares are not required to maintain this market, and the Fund is not required to redeem Preferred Shares if an auction or an attempted secondary market sale fails because of a lack of buyers. If you sell your Preferred Shares to a broker-dealer between auctions, you may receive less than the price you paid for them, especially when market interest rates have risen since the last auction and especially during a special dividend period.

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Ratings and Asset Coverage Risk. While Moody's and Fitch assign ratings of "Aaa" or "AAA" to the Preferred Shares, respectively, the ratings do not eliminate or necessarily mitigate the risks of investing in Preferred Shares. A rating agency could downgrade the Preferred Shares, which may make the shares less liquid at an auction or in the secondary market. If a rating agency downgrades the Preferred Shares, the dividend rate on the Preferred Shares will be the applicable maximum rate based on the credit rating of the Preferred Shares. See "Description of Preferred Shares" for a description of the asset maintenance tests the Fund must meet.

The following are general risks of investing in the Fund:

Credit Risks and Realization of Investment Objective. Senior Loans, like other corporate debt obligations, are subject to the risk of non-payment of scheduled interest or principal. Issuers of Senior Loans may have either issued debt securities that are rated lower than investment grade, i.e., rated lower than "Baa" by Moody's or "BBB" by Fitch, or, if they had issued debt securities, such debt securities would likely be rated lower than investment grade. Debt securities rated lower than investment grade are frequently called "junk bonds," and are generally considered predominantly speculative with respect to the issuing company's ability to meet principal and interest payments. Such non-payment would result in a reduction of income to the Fund, a potential reduction in the value of the Senior Loan experiencing non-payment and a potential decrease in the NAV of the Fund. Because the primary source of income for the Fund is the interest and principal payments on the Senior Loans in which it invests, any payment default by an issuer of a Senior Loan would have a negative impact on the Fund's ability to pay dividends on the common shares or the Preferred Shares, and could result in the redemption of some or all of the Preferred Shares. As of December 31, 2003, approximately 3% of the Fund's net assets and 2% of total assets consisted of non-performing Senior Loans.

Although, with respect to collateralized Senior Loans, the Fund generally will invest only in Senior Loans that the Adviser believes are secured by specific collateral, which may include guarantees, the value of which exceeds the principal amount of the Senior Loan at the time of initial investment, there can be no assurance that the liquidation of any such collateral 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 the bankruptcy of a Borrower, the Fund could experience delays or limitations 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 may lose all or substantially all of its value in the event of bankruptcy of the Borrower. The Agent generally is responsible for determining that the Lenders have obtained a perfected security interest in the collateral securing the Senior Loan. In the event that the Fund does not believe that a perfected security interest has been obtained with respect to a collateralized Senior Loan, the Fund will only obtain an interest in such Senior Loan if the Agent is a Designated Custodian. Some Senior Loans in which the Fund may invest are subject to the risk that a court, pursuant to fraudulent conveyance or other similar laws, could subordinate such Senior Loans to presently existing or future indebtedness of the Borrower or take other action detrimental to the holders of Senior Loans, such as the Fund, including, under certain circumstances, invalidating such Senior Loans. Lenders commonly have certain obligations pursuant to the Loan Agreement, which may include the obligation to make additional loans or release collateral in certain circumstances.

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On behalf of the several Lenders, the Agent generally will be required to administer and manage the Senior Loan and, with respect to collateralized Senior Loans, to service or monitor the collateral. In this connection, the valuation of assets pledged as collateral will reflect market value and the Agent may rely on independent appraisals as to the value of specific collateral. The Agent, however, may not obtain an independent appraisal as to the value of assets pledged as collateral in all cases. The Fund normally will rely primarily on the Agent (where the Fund is an Original Lender or owns an Assignment) or the selling Lender (where the Fund owns a Participation) to collect principal of and interest on a Senior Loan. Furthermore, the Fund usually will rely on the Agent (where the Fund is an Original Lender or owns an Assignment) or the selling Lender (where the Fund owns a Participation) to monitor compliance by the Borrower with the restrictive covenants in the Loan Agreement and notify the Fund of any adverse change

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in the Borrower's financial condition or any declaration of insolvency. Collateralized Senior Loans will frequently be secured by all assets of the Borrower that qualify as collateral, which may include common stock of the Borrower or its subsidiaries. Additionally, the terms of the Loan Agreement may require the Borrower to pledge additional collateral to secure the Senior Loan, and enable the Agent, upon proper authorization of the Lenders, to take possession of and liquidate the collateral and to distribute the liquidation proceeds pro rata among the Lenders. If the terms of a Senior Loan do not require the Borrower to pledge additional collateral in the event of a decline in the value of the original collateral, the Fund will be exposed to the risk that the value of the collateral will not at all times equal or exceed the amount of the Borrower's obligations under the Senior Loan. Lenders that have sold Participation interests in such Senior Loan will distribute liquidation proceeds received by the Lenders pro rata among the holders of such Participations. The Adviser will also monitor these aspects of the Fund's investments and, where the Fund is an Original Lender or owns an Assignment, will be directly involved with the Agent and the other Lenders regarding the exercise of credit remedies.

Senior Loans in which the Fund will invest historically have not been rated by a nationally recognized statistical rating organization, will not be registered with the SEC or any state securities commission and will not be listed on any national securities exchange. Although the Fund will generally have access to financial and other information made available to the Lenders in connection with Senior Loans, the amount of public information available with respect to Senior Loans will generally be less extensive than that available for rated, registered or exchange-listed securities. As a result, the performance of the Fund and its ability to meet its investment objective is more dependent on the analytical ability of the Adviser than would be the case for an investment company that invests primarily in rated, registered or exchange-listed securities.

To the extent that legislation or state or federal regulations governing certain financial institutions impose additional requirements or restrictions with respect to the ability of such institutions to make loans in connection with highly leveraged transactions, the availability of Senior Loan interests for investment by the Fund may be adversely affected. In addition, such requirements or restrictions may reduce or eliminate sources of financing for certain Borrowers. Further, to the extent that legislation or federal or state regulations governing certain financial institutions require such institutions to dispose of Senior Loan interests relating to highly leveraged transactions or subject such Senior Loan interests to increased regulatory scrutiny, such

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financial institutions may determine to sell such Senior Loan interests in a manner that results in a price which, in the opinion of the Adviser, is not indicative of fair value. Were the Fund to attempt to sell a Senior Loan interest at a time when a financial institution was engaging in such a sale with respect to such Senior Loan interest, the price at which the Fund could consummate such a sale might be adversely affected.

Limited Secondary Market For Senior Loans. Although it is growing, the secondary market for Senior Loans is currently limited. Senior Loans, at present, generally are not readily marketable and may be subject to restrictions on resale. Interests in Senior Loans generally are not listed on any national securities exchange or automated quotation system and no active trading market may exist for many of the Senior Loans in which the Fund will invest. To the extent that a secondary market may exist for certain of the Senior Loans in which the Fund invests, such market may be subject to irregular trading activity, wide bid/ask spreads and extended trade settlement periods. Senior Loans are thus relatively illiquid, which illiquidity may impair the Fund's ability to realize the full value of its assets in the event of a voluntary or involuntary liquidation of such assets. Liquidity relates to the ability of the Fund to sell an investment in a timely manner. The market for relatively illiquid securities tends to be more volatile than the market for more liquid securities. The Fund has no limitation on the amount of its assets which may be invested in securities which are not readily marketable or are subject to restrictions on resale. The substantial portion of the Fund's assets invested in Senior Loan interests may restrict the ability of the Fund to dispose of its investments in a timely fashion and at a fair price, and could result in capital losses to the Fund and common shareholders. However, many of the Senior Loans in which the Fund expects to purchase interests are of a relatively large principal amount and are held by a relatively large number of owners which should, in the Adviser's opinion, enhance the relative liquidity of such interests.

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Interest Rate Risk. When interest rates decline, the value of a portfolio invested in Senior Loans may rise. Conversely, when interest rates rise, the value of a portfolio invested in Senior Loans may decline. Interest rates are near historical lows and, as a result, it is likely that they will rise. Because floating or variable rates on Senior Loans only reset periodically, changes in prevailing interest rates may cause some fluctuations in the Fund's NAV. Similarly, a sudden and significant increase in market interest rates may cause a decline in the Fund's NAV. A material decline in the Fund's NAV may impair the Fund's ability to maintain required levels of asset coverage.

Investment in Non-U.S. Issuers. The Fund may invest in Senior Loans and debt securities of Borrowers that are organized or located in countries other than the United States, provided that such Senior Loans and debt securities are denominated in U.S. dollars and provide for the payment of interest and repayment of principal in U.S. dollars. Investments in non-U.S. issuers involve special risks, including that non-U.S. issuers may be subject to less rigorous accounting and reporting requirements than U.S. issuers, less rigorous regulatory requirements, differing legal systems and laws relating to creditors' rights, the potential inability to enforce legal judgments and foreclose on collateral, possible restrictions on expatriation and repatriation of capital and the potential for political, social and economic adversity.

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**Leverage.** The Fund uses financial leverage for investment purposes. The use of financial leverage will, among other things, result in greater volatility in the net asset value of the Fund's common shares and may, in certain circumstances, result in periods in which the Fund may not earn sufficient income from investments to pay interest on indebtedness or dividends. See the discussion of the risks of leverage above under the subheading "Leverage Risks."

**Income Risk.** The Fund invests primarily in Senior Loans whose interest rates reset frequently. If market interest rates fall, these interest rates will be reset at lower levels, reducing the Fund's income.

**Non-Diversification.** The Fund has registered as a "non-diversified" investment company so that, subject to its investment restrictions, it will be able to invest more than 5% of the value of its assets in the obligations of any single issuer, including Senior Loans of a single Borrower or Participations purchased from a single Lender. See "Investment Restrictions" in the SAI. The Fund does not intend, however, to invest more than 5% of the value of its assets in interests in Senior Loans of a single Borrower. To the extent the Fund invests a relatively high percentage of its assets in obligations of a limited number of issuers, the Fund will be more susceptible than a more widely diversified investment company to any single corporate, economic, political or regulatory occurrence.

### DESCRIPTION OF COMMERCIAL PAPER PROGRAM

The Fund has entered into a \$700 million revolving credit agreement with Corporate Receivables Corporation and Preferred Receivables Funding Corporation (together with their permitted successors and assigns, the "Conduit Lenders") and with Citicorp North America, Inc. and Bank One, NA (Main Office Chicago) (together with their permitted assigns, the "Secondary Lenders") whereby the Conduit Lenders and the Secondary Lenders from time to time agree to make advances to the Fund on the terms and subject to the conditions in the revolving credit agreement (the "Credit Agreement"). Each of the Conduit Lenders has the authority to lend a maximum of \$350 million to the Fund, and a Secondary Lender may lend to the Fund in the event a related Conduit Lender declines to make advances to the Fund. The Credit Agreement is secured by the assets of the Fund. For the fiscal year ended July 31, 2003, the average daily balance of borrowings under the Credit Agreement was \$472,686,578 with a weighted average interest rate of 1.35%.

A copy of the Credit Agreement is filed as an exhibit to the Registration Statement relating to the Preferred Shares and the description of the Credit Agreement herein is qualified by reference to the Credit Agreement. The Credit Agreement includes usual and customary covenants for their respective type of transaction, including limits on the Fund's ability to (i) incur liens or pledge portfolio securities, (ii) change its investment objective or fundamental investment restrictions without the approval of lenders, (iii) participate in any merger, consolidation, reorganization, liquidation or sale of substantially all of the

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Fund's assets without the consent of the lenders, (iv) make certain changes in its capital structure, (v) amend the Fund documents in a manner which could adversely affect the rights, interests or obligations of any of the lenders, (vi) engage in any business other than as contemplated by the Fund's prospectus, investment policies and investment restrictions, (vii) create, incur, assume or permit to exist certain debt except for certain specified types of debt and (viii) permit any of its affiliates under the Employee Retirement Income Security Act of 1974 ("ERISA") to cause or permit to occur an event that could result in the imposition of a lien under the Code or ERISA. In addition, the Credit Agreement does not permit the Fund's asset coverage ratio (as defined in the Credit Agreements) to fall below 300% at any time (the "Credit Agreement Asset Coverage Test").

The Credit Agreement limits the Fund's ability to pay dividends or make other distributions, including with respect to the Preferred Shares, or purchase or redeem shares, including Preferred Shares, unless the Fund complies with the Credit Agreement Asset Coverage Test. In addition, the Credit Agreement does not permit the Fund to declare dividends or other distributions with respect to the Preferred Shares or purchase or redeem Preferred Shares (i) at any time that an event of default under a Credit Agreement for the credit facility program has occurred and is continuing or (ii) if, after giving effect to such declaration, the Fund would not meet the asset coverage ratios set forth in the Credit Agreement.

Under the requirements of the 1940 Act, the Fund must have asset coverage of at least 300% immediately after any borrowing, including borrowings under the credit facility program. For this purpose, asset coverage means the ratio which the value of the total assets of the Fund, less liabilities and indebtedness not represented by senior securities, bears to the aggregate amount of borrowings representing indebtedness of the Fund.

The Credit Agreement has specified events of default which permit the lenders to seek remedies against the assets of the Fund. These events of default are customary for the types of transaction reflected by the Credit Agreement and include: (i) cross-default and cross-acceleration events with respect to the Fund or the Adviser; (ii) a bankruptcy or insolvency event with respect to the Fund or the Adviser; (iii) specified judgments against the Fund or the Adviser; (iv) misrepresentations by the Fund or the Adviser to the lenders; (v) liens by certain governmental agencies against the Fund or the Adviser; (vi) failure for the lenders to have a first priority perfected security interest in the assets of the Fund; (vii) material modifications of certain specified transaction documents; (viii) a material reduction in the value of the Fund's investments; (ix) change of control or change of management in the Adviser; and (x) failure to comply with terms of the Credit Agreement.

Without preferred shares issued and outstanding, common shareholders elect all of the trustees of the Fund. With preferred shares issued and outstanding, holders of any preferred shares, including the Preferred Shares, will elect two trustees. Under the 1940 Act, upon failure by the Fund to pay dividends on preferred shares in an amount equal to two full years' dividends arrearage, the holders of preferred shares, including the Preferred Shares, shall be entitled to elect a majority of the Board of Trustees until all such dividends arrearage has been paid or provided for.

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The lenders with respect to any borrowing by the Fund may be entitled to elect a majority of the Board of Trustees if certain asset coverage requirements are not maintained. In addition, failure to maintain certain asset coverage requirements may result in a default under the terms of any preferred shares or borrowing. The terms of any borrowing or preferred share issuance may entitle holders of any preferred shares or lenders, as the case may be, to elect a majority of the Board of Trustees in certain other circumstances. See "Description of Capital Structure."

### NET ASSET VALUE

The NAV per share of the Fund's common shares is determined by calculating the total value of the Fund's assets, including assets attributable to any preferred shares outstanding, deducting its total liabilities and the liquidation preference of any preferred shares outstanding, including the Preferred Shares (without giving effect to any potential redemption premium with respect to such preferred shares), and dividing the

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result by the number of common shares outstanding. The NAV is computed on each business day as of 5:00 p.m. Eastern time. The Fund reserves the right to calculate the NAV more frequently if deemed desirable.

Senior Loans are valued by the Fund following valuation guidelines established and periodically reviewed by the Fund's Board of Trustees. Under the valuation guidelines, Senior Loans and securities for which reliable market quotes are readily available are valued at the mean of such bid and ask quotes, and all other Senior Loans, securities and assets of the Fund are valued at fair value in good faith following procedures established by the Board of Trustees. Subject to criteria established by the Fund's Board of Trustees about the availability and reliability of market indicators obtained from independent pricing sources approved by the Board of Trustees, certain Senior Loans will be valued on the basis of such indicators. Other Senior Loans will be valued by independent pricing sources approved by the Fund's Board of Trustees based upon pricing models developed, maintained and operated by those pricing sources or valued by the Adviser by considering a number of factors including consideration of market indicators, transactions in instruments which the Adviser believes may be comparable (including comparable credit quality, interest rate, interest rate redetermination period and maturity), the credit worthiness of the Borrower, the current interest rate, the period until next interest rate redetermination and the maturity of such Senior Loan interests. Consideration of comparable instruments may include commercial paper, negotiable certificates of deposit and short-term variable rate securities which have adjustment periods comparable to the Senior Loan interests in the Fund's portfolio. The fair value of Senior Loans are reviewed and approved by the Fund's Valuation Committee and by the Fund's Board of Trustees. To the extent that an active secondary trading market in Senior Loan interests develops to a reliable degree, the Fund may rely to an increasing extent on market prices and quotations in valuing Senior Loan interests in the Fund's portfolio. The Fund and the Board of Trustees will continue to monitor developments in the Senior Loan market and will make modifications to the current valuation methodology as deemed appropriate.

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It is expected that the Fund's NAV will fluctuate as a function of interest rate and credit factors. Because of the short-term, adjustable rate nature of such instruments held by the Fund, however, the Fund's NAV is expected to fluctuate less in response to changes in interest rates than the net asset values of investment companies with portfolios consisting primarily of traditional longer-term, fixed-income securities. In light of the senior nature of Senior Loan interests that may be included in the Fund's portfolio, and taking into account the Fund's access to non-public information with respect to Borrowers relating to such Senior Loan interests, the Fund does not currently believe that consideration on a systematic basis of ratings provided by any nationally recognized statistical rating organization or price fluctuations with respect to long- or short-term debt of such Borrowers subordinate to the Senior Loans of such Borrowers is necessary for a determination of the value of such Senior Loan interests. Accordingly, the Fund generally will not systematically consider (but may consider in certain instances) and, in any event, will not rely upon such ratings or price fluctuations in determining the value of Senior Loan interests in the Fund's portfolio.

Securities other than Senior Loans held in the Fund's portfolio (other than short-term obligations, but including listed issues) may be valued on the basis of prices furnished by one or more pricing services that determine prices for normal, institutional-size trading units of such securities using market information, transactions for comparable securities and various relationships between securities that are generally recognized by institutional traders. In certain circumstances, portfolio securities will be valued at the last sale price on the exchange that is the primary market for the securities, or the last quoted bid price for those securities for which the over-the-counter market is the primary market or for listed securities in which there were no sales during the day. The value of interest rate swaps will be determined in accordance with a discounted present value formula and then confirmed by obtaining a bank quotation.

Short-term obligations held by the Fund that mature in 60 days or less are valued at amortized cost if their original term to maturity when acquired by the Fund was 60 days or less, or are valued at amortized cost using their value on the 61st day prior to maturity if their original term to maturity when acquired by the Fund was more than 60 days, unless in each case this is determined not to represent fair value.

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Repurchase agreements will be valued at cost plus accrued interest. Securities for which there exist no price quotations or valuations and all other assets are valued at fair value as determined in good faith by or on behalf of the Board of Trustees.

### DESCRIPTION OF PREFERRED SHARES

The following is a brief description of the terms of the Preferred Shares. For the complete terms of the Preferred Shares, you may refer to the Fund's Certificate attached as Appendix B to the Fund's SAI.

The Fund's Declaration of Trust authorizes the issuance of up to 100,000,000 shares of beneficial interest with preference rights, including the

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Preferred Shares, having a par value of \$0.01 per share, in one or more series, with rights as determined by the Board of Trustees, by action of the Board of Trustees without the approval of the common shareholders.

Under the requirements of the 1940 Act, the Fund must, immediately after the issuance of the Preferred Shares, have an "asset coverage" of at least 200%. With respect to the Preferred Shares, asset coverage means the ratio which the value of the total assets of the Fund, less all liabilities and indebtedness not represented by senior securities (as defined in the 1940 Act), bears to the aggregate amount of senior securities representing indebtedness of the Fund, if any, plus the aggregate liquidation preference of the Preferred Shares.

### LIQUIDATION PREFERENCE

Subject to the rights of holders of any series ranking on a parity with Preferred Shares with respect to the distribution of assets upon liquidation of the Fund, whether voluntary or involuntary, the holders of Preferred Shares then outstanding will be entitled to receive and to be paid out of the assets of the Fund available for distribution to its shareholders, before any payment or distribution shall be made on the common shares but after payments are made on the Fund's commercial paper program and other senior obligations, a preferential liquidating distribution equal to the liquidation preference with respect to such shares (\$25,000 per share), plus redemption premium, if any, plus an amount equal to all dividends thereon (whether or not earned or declared) accumulated but unpaid to and including the date of final distribution. After the payment of the full preferential amounts provided for as described herein, Preferred Shareholders as such shall have no right or claim to any of the remaining assets of the Fund.

Neither the consolidation nor merger of the Fund with or into any other corporation or corporations, nor the sale, lease, exchange or transfer by the Fund of all or substantially all of its property and assets, shall be deemed to be a liquidation, dissolution or winding up of the Fund for the purposes of the foregoing paragraph.

### SUMMARY OF AUCTION PROCEDURES

The following is a brief summary of the auction procedures. They are described in more detail in the SAI. The auction determines the dividend rate for Preferred Shares, but the dividend rate will not be higher than the maximum rate. See "-- Dividends and Dividend Periods" below. You may buy, sell or hold Preferred Shares in the auction.

If you own Preferred Shares, you may instruct, orally or in writing, a broker-dealer to enter an order in the auction. Existing Preferred Shareholders can enter three kinds of orders regarding their Preferred Shares: sell, bid, and hold.

- Sell Order -- If you enter a sell order, you indicate that you want to sell shares of such series at \$25,000 per share, without regard to the applicable rate for such series for the next dividend period.

- Bid -- If you enter a bid (or "hold at a rate") order, you indicate that you want to sell shares of such series at \$25,000 per share only if the next dividend period's dividend rate is less than the rate you specify in a bid.

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- Hold Order -- If you enter a hold order, you indicate that you want to continue to own such series, without regard to the applicable rate for shares of such series for the next dividend period.

You may submit different types of orders for your Preferred Shares, as well as orders for additional Preferred Shares. All orders must be for whole shares. All orders you submit are irrevocable. There are a fixed number of Preferred Shares, and the dividend rate likely will vary from auction to auction depending on the number of bidders, the number of shares the bidders seek to buy and general economic conditions, including current interest rates. If you own Preferred Shares and submit a bid higher than the maximum rate, your bid will be treated as a sell order. If you do not enter an order, the broker-dealer will assume that you want to continue to hold Preferred Shares, but if you fail to submit an order and the dividend period is longer than 7 days, the broker-dealer will treat your failure to submit a bid as a sell order.

If you do not currently own Preferred Shares, or want to buy more shares, you may instruct a broker-dealer to enter a bid order to buy shares in an auction at \$25,000 per share at or above a specified dividend rate. If your bid specifies a rate higher than the maximum rate, your order will not be accepted.

Broker-dealers will submit orders from existing and potential shareholders to the auction agent. Neither the Fund nor the auction agent will be responsible for a broker-dealer's failure to submit orders from existing shareholders and potential shareholders. A broker-dealer's failure to submit orders for Preferred Shares held by it or its customers will be treated in the same manner as a shareholder's failure to submit an order to the broker-dealer. A broker-dealer may submit orders to the auction agent for its own account provided it is not an affiliate of the Fund.

The auction agent after each auction for Preferred Shares will pay to each broker-dealer, from funds provided by the Fund, a service charge at the annual rate of 1/4 of 1% in the case of any auction immediately preceding a 7-day dividend period, or a percentage agreed to by the Fund and the broker-dealers, in the case of any auction immediately preceding a special dividend period, of the purchase price of Preferred Shares placed by the broker-dealers at the auction.

If the number of Preferred Shares subject to bid orders with a dividend rate equal to or lower than the maximum rate for Preferred Shares is at least equal to the number of Preferred Shares subject to sell orders, then the dividend rate for the next dividend period will be the lowest rate submitted which, taking into account that rate and all lower rates submitted in order from existing and potential shareholders, would result in existing and potential shareholders owning all the Preferred Shares available for purchase in the

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auction.

If the number of Preferred Shares subject to bid orders with a dividend rate equal to or lower than the maximum rate for Preferred Shares is less than the number of Preferred Shares subject to sell orders, then the auction is considered to be a failed auction, and the dividend rate will be the maximum rate. In that event, existing shareholders that have submitted sell orders (or are treated as having submitted sell orders) may not be able to sell any or all of the shares for which they submitted sell orders.

The auction agent will not accept a bid above the maximum rate. The purpose of the maximum rate is to place an upper limit on dividends of Preferred Shares and in so doing to help protect the earnings available to pay common share dividends, and to serve as the dividend rate in the event of a failed auction (that is, an auction where there are more Preferred Shares offered for sale than there are buyers for those shares).

If broker-dealers submit or are deemed to submit hold orders for all outstanding Preferred Shares, that is considered an "all hold" auction and the dividend rate for the next dividend period will be the all hold rate. The "all hold rate" is 80% of the Reference Rate. The Reference Rate is, with respect to a dividend period having 364 or fewer days, the LIBOR Rate and, with respect to a dividend period having 365 or more days, the Treasury Index Rate (each as defined below).

The auction procedures include a pro rata allocation of shares for purchase and sale. This allocation process may result in an existing shareholder continuing to hold or selling, or a potential shareholder buying, fewer shares than the number of shares in its order. If this happens, broker-dealers will be required to make appropriate pro rata allocations among their customers.

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Settlement of purchases and sales will be made on the next business day (which also is a dividend payment date) after the auction date through The Depository Trust Company. Purchasers will pay for their shares through broker-dealers in same-day funds to The Depository Trust Company against delivery to the broker-dealers. The Depository Trust Company will make payment to the sellers' broker-dealers in accordance with its normal procedures, which require broker-dealers to make payment against delivery in same-day funds. Throughout this Prospectus, a business day is a day on which the NYSE is open for trading, and which is neither a Saturday, Sunday nor any other day on which banks in New York, New York are authorized or obligated by law to close.

The auctions for each series of Preferred Shares will normally be held every seven days, and each subsequent dividend period will normally begin on the following business day.

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

Current Shareholder A      Owns 500 shares, wants to sell      Bid order of 1.5% for all 500

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	all 500 shares if auction rate is less than 1.5%	shares
Current Shareholder B	Owns 300 shares, wants to hold	Hold order -- will take the auction rate
Current Shareholder C	Owns 200 shares, wants to sell all 200 shares if auction rate is less than 1.3%	Bid order of 1.3% rate for all 200 shares
Potential Shareholder D	Wants to buy 200 shares	Places order to buy at or above 1.4%
Potential Shareholder E	Wants to buy 300 shares	Places order to buy at or above 1.3%
Potential Shareholder F	Wants to buy 200 shares	Places order to buy at or above 1.5%

The lowest dividend rate that will result in all 1,000 Preferred Shares continuing to be held by either current or potential Preferred Shareholders is 1.4% (the offer by D). Therefore, the dividend rate will be 1.4%. Current Shareholders B and C will continue to own their shares. Current Shareholder A will sell its shares because A's dividend rate bid was higher than the dividend rate. Potential Shareholder D will buy 200 shares and Potential Shareholder E will buy 300 shares because their bid rates were at or below the dividend rate. Potential Shareholder F will not buy any shares because its bid rate was above the dividend rate.

### SECONDARY MARKET TRADING AND TRANSFER OF PREFERRED SHARES

The broker-dealers (including the underwriters) expect, but are not obligated, to maintain a secondary trading market in Preferred Shares outside of auctions, and may discontinue such activity at any time. There can be no assurance that a secondary trading market for Preferred Shares will develop or, if it does develop, that it will provide owners with liquidity of investment. The Preferred Shares will not be registered on any stock exchange or on the NASDAQ Stock Market. Investors who purchase Preferred Shares in an auction for a special dividend period should note that because the dividend rate on such shares will be fixed for the length of that dividend period, the value of such shares may fluctuate in response to the changes in interest rates, and may be more or less than their original cost if sold on the open market in advance of the next auction thereof, depending on market conditions.

An existing shareholder may sell, transfer, or otherwise dispose of Preferred Shares only in whole shares and only (1) pursuant to a bid or sell order placed with the auction agent in accordance with the auction procedures or (2) to or through a broker-dealer; provided, however, that (a) a sale, transfer or other disposition of Preferred Shares from a customer of a broker-dealer who is listed on the records of that broker-dealer as the holder of such shares to that broker-dealer or another customer of that broker-dealer shall not be deemed to be a sale, transfer or other disposition for purposes of the foregoing if such broker-dealer remains the existing shareholder of the shares so sold, transferred or disposed of immediately after such sale, transfer or disposition and (b) in the case of all transfers other than pursuant to auctions,

the broker-dealer (or other person, if permitted by the Fund) to whom such transfer is made shall advise the auction agent of such transfer.

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### DIVIDENDS AND DIVIDEND PERIODS

General. The following is a general description of dividends and dividend periods for the Preferred Shares. See the SAI for a more detailed discussion of this topic. The dividend rate for the initial dividend period for Preferred Shares offered in this Prospectus will be the rate set out on the inside front cover of this Prospectus. For subsequent dividend periods, Preferred Shares will pay dividends based on a rate set at the auction, normally held weekly, but the rate set at the auction will not exceed the maximum rate. Dividend periods generally will be 7 days, and a dividend period generally will begin on the first calendar day after an auction for such series. In most instances, dividends are also paid weekly, on the business day following the end of the dividend period. The Fund, subject to some limitations, may change the length of dividend periods, designating them as "special dividend periods." See "-- Designation of Special Dividend Periods" below.

Dividend Payments. Except as provided below, the dividend payment date will be the first business day after the dividend period ends. The dividend payment date for special dividend periods of more than 7 days will be set out in the notice designating a special dividend period. See "-- Designation of Special Dividend Periods" below for a discussion of payment dates for a special dividend period.

Dividends on Preferred Shares will be paid on the dividend payment date to holders of record as their names appear on the Fund's record books on the business day next preceding the dividend payment date. If dividends are in arrears, they may be declared and paid at any time to holders of record as their names appear on the Fund's record books on such date, not more than 15 days before the payment date, as the Fund's Board of Trustees may fix.

The Depository Trust Company, in accordance with its current procedures, is expected to credit in same-day funds on each dividend payment date dividends received from the Fund to the accounts of broker-dealers who act on behalf of Preferred Shareholders. Such broker-dealers, in turn, are expected to distribute dividend payments to the person for whom they are acting as agents. If a broker-dealer does not make dividends available to holders of Preferred Shares in same-day funds, these shareholders will not have funds available until the next business day.

Dividend Rate Set at Auction. Preferred Shares pay dividends based on a rate set at auction. The auction usually is held weekly, but may be held less frequently. The auction sets the dividend rate, and Preferred Shares may be bought and sold at the auction. The Bank of New York, the auction agent, reviews orders from broker-dealers on behalf of existing shareholders that wish to sell, hold at the auction rate or hold only at a specified rate, and on behalf of potential shareholders that wish to buy Preferred Shares. The auction agent then determines the lowest dividend rate that will result in all of the outstanding Preferred Shares continuing to be held. The Preferred Shares in this offering will trade at auctions starting in the week following this offering. See "-- Summary of Auction Procedures" above.

Determination of Dividend Rates. The Fund computes the dividends per share

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of each series of Preferred Shares by multiplying the dividend rate determined at the auction by a fraction, the numerator of which normally is 7 and the denominator of which is 360. This rate is then multiplied by \$25,000 to arrive at the dividend per share. The numerator may be different if the dividend period includes a holiday.

If an auction for any subsequent dividend period of Preferred Shares is not held for any reason other than as described below, the dividend rate on those shares will be the maximum rate on the auction date for that subsequent dividend period.

Maximum Rate. The dividend rate that results from an auction for Preferred Shares will not be greater than the "maximum rate." The maximum rate for any regular dividend period will be the higher of the applicable percentage of the reference rate, or the applicable spread plus the reference rate. The reference rate will be the applicable LIBOR Rate (as defined below) (for a dividend period of fewer than 365 days) or the Treasury Index Rate (as defined below) (for a dividend period of 365 days or more).

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The applicable percentage and applicable spread for any regular dividend period will generally be determined on the credit ratings assigned to the Preferred Shares by Moody's and Fitch on the auction date for such period (as set forth in the table below). If Moody's and/or Fitch shall not make such rating available, the rate shall be determined by reference to equivalent ratings issued by a substitute rating agency. In the case of a special dividend period, (1) the maximum applicable rate will be specified by the Fund in the notice of special dividend period for such dividend payment period, (2) the applicable percentage and applicable spread will be determined on the date two business days before the first day of such special dividend period and (3) the reference rate will be the applicable LIBOR Rate (for a dividend period of fewer than 365 days) or the Treasury Index Rate (for a dividend period of 365 days or more). In no event shall the maximum rate be more than 18%.

MOODY'S CREDIT RATING	FITCH'S CREDIT RATING	APPLICABLE PERCENTAGE	APPLICABLE SPREAD
Aaa.....	AAA	150%	150 bps
Aa3 to Aa1.....	AA- to AA+	250%	250 bps
A3 to A1.....	A- to A+	350%	350 bps
Baal and lower.....	BBB+ and lower	550%	550 bps

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

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The "LIBOR Rate" is the applicable London Inter-Bank Offered Rate for deposits in U.S. dollars for the period most closely approximating the applicable dividend period for a series of Preferred Shares. For a more detailed description, please see the Certificate.

The "Treasury Index Rate" is the average yield to maturity for certain U.S. Treasury securities having substantially the same length to maturity as the applicable dividend period for a series of Preferred Shares. For a more detailed description, please see the Certificate.

Assuming the Fund maintains an Aaa/AAA rating on the Preferred Shares, the practical effect of the different methods used to calculate the maximum rate is shown in the table below:

REFERENCE RATE -----	MAXIMUM RATE USING APPLICABLE PERCENTAGE -----	MAXIMUM RATE USING APPLICABLE SPREAD -----	METHOD USED TO DETERMINE MAXIMUM RATE -----
1%	1.50%	2.50%	Spread
2%	3.00%	3.50%	Spread
3%	4.50%	4.50%	Either
4%	6.00%	5.50%	Percentage
5%	7.50%	6.50%	Percentage

Effect of Failure to Pay Dividends in a Timely Manner. If the Fund fails to pay, in a timely manner, the auction agent the full amount of any dividend on any Preferred Shares, but the Fund cures the failure and pays any late charge before 12:00 noon New York City time on the third business day following the date the failure occurred, no auction will be held for Preferred Shares of that series for the first subsequent dividend period thereafter, and the dividend rate for Preferred Shares of that series for that subsequent dividend period will be the maximum rate.

However, if the Fund does not effect a timely cure, no auction will be held for Preferred Shares of that series for the first subsequent dividend period thereafter (and for any dividend period thereafter, to and including the dividend period during which the failure is cured and the late charge is paid), and the dividend rate for Preferred Shares of that series for each subsequent dividend period will be the default rate.

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fewer than 184 days and 300% of the applicable Treasury Index Rate for a dividend period of 184 days or more. Late charges are also calculated at the applicable default rate.

Restrictions on Dividends and Other Distributions. When the Fund has any Preferred Shares outstanding, the Fund may not pay any dividend or distribution (other than a dividend or distribution paid in shares, or options, warrants or rights to subscribe for or purchase, common shares) in respect of common shares or call for redemption, redeem, purchase or otherwise acquire for consideration any common shares (except by conversion into or exchange for shares of the Fund ranking junior to the Preferred Shares as to the payment of dividends and the distribution of assets upon liquidation), unless (1) it has paid all cumulative dividends on Preferred Shares; (2) it has redeemed any Preferred Shares that it has called for mandatory redemption; and (3) after paying the dividend, the Fund meets both asset coverage requirements described under "Rating Agency Guidelines."

Except as set forth in the next sentence, no dividends shall be declared or paid or set apart for payment on any series of shares of the Fund ranking, as to the payment of dividends, on a parity with the Preferred Shares for any period unless full cumulative dividends have been or contemporaneously are declared and paid on the Preferred Shares through their most recent dividend payment date. When dividends are not paid in full upon the Preferred Shares through their most recent dividend payment date or upon any other series of shares ranking on a parity as to the payment of dividends with Preferred Shares through their most recent respective dividend payment dates, all dividends declared upon Preferred Shares and any other such series of shares ranking on a parity as to the payment of dividends with Preferred Shares shall be declared pro rata so that the amount of dividends declared per share on Preferred Shares and such other series of preferred shares shall in all cases bear to each other the same ratio that accumulated dividends per share on the Preferred Shares and such other series of preferred shares bear to each other.

### DESIGNATION OF SPECIAL DIVIDEND PERIODS

The Fund may instruct the auction agent to hold auctions and pay dividends less frequently than weekly. The Fund may do this if, for example, the Fund expects that short-term rates might increase or market conditions otherwise change, in an effort to optimize the effect of the Fund's leverage on common shareholders. The Fund does not currently expect to hold auctions and pay dividends less frequently than weekly in the near future. If the Fund designates a special dividend period, changes in interest rates could affect the price received if the Preferred Shares were sold in the secondary market.

Before the Fund designates a special dividend period: (1) at least 7 business days (or 2 business days in the event the duration of the dividend period prior to such special dividend period is less than 8 days) and not more than 30 business days before the first day of the proposed special dividend period, the Fund must issue a press release stating its intention to designate a special dividend period and inform the auction agent of the proposed special dividend period by telephonic or other means and confirm it in writing promptly thereafter and (2) the Fund must inform the auction agent of the proposed special dividend period by 3:00 p.m. New York City time on the second business day before the first day of the proposed special dividend period.

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### VOTING RIGHTS

In addition to voting rights described below under "Description of Capital Structure" and in the SAI under "Investment Restrictions," holders of preferred shares, including the Preferred Shares, voting as a separate class, are entitled to elect (1) two trustees of the Fund at all times and (2) a majority of the trustees if at any time dividends on any preferred shares shall be unpaid in an amount equal to two years' dividends thereon, and to continue to be so represented until all dividends in arrears shall have been paid or otherwise provided for. Common shareholders will elect the remaining trustees. So long as any of the Preferred Shares are outstanding, the Fund will not, without the affirmative vote of the holders of a majority of the outstanding Preferred Shares: (i) amend, alter or repeal any of the preferences, rights or

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powers of such class so as to affect materially and adversely such preferences, rights or powers; (ii) increase the authorized number of Preferred Shares; (iii) create, authorize or issue shares of any class of shares ranking senior to or on parity with the Preferred Shares or any other series of preferred shares with respect to the payment of dividends or the distribution of assets on liquidation; (iv) institute any proceedings to be adjudicated bankrupt or insolvent, or consent to the institution of bankruptcy or insolvency proceedings against it, or file a petition seeking or consenting to reorganization or relief under any applicable federal or state law relating to bankruptcy or insolvency, or consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Fund or a substantial part of its property, or make any assignment for the benefit of creditors, or, except as may be required by applicable law, admit in writing its inability to pay its debts generally as they become due or take any corporate action in furtherance of any such action; (v) create, incur or suffer to exist, or agree to create, incur or suffer to exist, or consent to cause or permit in the future (upon the happening of a contingency or otherwise) the creation, incurrence or existence of any material lien, mortgage, pledge, charge, security interest, security agreement, conditional sale or trust receipt or other material encumbrance of any kind upon any of the Fund's assets as a whole, except (A) liens the validity of which are being contested in good faith by appropriate proceedings, (B) liens for taxes that are not then due and payable or that can be paid thereafter without penalty, (C) liens, pledges, charges, security interests, security agreements or other encumbrances arising in connection with any indebtedness senior to the Preferred Shares, (D) liens, pledges, charges, security interests, security agreements or other encumbrances arising in connection with any indebtedness permitted under clause (vi) below and (E) liens to secure payment for services rendered including, without limitation, services rendered by the Fund's dividend paying agent and the auction agent; or (vi) create, authorize, issue, incur or suffer to exist any indebtedness for borrowed money or any direct or indirect guarantee of such indebtedness for borrowed money or any direct or indirect guarantee of such indebtedness, except the Fund may borrow as may be permitted by the Fund's investment restrictions; provided, however, that transfers of assets by the Fund subject to an obligation to repurchase shall not be deemed to be indebtedness for purposes of this provision to the extent that after any such transaction the Fund has eligible assets with an aggregate discounted value at least equal to the Preferred Shares Basic Maintenance Amount as of the immediately preceding valuation date. For a description of the Preferred Shares Basic Maintenance Amount, see "Rating Agency Guidelines."

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In addition, the affirmative vote of the holders of a majority of the outstanding Preferred Shares shall be required to approve any plan of reorganization (as such term is used in the 1940 Act) adversely affecting such shares or any action requiring a vote of security holders of the Fund under Section 13(a) of the 1940 Act. In the event a vote of Preferred Shareholders is required pursuant to the provisions of Section 13(a) of the 1940 Act, the Fund shall, not later than ten business days prior to the date on which such vote is to be taken, notify each rating agency that such vote is to be taken and the nature of the action with respect to which such vote is to be taken and shall, not later than ten business days after the date on which such vote is taken, notify each rating agency of the results of such vote.

The affirmative vote of the holders of a majority of the outstanding Preferred Shares of any series, voting separately from any other series, shall be required with respect to any matter that materially and adversely affects the rights, preferences, or powers of that series in a manner different from that of other series or classes of the Fund's shares of beneficial interest. For purposes of the foregoing, no matter shall be deemed to adversely affect any right, preference or power unless such matter: (i) alters or abolishes any preferential right of such series; (ii) creates, alters or abolishes any right in respect of redemption of such series; or (iii) creates or alters (other than to abolish) any restriction on transfer applicable to such series. The vote of holders of any series described in this paragraph will in each case be in addition to a separate vote of the requisite percentage of common shares and/or preferred shares necessary to authorize the action in question.

### REDEMPTION

**Mandatory Redemption.** In the event the Fund does not timely cure a failure to (1) maintain a discounted value of its portfolio equal to the Preferred Shares Basic Maintenance Amount, (2) maintain

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the 1940 Act Preferred Shares Asset Coverage (as defined under "Rating Agency Guidelines" below) or (3) file a required certificate related to asset coverage on time, the Preferred Shares will be subject to mandatory redemption out of funds legally available therefor in accordance with the Declaration of Trust, the Certificate and applicable law, at the redemption price of \$25,000 per share plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared) to (but not including) the date fixed for redemption. Any such redemption will be limited to the number of Preferred Shares necessary to restore the required discounted value or the 1940 Act Preferred Shares Asset Coverage, as the case may be.

In determining the number of Preferred Shares required to be redeemed in accordance with the foregoing, the Fund will allocate the number of shares required to be redeemed to satisfy the Preferred Shares Basic Maintenance Amount or the 1940 Act Preferred Shares Asset Coverage, as the case may be, pro rata among the Preferred Shares and other preferred shares of the Fund, subject to redemption or retirement. If fewer than all outstanding shares of any series are, as a result, to be redeemed, the Fund may redeem such shares by lot or other method that it deems fair and equitable.

**Optional Redemption.** To the extent permitted under the 1940 Act and Massachusetts law, the Fund at its option may redeem Preferred Shares having a

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dividend period of one year or less, in whole or in part, on the business day after the last day of such dividend period upon not less than 15 calendar days and not more than 40 calendar days prior notice. The optional redemption price per share shall be \$25,000 per share, plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared) to the date fixed for redemption. Preferred Shares having a dividend period of more than one year are redeemable at the option of the Fund, in whole or in part, prior to the end of the relevant dividend period, subject to any specific redemption provisions, which may include the payment of redemption premiums to the extent required under any applicable specific redemption provisions. The Fund shall not effect any optional redemption unless after giving effect thereto (i) the Fund has available certain deposit securities with maturity or tender dates not later than the day preceding the applicable redemption date and having a value not less than the amount (including any applicable premium) due to holders of Preferred Shares by reason of the redemption of Preferred Shares on such date fixed for the redemption and (ii) the Fund would have eligible assets with an aggregate discounted value at least equal to the Preferred Shares Basic Maintenance Amount.

Notwithstanding the foregoing, no Preferred Shares may be redeemed at the option of the Fund unless all dividends in arrears on all outstanding preferred shares, including the Preferred Shares, have been or are being contemporaneously paid or set aside for payment; provided however, that the foregoing shall not prevent the purchase or acquisition of outstanding preferred shares pursuant to the successful completion of an otherwise lawful purchase or exchange offer made on the same terms to holders of all outstanding preferred shares.

### RATING AGENCY GUIDELINES

The Fund is required under Moody's and Fitch guidelines to maintain assets having in the aggregate a discounted value at least equal to the Preferred Shares Basic Maintenance Amount. Moody's and Fitch have each established separate guidelines for determining discounted value. To the extent any particular portfolio holding does not satisfy the applicable rating agency's guidelines, all or a portion of such holding's value will not be included in the calculation of discounted value (as defined by such rating agency). The Moody's and Fitch guidelines also impose certain diversification requirements on the Fund's overall portfolio. The Preferred Shares Basic Maintenance Amount includes the sum of (i) the aggregate liquidation preference of the Preferred Shares then outstanding, (ii) the total principal of any senior debt (plus accrued and projected dividends), (iii) certain Fund expenses and (iv) certain other current liabilities.

The Fund is also required under rating agency guidelines to maintain, with respect to the Preferred Shares, as of the last business day of each month in which any Preferred Shares are outstanding, asset coverage of at least 200% with respect to senior securities which are shares of beneficial interest in the

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Fund, including Preferred Shares (or such other asset coverage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities which are shares of a closed-end investment company as a condition of declaring dividends on its common shares) ("1940 Act Preferred Shares Asset Coverage"). Based on the Fund's assets and liabilities as of December 31, 2003 the 1940 Act Preferred Shares Asset Coverage with respect to Preferred Shares, assuming the issuance of all Preferred Shares offered hereby

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and the use of the proceeds as intended, and assuming \$25,000,000 of borrowing under the Fund's commercial paper program, would be computed as follows:

Value of Fund assets less liabilities not constituting senior securities	=	\$2,247,106,303	=	310%
-----		-----		
Senior securities representing indebtedness plus liquidation value of the Preferred Shares		\$725,000,000		

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

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

As described by Moody's and Fitch, a preferred share rating is an assessment of the capacity and willingness of an issuer to pay preferred share obligations. The ratings on the Preferred Shares are not recommendations to purchase, hold or sell Preferred Shares, inasmuch as the ratings do not comment as to market price or suitability for a particular investor. The rating agency guidelines described above also do not address the likelihood that an owner of Preferred Shares will be able to sell such shares in an auction or otherwise. The ratings are based on current information furnished to Moody's and Fitch by the Fund and the Adviser, and information obtained from other sources. The ratings may be changed, suspended or withdrawn as a result of changes in, or the unavailability of, such information.

The rating agency guidelines will apply to Preferred Shares only so long as such rating agency is rating such shares. The Fund will pay fees to Moody's or Fitch, or both, for rating Preferred Shares.

MANAGEMENT OF THE FUND

BOARD OF TRUSTEES

The Fund's Board of Trustees is responsible for the overall management and supervision of the Fund's business, including the review and supervision of the duties performed by the Adviser under the Fund's investment advisory agreement.

THE ADVISER

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Van Kampen Asset Management is the Fund's Adviser. On November 30, 2003, the Fund's investment adviser, Van Kampen Investment Advisory Corp., was merged with and into its affiliate, Van Kampen Asset Management. The Adviser is a wholly-owned subsidiary of Van Kampen Investments. Van Kampen Investments is a diversified asset management company that administers more than

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three million retail investor accounts, has extensive capabilities for managing institutional portfolios and has more than \$84 billion under management or supervision as of December 31, 2003. Van Kampen Investments has more than 50 open-end funds, more than 30 closed-end funds and more than 2,700 unit investment trusts that are distributed by authorized dealers nationwide. Van Kampen Investments is an indirect wholly-owned subsidiary of Morgan Stanley. Morgan Stanley is a full service securities firm engaged in securities trading and brokerage activities, investment banking, research and analysis, financing and financial advisory services. The Adviser's principal place of business is located at 1221 Avenue of the Americas, New York, New York 10020.

### INVESTMENT ADVISORY AGREEMENT

The investment advisory agreement (the "Advisory Agreement") between the Adviser and the Fund provides that the Adviser will supply investment research and portfolio management, including the selection of securities for the Fund to purchase, hold or sell and the selection of financial institutions through whom the Fund's portfolio transactions are executed. For the services provided by the Adviser under the Advisory Agreement, the Fund pays the Adviser a monthly fee (accrued daily and paid monthly) computed based upon an annual rate equal to 0.85% applied to the average daily managed assets of the Fund (which for purposes of determining such fee, shall mean the average daily gross asset value of the Fund, minus the sum of accrued liabilities other than the aggregate amount of any borrowings undertaken by the Fund). Because leverage will increase the amount of total assets, the Fund will pay a greater amount of advisory fees when leverage is utilized. Under the Advisory Agreement, the Adviser also furnishes offices and necessary facilities and equipment, and permits its officers and employees to serve without compensation as trustees and officers of the Fund if duly elected to such positions. The Fund pays all other expenses incurred in the operation of the Fund including, but not limited to, direct charges relating to the purchase and sale of financial instruments in its portfolio, interest charges, fees and expenses of legal counsel and independent auditors, taxes and governmental fees, cost of share certificates, expenses (including clerical expenses) of issuance, sale or repurchase of any of the Fund's portfolio holdings, expenses in connection with the Fund's dividend reinvestments, membership fees in trade associations, expenses of registering and qualifying the common shares of the Fund for sale under federal and state securities laws, expenses of printing and distributing reports, notices and proxy materials to existing holders of common shares, expenses of filing reports and other documents filed with governmental agencies, expenses of annual and special meetings of common shareholders, fees and disbursements of the transfer agents, custodians and sub-custodians, expenses of disbursing dividends and distributions, fees, expenses and out-of-pocket costs of trustees of the Fund who are not affiliated with the Adviser, insurance premiums, indemnification and other expenses not expressly provided for in the Advisory Agreement or the Administration Agreement (as defined below) and any extraordinary expenses of a

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non-recurring nature. The Adviser may in its sole discretion from time to time waive all or a portion of the advisory fee or reimburse the Fund for all or a portion of its other expenses.

The Advisory Agreement continues from year to year, unless earlier terminated as described below, if approved annually (a) by the Board of Trustees of the Fund or by a majority of the Fund's common shares and (b) by a majority of the trustees who are not parties to the agreement or interested persons of any such party, in compliance with the requirements of the 1940 Act. The Advisory Agreement may be terminated without penalty upon 60 days written notice by either party and will automatically terminate in the event of assignment. The Advisory Agreement provides that the Adviser shall not be liable for any error of judgment or of law, or for any loss suffered by the Fund in connection with the matters to which the Advisory Agreement relates, except a loss resulting from willful misfeasance, bad faith or gross negligence on the part of the Adviser in the performance of its obligations and duties, or by reason of its reckless disregard of its obligations and duties under the Advisory Agreement.

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### PORTFOLIO MANAGEMENT

Howard Tiffen, Senior Vice President of the Adviser and Vice President of the Senior Loan funds advised by the Adviser, is primarily responsible for the day-to-day management of the Fund. Mr. Tiffen assumed portfolio management responsibilities for the Fund in December 1999. Mr. Tiffen also has primary responsibility for the day-to-day management of Van Kampen Senior Loan Fund, a continuously offered closed-end investment company investing primarily in Senior Loans and having investment objectives and policies substantially similar to those of the Fund. Mr. Tiffen has over 25 years of investment experience and manages, as of December 31, 2003, over \$3.7 billion in Senior Loan assets for Van Kampen. Prior to joining the Adviser, Mr. Tiffen was a senior portfolio manager for the Senior Loan fund of another investment management company from 1995 to 1999. From 1982 to 1995, Mr. Tiffen held positions in the lending and capital markets functions at Bank of America and its predecessor, Continental Bank. Mr. Tiffen received a bachelor's degree from Northwestern University, Chicago, Illinois. He also is an associate of the Chartered Institute of Bankers and a member of the Economic Club of Chicago.

### THE ADMINISTRATOR

The Administrator for the Fund is Van Kampen Investments. The Administrator's principal business address is 1221 Avenue of the Americas, New York, New York 10020. The Administrator is an indirect wholly-owned subsidiary of Morgan Stanley. The Administrator maintains offices and regional representatives in major cities across the nation.

Pursuant to the administration agreement between the Fund and the Administrator (the "Administration Agreement") and in consideration of its administrative fee, the Administrator will (i) monitor the provisions of the Loan Agreements and any agreements with respect to Participations and Assignments and be responsible for recordkeeping with respect to Senior Loans in the Fund's portfolio; (ii) arrange for the printing and dissemination of proxies

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and reports to holders of the Fund's shares; (iii) in connection with the issuance of any preferred shares by the Fund, calculate, monitor and provide to any rating agencies rating any preferred shares such asset coverage and liquidity reports as the Board of Trustees deems advisable; (iv) negotiate the terms and conditions under which custodian services will be provided to the Fund and the fees to be paid by the Fund in connection therewith; (v) negotiate the terms and conditions under which dividend disbursing services will be provided to the Fund, and the fees to be paid by the Fund in connection therewith and review the provision of dividend disbursing services to the Fund; (vi) provide the Fund's dividend disbursing agent and custodian with such information as is required for such parties to effect payment of dividends and distributions and to implement the Fund's dividend reinvestment plan; (vii) make such reports and recommendations to the Board of Trustees as the trustees reasonably request or deem appropriate; and (viii) provide certain shareholder services to holders or potential holders of the Fund's securities.

For the services rendered to the Fund and related expenses borne by the Administrator, the Fund pays the Administrator a monthly fee (accrued daily and paid monthly) computed based upon an annual rate equal to 0.20% applied to the Fund's average daily managed assets (which for purposes of determining such fee, shall mean the average daily gross asset value of the Fund, minus the sum of accrued liabilities other than the aggregate amount of any borrowings undertaken by the Fund). Because leverage will increase the amount of total assets, the Fund will pay a greater amount of administration fees when leverage is utilized.

CUSTODIAN AND AUCTION AGENT, TRANSFER AGENT,  
DIVIDEND PAYING AGENT AND REGISTRAR

The Fund's securities and cash are held pursuant to a custodian agreement by State Street Bank and Trust Company, whose principal place of business is 225 West Franklin Street, Boston, Massachusetts 02015-1713. Boston Equiserve, L.P., whose principal place of business is Blue Hills Office Park, 150 Royal Street, Canton, Massachusetts 02021, serves as transfer agent, dividend paying agent and registrar for the Fund's common shares. The Depository Trust Company will act as securities depository for the Preferred

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Shares. The Bank of New York, whose principal place of business is 100 Church Street, 8th Floor New York, New York 10286, will act as auction agent, transfer agent, dividend paying agent and registrar for the Preferred Shares.

### FEDERAL TAXATION

The following federal tax discussion is only a summary of certain federal income tax considerations generally applicable to investments in the Fund. It is based on the Code, existing Treasury regulations, rulings published by the Internal Revenue Service (the "Service") and other applicable authority, as of the date of this Prospectus. These authorities are subject to change by legislative or administrative action (retroactively or prospectively). For additional information regarding tax considerations, see the SAI. There may be other tax considerations applicable to particular investors. In addition, income earned through an investment in the Fund may be subject to state, local and foreign taxes.

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### FEDERAL TAXATION OF THE FUND

The Fund has elected to be and intends to qualify each year for taxation as a regulated investment company under Subchapter M of the Code. Provided that the Fund so qualifies and distributes at least 90% of the sum of its investment company taxable income (as that term is defined in the Code, but without regard to the deduction for dividends paid) and certain other income, it will not be subject to federal income tax on income distributed timely to its shareholders in the form of dividends or capital gain dividends. The Fund intends to distribute all of its investment company taxable income and net capital gain (which is the excess of net long-term capital gain over net short-term capital loss) each year.

To satisfy the distribution requirement applicable to regulated investment companies, amounts paid as dividends by the Fund to its shareholders, including its Preferred Shareholders, must qualify for the dividends-paid deduction. In certain circumstances, the Service could take the position that dividends paid on the Preferred Shares constitute preferential dividends under Section 562(c) of the Code, and thus do not qualify for the dividends-paid deduction. If this position were upheld, the Fund could be subject to tax and/or could fail to qualify to be taxed as a regulated investment company. The Fund believes, however, that such a position, if asserted by the Service, would be unlikely to prevail if the issue were properly litigated.

If at any time the Fund does not meet applicable asset coverage requirements, it may be required to suspend distributions until the requisite asset coverage is restored. Any such suspension may prevent the Fund from qualifying as a regulated investment company or may cause the Fund to pay a nondeductible 4% federal excise tax (imposed on regulated investment companies that fail to distribute for a given calendar year, generally, at least 98% of their net investment income and capital gain net income plus certain other amounts). The Fund may call Preferred Shares to maintain or restore the requisite asset coverage.

If the Fund were to fail to qualify as a regulated investment company, the Fund would be taxed in the same manner as an ordinary corporation and distributions to its shareholders would not be deductible by the Fund in computing its taxable income. In addition, the Fund's distributions, to the extent derived from the Fund's current or accumulated earnings and profits, would be taxable to shareholders as ordinary dividends. Such distributions generally will be eligible (i) for the dividends received deduction in the case of corporate shareholders and (ii) for treatment as "qualified dividend income" in the case of individual shareholders.

### FEDERAL INCOME TAXATION OF PREFERRED SHAREHOLDERS

The Fund believes that the Preferred Shares will constitute stock of the Fund and distributions with respect to the Preferred Shares (other than distributions in redemption of Preferred Shares that are treated as exchanges of stock under Section 302(b) of the Code) thus will constitute dividends to the extent attributable to the Fund's current and accumulated earnings and profits.

It is possible, however, that the

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Service might take a contrary position asserting, for example, that the Preferred Shares constitute debt of the Fund. If this position were upheld, distributions by the Fund to Preferred Shareholders would constitute interest, whether or not they exceeded the Fund's earnings and profits, and would be taxed as ordinary income. The Fund believes, however, that such a position, if asserted by the Service, would be unlikely to prevail if the issue were properly litigated. On May 28, 2003, President Bush signed into the law the Jobs and Growth Tax Relief Reconciliation Act of 2003, which contains provisions that reduce the U.S. federal income tax rates on (1) long-term capital gains received by individuals and (2) "qualified dividend income" received by individuals from certain domestic and foreign corporations. The reduced rates apply to long-term capital gains from sales or exchanges in taxable years ending on or after May 6, 2003 and cease to apply for taxable years beginning after December 31, 2008. Because the Fund intends to invest primarily in Senior Loans and other senior debt securities, ordinary income dividends paid by the Fund generally will not be eligible for the reduced rates applicable to "qualified dividend income" and generally will not qualify for the dividends received deduction available to corporations. Distributions from the Fund designated as capital gain dividends will be eligible for the rate applicable to long-term capital gains. Distributions, if any, in excess of the Fund's current and accumulated earnings and profits will first reduce the tax basis of the Preferred Shares and, after such basis has been reduced to zero, will constitute capital gains (assuming such Preferred Shares are held as a capital asset).

Distributions of net capital gain that are designated by the Fund as capital gain dividends will be treated as long-term capital gains in the hands of holders regardless of the holders' respective holding periods for their Preferred Shares. The Service currently takes the position that a regulated investment company that has two or more classes of stock must allocate to each such class proportionate amounts of each type of its income (such as ordinary income and capital gains). Accordingly, the Fund intends to designate the portion of its distributions as capital gain dividends in compliance with this position.

The sale of Preferred Shares will be a taxable transaction for federal income tax purposes. Selling Preferred Shareholders will generally recognize gain or loss in an amount equal to the difference between the amount received in exchange for the Preferred Shares and their basis in the Preferred Shares. If such Preferred Shares are held as a capital asset, the gain or loss will generally be a capital gain or loss. Similarly, a redemption (including a redemption resulting from liquidation of the Fund), if any, of Preferred Shares by the Fund generally will give rise to capital gain or loss if the redemption is treated as an exchange of stock under Section 302(b) of the Code. Generally, a holder's gain or loss will be a long-term gain or loss if the shares have been held for more than one year. Any loss realized upon a taxable disposition of Preferred Shares held for six months or less will be treated as a long-term capital loss to the extent of any capital gain dividends received by the shareholder with respect to such shares. Also, any loss realized upon a taxable disposition of Preferred Shares may be disallowed if other Preferred Shares are acquired within a 61-day period beginning 30 days before and ending 30 days after the date the shares are disposed of. If disallowed, the loss will be

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reflected by an upward adjustment to the basis of the shares acquired.

### BACKUP WITHHOLDING

The Fund may be required to withhold, for U.S. federal income taxes, a certain percentage of all dividends and redemption proceeds payable to shareholders who fail to provide the Fund with their correct taxpayer identification number or who fail to make required certifications, or if the Fund or a shareholder has been notified by the Service that they are subject to backup withholding. Corporate shareholders and other shareholders specified in the Code are exempt from such backup withholding. Backup withholding is not an additional tax. Any amounts withheld may be credited against the shareholder's U.S. federal income tax liability if the appropriate information is provided to the Service.

### OTHER TAXATION

Foreign shareholders, including shareholders who are non-resident aliens, may be subject to U.S. withholding tax on certain distributions at a rate of 30% or such lower rate as may be prescribed by any applicable treaty. (This U.S. federal tax rate may significantly exceed the effective U.S. federal tax

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that would apply if such foreign investors held their share of the Fund's assets directly rather than indirectly through their investment in the Fund.) Investors are advised to consult their own tax advisors with respect to the application to their own circumstances of the above-described general U.S. federal taxation rules and with respect to the state, local or foreign tax consequences to them of an investment in Preferred Shares.

### TAX SHELTER REPORTING REGULATIONS

Under recently promulgated Treasury regulations, if a shareholder recognizes a loss with respect to shares of \$2 million or more for an individual shareholder or \$10 million or more for a corporate shareholder in any single taxable year (or a greater loss over a combination of years), the shareholder must file with the Service a disclosure statement on Form 8886. Direct shareholders of portfolio securities are in many cases excepted from this reporting requirement, but under current guidance, shareholders of a regulated investment company are not excepted. Future guidance may extend the current exception from this reporting requirement to shareholders of most or all regulated investment companies. The fact that a loss is reportable under these regulations does not affect the legal determination of whether the taxpayer's treatment of the loss is proper. Preferred Shareholders should consult their tax advisors to determine the applicability of these regulations in light of their individual circumstances.

### DESCRIPTION OF CAPITAL STRUCTURE

The Fund is an unincorporated business trust established under the laws of the Commonwealth of Massachusetts by the Declaration of Trust dated April 7, 1998. The Declaration of Trust provides that the Board of Trustees of the Fund may authorize separate classes of shares of beneficial interest. The Board of Trustees has authorized an unlimited number of shares of beneficial interest, par value \$0.01 per share, all of which were initially classified as common

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shares. The Declaration of Trust also authorizes 100,000,000 shares of beneficial interest with preference rights, including preferred shares, having a par value of \$0.01 per share, in one or more series, with rights as determined by the Board of Trustees, by action of the Board of Trustees without the approval of the common shareholders. The following table shows the amount of (i) shares authorized, (ii) shares held by the Fund for its own account and (iii) shares outstanding, for each class of authorized securities of the Fund as of December 31, 2003.

TITLE OF CLASS -----	AMOUNT AUTHORIZED -----	AMOUNT HELD BY FUND FOR ITS OWN ACCOUNT -----	AMOUNT OUTST -----
Common shares.....	Unlimited	0	180,010,0
Preferred Shares, Series M.....	5,600	0	0
Preferred Shares, Series T.....	5,600	0	0
Preferred Shares, Series W.....	5,600	0	0
Preferred Shares, Series TH.....	5,600	0	0
Preferred Shares, Series F.....	5,600	0	0

Each common share represents an equal proportionate interest in the assets of the Fund with each other common share in the Fund. Common shareholders will be entitled to the payment of dividends when, as and if declared by the Board of Trustees. The 1940 Act or the terms of any borrowings or Preferred Shares may limit the payment of dividends to the common shareholders. Each whole common share shall be entitled to one vote as to matters on which it is entitled to vote pursuant to the terms of the Fund's Declaration of Trust on file with the SEC. Upon liquidation of the Fund, after paying or adequately providing for the payment of all liabilities of the Fund and the liquidation preference with respect to any outstanding Preferred Shares, and upon receipt of such releases, indemnities and refunding agreements as they deem necessary for their protection, the Board of Trustees may distribute the remaining assets of the Fund among the common shareholders.

The Declaration of Trust provides that shareholders are not liable for any liabilities of the Fund, requires inclusion of a clause to that effect in every agreement entered into by the Fund and indemnifies

shareholders against any such liability. Although shareholders of an unincorporated business trust established under Massachusetts law, in certain limited circumstances, may be held personally liable for the obligations of the trust as though they were general partners, the provisions of the Declaration of Trust described in the foregoing sentence make the likelihood of such personal liability remote. The Declaration of Trust further provides that obligations of the Fund are not binding upon trustees individually but only upon the property of the Fund and that the trustees will not be liable for errors of judgment or mistakes of fact or law, but nothing in the Declaration of Trust protects a trustee against any liability to which he or she would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence or reckless disregard

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of the duties involved in the conduct of his or her office.

While there are any Preferred Shares or borrowings outstanding, the Fund may not declare any cash dividend or other distribution on its common shares, unless at the time of such declaration, (1) all accrued dividends on Preferred Shares or accrued interest on borrowings has been paid and (2) the value of the Fund's total assets (determined after deducting the amount of such dividend or other distribution), less all liabilities and indebtedness of the Fund not represented by senior securities, is at least 300% of the aggregate amount of such securities representing indebtedness and at least 200% of the aggregate amount of securities representing indebtedness plus the aggregate liquidation value of the Preferred Shares (expected to equal the aggregate original purchase price of the 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, the Fund is required to comply with other asset coverage requirements as a condition of the Fund obtaining a rating of the Preferred Shares from a nationally recognized statistical rating organization and as a condition to borrowing money. This limitation on the Fund's ability to make distributions on its common shares could in certain circumstances impair the ability of the Fund to maintain its qualification for taxation as a regulated investment company. The Fund intends, however, to the extent possible to purchase or redeem Preferred Shares or to repay borrowings from time to time to maintain compliance with such asset coverage requirements and may pay special dividends to Preferred Shareholders in certain circumstances in connection with any such impairment of the Fund's status as a regulated investment company. Depending on the timing of any such redemption or repayment, the Fund may be required to pay a premium in addition to the liquidation preference of the Preferred Shares or the principal amount of the borrowings to the holders thereof. See "-- Borrowings" below.

The Fund has no present intention of offering additional common shares. Other offerings of its common shares, if made, will require approval of the Fund's Board of Trustees. Any additional offering will not be sold at a price per common share below the then current NAV (exclusive of underwriting discounts and commissions) except in connection with an offering to existing common shareholders or with the consent of a majority of the Fund's outstanding common shares. The common shares have no preemptive rights.

The common shares trade on the NYSE under the symbol "VVR." The following table shows for the Fund's common shares for the periods indicated: (1) the high and low closing prices as shown on the NYSE Composite Transaction Tape; (2) the NAV per common share represented by each of the high and low closing prices as shown on the NYSE Composite Transaction Tape; and (3) the discount from or premium to NAV per common share (expressed as a percentage) represented by these closing prices. The table also sets forth the average daily volume of shares traded as shown on the NYSE Composite Transaction Tape during the respective quarter.

CALENDAR QUARTER ENDED	PRICE		NAV		PREMIUM/ (DISCOUNT) MARKET PRICE TO NAV		AVERAGE DAILY VOLUME
	HIGH	LOW	HIGH	LOW	HIGH	LOW	
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March 31, 2003.....	\$7.29	\$6.71	\$7.74	\$7.64	(5.81)%	(12.17)%	343,721
June 30, 2003.....	\$7.89	\$7.23	\$8.03	\$7.70	(1.74)%	(6.10)%	435,211
September 30, 2003.....	\$8.19	\$7.73	\$8.24	\$8.04	(0.61)%	(3.86)%	438,798
December 31, 2003.....	\$8.74	\$7.93	\$8.46	\$8.26	3.31%	(4.00)%	408,890

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On December 31, 2003, the last reported sales price of the Fund's common shares on the NYSE was \$8.63 and the Fund's NAV was \$8.46, representing a 2% premium of market price to NAV as of that date.

BORROWINGS

The Fund's current fundamental investment restriction regarding senior securities allows the Fund, without prior approval of the common shareholders, to borrow money in an amount up to 33 1/3% of the Fund's total assets. In this connection, the Fund may issue notes or other evidence of indebtedness (including bank borrowings or commercial paper) and may secure any such borrowings by mortgaging, pledging or otherwise subjecting as security the Fund's assets. In connection with such borrowing, the Fund may be required to maintain minimum average balances with the lender or to pay a commitment or other fee to maintain a line of credit. Any such requirements will increase the cost of borrowing over the stated interest rate. Under the requirements of the 1940 Act, the Fund, immediately after any such borrowings, must have an "asset coverage" of at least 300%. With respect to any such borrowing, asset coverage means the ratio which the value of the total assets of the Fund, less all liabilities and indebtedness not represented by senior securities (as defined in the 1940 Act), bears to the aggregate amount of such borrowing represented by senior securities by the Fund. Certain types of borrowing may result in the Fund being subject to covenants in credit agreements relating to asset coverages or portfolio composition or otherwise. Such restrictions may be more stringent than those imposed by the 1940 Act. The rights of lenders to the Fund to receive interest on and repayment of principal of any such borrowings will be senior to those of the common shareholders, and the terms of any such borrowings may contain provisions which limit certain activities of the Fund, including the payment of dividends to common shareholders in certain circumstances. In the event that such provisions would impair the Fund's status as a regulated investment company, the Fund, subject to its ability to liquidate its relatively illiquid portfolio, intends to repay the borrowings. Further, the terms of any such borrowing may and the 1940 Act does (in certain circumstances) require that the lenders to the Fund have certain voting rights in the event of a failure to maintain certain asset coverage requirements. Any borrowing will likely rank senior to or pari passu with all other existing and future borrowings of the Fund. The Fund may also borrow up to an additional 5% of its total assets for temporary purposes. See "Investment Restrictions" in the SAI.

The Fund has filed a proxy statement seeking a shareholder vote to amend the aforementioned investment restriction regarding the Fund's use of financial leverage to allow the Fund to utilize financial leverage to the maximum extent allowable under the 1940 Act. The Fund expects to hold a shareholder meeting to vote on this proposal on April 8, 2004.

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### CONVERSION TO OPEN-END FUND

The Fund may be converted to an open-end investment company at any time by an amendment to the Declaration of Trust. The Declaration of Trust provides that such an amendment would require the approval of (a) a majority of the trustees, including the approval by a majority of the disinterested trustees of the Fund and (b) the lesser of (i) 67% or more of the Fund's common shares and preferred shares, each voting as a class, present at a meeting at which holders of more than 50% of the outstanding shares of each class are present in person or by proxy or (ii) more than 50% of the outstanding common shares and preferred shares, each voting as a class. If approved in the foregoing manner, conversion of the Fund 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. The composition of the Fund's portfolio likely would prohibit the Fund from complying with regulations of the SEC applicable to open-end investment companies. Accordingly, conversion likely would require significant changes in the Fund's investment policies and liquidation of a substantial portion of its relatively illiquid portfolio. Conversion of the Fund to an open-end investment company also would require the redemption of all outstanding preferred shares, including the Preferred Shares, and could require the repayment of borrowings, which would eliminate the leveraged capital structure of the Fund with respect to the common shares. In the event of conversion, the common shares would cease to be listed on the NYSE or other national securities

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exchange or market system. 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 redemption. The Fund expects to pay all such redemption requests in cash, but intends to reserve 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 common shares will be sold at NAV plus a sales load.

### REPURCHASE OF COMMON SHARES

Shares of closed-end management investment companies frequently trade at a discount to their NAVs but in some cases trade at a premium. In recognition of the possibility that the Fund's common shares might similarly trade at a discount, the Fund's Board of Trustees has determined that from time to time it may be in the interest of common shareholders for the Fund to take action to attempt to reduce or eliminate a market value discount from NAV. The Board of Trustees, in consultation with the Adviser, will review on a quarterly basis the possibility of open market repurchases and/or tender offers for the common shares and will consider such factors as the market price of the common shares, the NAV of the common shares, the liquidity of the assets of the Fund, whether such transactions would impair the Fund's status as a regulated investment company or result in a failure to comply with applicable asset coverage requirements, general economic conditions and such other events or conditions which may have a material effect on the Fund's ability to consummate such transactions. There are no assurances that the Board of Trustees will, in fact, decide to undertake either of these actions or, if undertaken, that such actions will result in the Fund's common shares trading at a price which is equal to or approximates their NAV. In addition, the Board of Trustees will not necessarily

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announce when it has given consideration to these matters. Common shares will not be repurchased unless after such repurchase the Fund would continue to satisfy the 1940 Act asset coverage requirements with respect to the Preferred Shares or any borrowing and any asset coverage requirements which may be imposed by any rating service as a condition of its rating of the Preferred Shares or by any lender with respect to any borrowing.

Although the Board of Trustees believes that common share repurchases and tenders generally could have a favorable effect on the market price of the Fund's common shares, it should be recognized that the acquisition of common shares by the Fund will decrease the total assets of the Fund and, therefore, have the effect of increasing the Fund's expense ratio and decreasing the asset coverage available with respect to the Preferred Shares and any borrowing. Because of the nature of the Fund's investment objective and policies and the Fund's portfolio, the Adviser anticipates potential difficulty in disposing of portfolio securities in order to consummate tender offers for the common shares. As a result, the Fund may be required to borrow money in order to finance repurchases and tender offers. Interest on any such borrowings will reduce the Fund's net investment income. See "Description of Capital Structure -- Borrowings." Disposition of portfolio securities may increase the Fund's portfolio turnover rate and will result in related costs to the Fund.

Even if a tender offer has been made, it is the Board of Trustees' announced policy, which may be changed by the Board of Trustees, that the Fund cannot accept tenders or effect repurchases if (1) such transactions, if consummated, would (a) result in the delisting of the Fund's common shares from the NYSE or other national securities exchange (the Fund understands that the NYSE would consider delisting if the aggregate market value of the Fund's outstanding common shares is less than \$5,000,000, the number of publicly held common shares falls below 600,000 or the number of round-lot holders falls below 1,200), (b) impair the Fund's status as a regulated investment company under the Code (which would make the Fund a taxable entity, causing the Fund's taxable income to be taxed at the Fund level) or (c) result in a failure to comply with applicable asset coverage requirements; (2) the amount of securities tendered would require liquidation of such a substantial portion of the Fund's securities that the Fund would not be able to liquidate portfolio securities in an orderly manner in light of the existing market conditions and such liquidation would have an adverse effect on the NAV of the Fund to the detriment of non-tendering shareholders; or (3) there is, in the Board of Trustees' judgment, any (a) material legal

action or proceeding instituted or threatened challenging such transactions or otherwise materially adversely affecting the Fund, (b) suspension of or limitation on prices for trading in securities generally on the NYSE, the American Stock Exchange or other national securities exchange or national market system, (c) declaration of a banking moratorium by federal or state authorities or any suspension of payment by banks in the United States or New York State, (d) limitation affecting the Fund or the issuers of its portfolio securities imposed by federal or state authorities on the extension of credit by lending institutions, (e) threatened or actual conditions of war, armed hostilities or other international or national calamity directly or indirectly involving the United States or (f) any other event or condition which would have a material adverse effect on the Fund or its shareholders if common shares were

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repurchased. The Board of Trustees may modify these conditions in light of experience.

Under the requirements of the 1940 Act, the Fund cannot accept tenders or effect repurchases of the common shares unless, after deducting the amount of the tender or repurchase price, the value of the Fund's total assets, less all liabilities and indebtedness of the 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 Preferred Shares (expected to equal the aggregate original purchase price of the 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, the Fund may be precluded from accepting tenders or effecting repurchases at any time dividends on the Preferred Shares or payment of interest or repayment of principal on any borrowings are in arrears. Any tender offer made by the Fund for its common shares will be at a price equal to the NAV of the common shares determined at the close of business on the day the offer ends. During the pendency of any tender offer by the Fund, the Fund will calculate daily the NAV of the common shares and will establish procedures which will be specified in the tender offer documents, to enable common shareholders to ascertain readily such NAV. The relative illiquidity of some of the Fund's portfolio securities could adversely impact the Fund's ability to calculate NAV in connection with determinations of pricing for tender offers, if any. Each offer will be made and common shareholders notified in accordance with the requirements of the Securities Exchange Act of 1934, as amended, and the 1940 Act, either by publication or mailing or both. Each offering document will contain such information as is prescribed by such laws and the rules and regulations promulgated thereunder.

Should the Fund determine to make a tender offer for its common shares, a notice describing the tender offer, containing information common shareholders should consider in deciding whether to tender their common shares and including instructions on how to tender common shares will be sent to shareholders of record. Information concerning the purchase price to be paid by the Fund and the manner in which shareholders may ascertain NAV during the pendency of a tender offer will also be set forth in the notice. When a tender offer is authorized to be made by the Fund's Board of Trustees, a common shareholder wishing to accept the offer will be required to tender all (but not less than all) of the common shares owned by such shareholder (or attributed to him for federal income tax purposes under Section 318 of the Code). The Fund will purchase all common shares tendered in accordance with the terms of the offer unless it determines in accordance with the terms of the offer to accept none of them. Each person tendering common shares will pay to the Fund a reasonable service charge, currently anticipated to be \$25.00, subject to change, to help defray certain costs, including the processing of tender forms, effecting payment, postage and handling. It is the position of the staff of the SEC that such service charge may not be deducted from the proceeds of the purchase. The Fund's transfer agent will receive a fee as an offset to these costs. The Fund expects that the cost to the Fund of effecting a tender offer will exceed the aggregate of all service charges received from those who tender their common shares. Costs associated with the tender will be charged against capital. Tendered common shares that have been accepted and purchased by the Fund will be held in treasury and may be retired by the Board of Trustees. Treasury common shares will be recorded and reported as an offset to shareholders' equity and accordingly will reduce the Fund's total assets. If treasury common shares are retired, common shares issued and outstanding and capital in excess of par value will be reduced accordingly.

PREFERRED SHARES

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

The Fund's Declaration of Trust authorizes the issuance of a class of preferred shares (which class may be divided into two or more series) as the Board of Trustees may, without shareholder approval, authorize. The Preferred Shares have such preferences, voting powers, terms of redemption, if any, and special or relative rights or privileges (including conversion rights, if any) as the Board of Trustees may determine and as are set forth in the Fund's Certificate establishing the terms of the Preferred Shares. The number of shares of the preferred class or series authorized is limited to 100,000,000 and the shares authorized may be represented in part by fractional shares. Under the Fund's Certificate, the Board of Trustees has authorized the creation of 28,000 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 M, T, W, TH and F Auction Rate Cumulative Preferred Shares.

UNDERWRITING

Citigroup Global Markets Inc. is acting as a representative of the underwriters named below (the "Underwriters"). Subject to the terms and conditions in the underwriting agreement dated the date hereof (the "Underwriting Agreement"), each Underwriter named below has severally agreed to purchase, and the Fund has agreed to sell to such Underwriter, the number of Preferred Shares set forth opposite the name of such Underwriter.

UNDERWRITERS -----	SERIES M -----	SERIES T -----	SERIES W -----	SERIES TH -----	SERIES F -----
Citigroup Global Markets Inc. ....					
Merrill Lynch, Pierce, Fenner & Smith Incorporated.....					
A.G. Edwards & Sons, Inc. ....					
Lehman Brothers Inc. ....					
Wachovia Capital Markets, LLC.....					
Total.....					

The Underwriting Agreement provides that the obligations of the Underwriters to purchase the shares included in this offering are subject to the

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approval of certain legal matters by counsel and to certain other conditions. The Underwriters are obligated to purchase all the Preferred Shares if they purchase any of the Preferred Shares.

The Underwriters propose to offer some of the shares directly to the public at the public offering price set forth on the cover page of this Prospectus and some of the shares to certain dealers at the public offering price less a concession not in excess of \$        per share. The sales load the Fund will pay of \$        per share is equal to        % of the initial offering price. The Underwriters may allow, and such dealers may reallow, a concession not in excess of \$        per share on sales to certain other dealers. If all of the Preferred Shares are not sold at the initial offering price, the representative may change the public offering price and other selling terms. Investors must pay for any Preferred Shares purchased on or before February        , 2004.

The Fund and the Adviser have each agreed that, for a period of 180 days from the date of the Underwriting Agreement, they will not, without the prior written consent of Citigroup Global Markets Inc., on behalf of the Underwriters, sell, contract to sell, or otherwise dispose of any senior securities (as defined in the 1940 Act) of the Fund, or any securities convertible into or exchangeable for senior securities or grant any options or warrants to purchase senior securities of the Fund other than Preferred Shares. Citigroup Global Markets Inc., on behalf of the Underwriters, in its sole discretion may release any of the securities subject to those lock-up agreements at any time without notice.

Because an affiliate of Citigroup Global Markets Inc. will receive a portion of the net proceeds, this offering is being conducted pursuant to conduct Rule 2710(c)(8) of the National Association of Securities Dealers, Inc. The Fund anticipates that from time to time certain Underwriters may act as brokers or dealers in connection with the execution of the Fund's portfolio transaction after they have ceased to be Underwriters and, subject to certain conditions, may act as brokers while they are Underwriters.

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

The Fund and the Adviser have agreed to indemnify the Underwriters in connection with this offering against certain liabilities, including liabilities arising under the Securities Act of 1933, as amended, or to contribute payments the Underwriters may be required to make for any of those liabilities. Insofar as indemnification for liability arising under the Securities Act of 1933, as amended (the "Securities Act"), may be permitted to trustees, officers and controlling persons of the registrant pursuant to the foregoing

provisions, or otherwise, the registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for

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indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a trustee, officer or controlling person of the registrant 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 Fund 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 and will be governed by the final adjudication of such issue.

The principal business address of Citigroup Global Markets Inc. is 388 Greenwich Street, New York, New York 10013.

### LEGAL MATTERS

Certain legal matters in connection with the Preferred Shares offered hereby will be passed upon for the Fund by Skadden, Arps, Slate, Meagher & Flom LLP, Chicago, Illinois, and for the Underwriters by Simpson Thacher & Bartlett LLP, New York, New York.

### EXPERTS

The financial statements of the Fund at July 31, 2003 and the selected per share data and ratios set forth under the caption "Financial Highlights" for each of the fiscal years ended 2000 through 2003 have been audited by Deloitte & Touche LLP, independent auditors, as set forth in their report incorporated by reference in the SAI, and are included in reliance upon their report given upon Deloitte & Touche LLP's authority as experts in accounting and auditing. The address of Deloitte & Touche LLP is 180 North Stetson Avenue, Chicago, Illinois. The selected per share data and ratios set forth under the caption "Financial Highlights" for the fiscal year ended July 31, 1999 and for the fiscal period ended July 31, 1998 were audited by the Fund's former independent auditors.

### FURTHER INFORMATION

The Fund has filed with the SEC, Washington, DC, a registration statement under the Securities Act with respect to the Preferred Shares offered hereby. Further information concerning these securities and the Fund may be found in the registration statement, of which this Prospectus constitutes a part, on file with the SEC. The Fund is subject to the informational requirements of the Securities Exchange Act of 1934, as amended, and the 1940 Act, and in accordance therewith files other Fund-related reports and information with the SEC. The Fund's registration statement, reports, proxy and information statements and other information may be inspected without charge at the SEC's public reference room at 450 Fifth Street, N.W., Washington, DC 20549, and copies of all or any part thereof may be obtained from such officer after payment of the fees prescribed by the SEC. Call 1-800-SEC-0330 for information about the SEC's public reference room. Such reports and other information concerning the Fund may also be inspected at the offices of the NYSE located at 20 Broad Street, New York, New York 10005.

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\$700,000,000

VAN KAMPEN SENIOR INCOME TRUST

AUCTION RATE CUMULATIVE PREFERRED SHARES

5,600 SHARES, SERIES M

5,600 SHARES, SERIES T

5,600 SHARES, SERIES W

5,600 SHARES, SERIES TH

5,600 SHARES, SERIES F

\$25,000 LIQUIDATION PREFERENCE PER SHARE

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PROSPECTUS

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FEBRUARY , 2004

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CITIGROUP

MERRILL LYNCH & CO.

A.G. EDWARDS & SONS, INC.

LEHMAN BROTHERS

WACHOVIA SECURITIES  
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THE INFORMATION IN THIS STATEMENT OF ADDITIONAL INFORMATION IS NOT COMPLETE AND MAY BE CHANGED. THE FUND MAY NOT SELL THESE SECURITIES UNTIL THE REGISTRATION STATEMENT FILED WITH THE SEC IS EFFECTIVE. THIS STATEMENT OF ADDITIONAL INFORMATION IS NOT AN OFFER TO SELL THESE SECURITIES AND IS NOT SOLICITING AN OFFER TO BUY THESE SECURITIES IN ANY STATE WHERE THE OFFER OR SALE IS NOT PERMITTED.

SUBJECT TO COMPLETION, DATED FEBRUARY 11, 2004

VAN KAMPEN SENIOR INCOME TRUST

STATEMENT OF ADDITIONAL INFORMATION

FEBRUARY , 2004

Van Kampen Senior Income Trust (the "Fund") is a non-diversified, closed-end management investment company registered under the Investment Company Act of 1940, as amended (the "1940 Act"). The Fund's investment objective is to provide a high level of current income, consistent with preservation of capital. The Fund seeks to achieve its objective by investing primarily in a professionally managed portfolio of interests in floating or variable rate senior loans ("Senior Loans") to corporations, partnerships and other entities ("Borrowers") which operate in a variety of industries and geographical regions. The Fund's investment adviser is Van Kampen Asset Management ("Asset Management" or the "Adviser").

The Fund is offering 5,600 Series M, 5,600 Series T, 5,600 Series W, 5,600 Series TH and 5,600 Series F Auction Rate Cumulative Preferred Shares, par value \$0.01 per share, liquidation preference \$25,000 per share (collectively "Preferred Shares").

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This Statement of Additional Information ("SAI") relating to this offering does not constitute a prospectus, but should be read in conjunction with the Prospectus relating thereto dated February , 2004. This SAI does not include all information that a prospective investor should consider before purchasing Preferred Shares in this offering, and investors should obtain and read the Prospectus prior to purchasing such shares. A copy of the Prospectus may be obtained without charge, by calling (800) 847-2424 (or (800) 421-2833 for the hearing impaired) or by writing to the Fund at 1 Parkview Plaza, PO Box 5555, Oakbrook Terrace, Illinois 60181-5555.

Capitalized terms used in this SAI and not otherwise defined are defined in the Fund's Certificate of Vote (the "Certificate") attached hereto as Appendix B.

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The Prospectus and SAI omit certain information contained in the registration statement filed with the Securities and Exchange Commission ("SEC"), Washington, D.C. The registration statement may be obtained from the SEC upon payment of the fee prescribed or inspected at the SEC's office for no charge. The registration statement is also available on the SEC's website ([WWW.SEC.GOV](http://WWW.SEC.GOV)).

### THE FUND

The Fund changed its name from "Van Kampen American Capital Senior Income Trust" to "Van Kampen Senior Income Trust" in 1998. The Fund's investment objective is to provide a high level of current income, consistent with preservation of capital. The Fund seeks to achieve its objective by investing

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primarily in a professionally managed portfolio of interests in floating rate or variable rate senior loans ("Senior Loans") to corporations, partnerships, and other entities ("Borrowers") which operate in a variety of industries and geographical regions (including domestic and foreign entities). Senior Loans in which the Fund invests generally pay interest at rates which are periodically redetermined by reference to a base lending rate plus a premium. These base lending rates are generally the prime rate offered by one or more major United States banks ("Prime Rate"), the London Inter-Bank Offered Rate ("LIBOR"), the Certificate of Deposit ("CD") rate or other base lending rates used by commercial lenders. The value of the Fund's portfolio may be affected by changes in the credit quality of Borrowers with respect to Senior Loan interests in which the Fund invests. No assurance can be given that the Fund will achieve its investment objective.

### INVESTMENT RESTRICTIONS

The Fund's investment objective and the following investment restrictions are fundamental and cannot be changed without the approval of the holders of a majority of the Fund's outstanding shares (defined as the lesser of (i) 67% or more of the voting securities present at a meeting of shareholders, if the holders of more than 50% of the outstanding voting securities are present or represented by proxy at such meeting, or (ii) more than 50% of the outstanding voting securities). All other investment policies or practices are considered by the Fund not to be fundamental and accordingly may be changed without shareholder approval. If a percentage restriction on investment or use of assets set forth below is adhered to at the time a transaction is effected, later changes in percentage resulting from changing market values will not be considered a deviation from policy (except with respect to restriction number 3 below). In accordance with the foregoing, the Fund may not:

1. Purchase any securities (other than obligations issued or guaranteed by the United States Government or by its agencies or instrumentalities) if as a result more than 5% of the Fund's total assets would then be invested in securities of a single issuer or if as a result the Fund would hold more than 10% of the outstanding voting securities of any single issuer; provided that, with respect to 50% of the Fund's assets, the Fund may invest up to 25% of its assets in the securities of any one issuer. For purposes of this restriction, the term issuer includes both the Borrower under a loan agreement and the lender selling a participation to the Fund together with any other persons interpositioned between such lender and the Fund with respect to a participation.

2. Purchase any security if, as a result of such purchase, 25% or more of the Fund's total assets (taken at current value) would be invested in the securities of Borrowers and other issuers having their principal business activities in the same industry (the electric, gas, water and telephone utility industries, commercial banks, thrift institutions and finance companies being treated as separate industries for purposes of this restriction); provided, that this limitation shall not apply with respect to obligations issued or guaranteed by the U.S. Government or by its agencies or instrumentalities.

3. Issue senior securities (including borrowing money or entering into reverse repurchase agreements) in excess of 33 1/3% of its total assets (including the amount of senior securities issued but excluding any liabilities and indebtedness not constituting senior securities) except that the Fund may borrow up to an additional 5% of its total assets for temporary purposes, or

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pledge its assets other than to secure such issuance or in connection with hedging transactions, when-issued and delayed delivery transactions and similar investment strategies.

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4. Make loans of money or property to any person, except for obtaining interests in Senior Loans in accordance with its investment objective, through loans of portfolio securities or the acquisition of securities subject to repurchase agreements.

5. Buy any security "on margin." Neither the deposit of initial or variation margin in connection with hedging transactions nor short-term credits as may be necessary for the clearance of such transactions is considered the purchase of a security on margin.

6. Sell any security "short," write, purchase or sell puts, calls or combinations thereof, or purchase or sell financial futures or options, except to the extent that the hedging transactions in which the Fund may engage would be deemed to be any of the foregoing transactions.

7. Act as an underwriter of securities, except to the extent the Fund may be deemed to be an underwriter in connection with the sale of or granting of interests in Senior Loans or other securities acquired by the Fund.

8. Make investments for the purpose of exercising control or participation in management, except to the extent that exercise by the Fund of its rights under loan agreements would be deemed to constitute such control or participation.

9. Invest in securities of other investment companies, except that the Fund may purchase securities of other investment companies to the extent permitted by (i) the 1940 Act, as amended from time to time, (ii) the rules and regulations promulgated by the SEC under the 1940 Act, as amended from time to time, or (iii) an exemption or other relief from the provisions of the 1940 Act.

10. Buy or sell oil, gas or other mineral leases, rights or royalty contracts except pursuant to the exercise by the Fund of its rights under loan agreements. In addition, the Fund may purchase securities of issuers which deal in, represent interests in or are secured by interests in such leases, rights or contracts.

11. Purchase or sell real estate, commodities or commodities contracts except pursuant to the exercise by the Fund of its rights under loan agreements, except to the extent the interests in Senior Loans the Fund may invest in are considered to be interests in real estate, commodities or commodities contracts and except to the extent that hedging instruments the Fund may invest in are considered to be commodities or commodities contracts.

12. Notwithstanding the investment policies and restrictions of the Fund, upon approval of the Board of Trustees, the Fund may invest all or part of its investable assets in a management investment company with substantially the same

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investment objective, policies and restrictions as the Fund.

For purposes of investment restriction numbers 1 and 2, the Fund will consider all relevant factors in determining whether to treat the lender selling a participation and any persons interpositioned between such lender and the Fund as an issuer, including: the terms of the loan agreement and other relevant agreements (including inter-creditor agreements and any agreements between such person and the Fund's custodian); the credit quality of such lender or interpositioned person; general economic conditions applicable to such lender or interpositioned person; and other factors relating to the degree of credit risk, if any, of such lender or interpositioned person incurred by the Fund.

For purposes of investment restriction number 9, as of the date of this SAI, the 1940 Act generally limits a fund's ability to invest in other investment companies as follows: the Fund and companies it controls cannot own more than 3% of an acquired fund's voting stock in; the securities of an acquired fund cannot exceed more than 5% of the assets of the Fund and companies it controls; and the securities of acquired funds as a group cannot exceed more than 10% of the assets of the Fund and companies it controls. The Fund will rely on representations of Borrowers in loan agreements in determining whether such Borrowers are investment companies.

The Fund generally will not engage in the trading of securities for the purpose of realizing short-term profits, but it will adjust its portfolio as it deems advisable in view of prevailing or anticipated market conditions to accomplish the Fund's investment objective. For example, the Fund may sell portfolio securities in anticipation of a movement in interest rates. Frequency of portfolio turnover will not be a limiting factor if the Fund considers it advantageous to purchase or sell securities. The Fund anticipates that the annual

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portfolio turnover rate of the Fund will not be in excess of 100%. A high rate of portfolio turnover involves correspondingly greater expenses than a lower rate, which expenses must be borne by the Fund and its shareholders.

### TRUSTEES AND OFFICERS

The business and affairs of the Fund are managed under the direction of the Fund's Board of Trustees and the Fund's officers appointed by the Board of Trustees. The tables below list the trustees and executive officers of the Fund and their principal occupations during the last five years, other directorships held by trustees and their affiliations, if any, with Van Kampen Investments Inc. ("Van Kampen Investments"), Asset Management, Van Kampen Funds Inc. (the "Distributor"), Van Kampen Advisors Inc., Van Kampen Exchange Corp. and Van Kampen Investor Services Inc. ("Investor Services"). The term "Fund Complex" includes each of the investment companies advised by Asset Management or its affiliates as of the date of this Statement of Additional Information. Trustees serve until reaching their retirement age or until their successors are duly elected and qualified. Officers are annually elected by the trustees.

### INDEPENDENT TRUSTEES

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NAME, AGE AND ADDRESS OF INDEPENDENT TRUSTEE	POSITION(S) HELD WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST 5 YEARS
David C. Arch (58) Blistex Inc. 1800 Swift Drive Oak Brook, IL 60523	Trustee	Trustee since 1998	Chairman and Chief Executive Officer of Blistex Inc., a consumer health care product manufacturer. Former Director of the World Presidents Organization-Chicago Chapter. Director of the Heartland Alliance, a nonprofit organization serving human needs based in Chicago.

NAME, AGE AND ADDRESS OF INDEPENDENT TRUSTEE	OTHER DIRECTORSHIPS HELD BY TRUSTEE
David C. Arch (58) Blistex Inc. 1800 Swift Drive Oak Brook, IL 60523	Trustee/Director/ Managing General Partner of funds in the Fund Complex.

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NAME, AGE AND ADDRESS OF INDEPENDENT TRUSTEE	POSITION(S) HELD WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST 5 YEARS
Rod Dammeyer (63) CAC, llc. 4350 LaJolla Village Drive Suite 980 San Diego, CA 92122-6223	Trustee	Trustee since 1998	President of CAC, llc., a private company offering capital investment and management advisory services. Prior to July 2000, Managing Partner of Equity Group Corporate Investment (EGI), a company that makes private investments in other companies.
Howard J Kerr (68) 736 North Western Avenue P.O. Box 317 Lake Forest, IL 60045	Trustee	Trustee since 1998	Prior to 1998, President and Chief Executive Officer of Pocklington Corporation, Inc., investment holding company. Director of the Marrow Foundation.
Hugo F. Sonnenschein (63) 1126 E. 59th Street Chicago, IL 60637	Trustee	Trustee since 1998	President Emeritus and Honorary Trustee of the University of Chicago and the Adam Smith Distinguished Service Professor in the Department of Economics at the University of Chicago. Prior to July 2000, President of the University of Chicago. Trustee of the University of Rochester and a member of its investment committee. Member of the National Academy of Sciences, the American Philosophical Society and a fellow of the

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American Academy of Arts and Sciences.

NAME, AGE AND ADDRESS OF INDEPENDENT TRUSTEE	OTHER DIRECTORSHIPS HELD BY TRUSTEE
<p>Rod Dammeyer (63) CAC, llc. 4350 LaJolla Village Drive Suite 980 San Diego, CA 92122-6223</p>	<p>Trustee/Director/ Managing General Partner of funds in the Fund Complex. Director of Stericycle, Inc., TheraSense, Inc., GATX Corporation, Vantana Medical Systems, Inc. and Trustee of The Scripps Research Institute and the University of Chicago Hospitals and Health Systems. Prior to January 2004, Director of TeleTech Holdings Inc. and Arris Group, Inc. Prior to May 2002, Director of Peregrine Systems Inc. Prior to February 2001, Vice Chairman and Director of Anixter International, Inc. and IMC Global Inc. Prior to July 2000, Director of Allied Riser Communications Corp., Matria Healthcare Inc., Transmedia Networks, Inc., CNA Surety, Corp. and Grupo Azcarero Mexico (GAM). Prior to April 1999, Director of Metal Management, Inc.</p>
<p>Howard J Kerr (68) 736 North Western Avenue P.O. Box 317 Lake Forest, IL 60045</p>	<p>Trustee/Director/ Managing General Partner of funds in the Fund Complex. Director of the Lake Forest Bank &amp; Trust.</p>
<p>Hugo F. Sonnenschein (63) 1126 E. 59th Street Chicago, IL 60637</p>	<p>Trustee/Director/ Managing General Partner of funds in the Fund Complex. Director of Winston Laboratories, Inc.</p>

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INTERESTED TRUSTEES\*

NAME, AGE AND ADDRESS OF INTERESTED TRUSTEE	POSITION(S) HELD WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST 5 YEARS
Richard F. Powers, III* (58) 1 Parkview Plaza P.O. Box 5555 Oakbrook Terrace, IL 60181	Trustee	Trustee since 1999	Advisory Director of Morgan Stanley. Prior December 2002, Chairman, Director, Pres Chief Executive Officer and Managing Di of Van Kampen Investments and its invest advisory, distribution and other subsidiaries. Prior to December 2002, President and Chief Executive Officer o funds in the Fund Complex. Prior to May Executive Vice President and Director o Marketing at Morgan Stanley and Directo Dean Witter, Discover & Co. and Dean Wi Realty. Prior to 1996, Director of Dean Witter Reynolds Inc.
Wayne W. Whalen* (64) 333 West Wacker Drive Chicago, IL 60606	Trustee	Trustee since 1998	Partner in the law firm of Skadden, Arp Slate, Meagher & Flom LLP, legal counse funds in the Fund Complex.

NAME, AGE AND ADDRESS OF INTERESTED TRUSTEE	OTHER DIRECTORSHIPS HELD BY TRUSTEE
Richard F. Powers, III* (58) 1 Parkview Plaza P.O. Box 5555 Oakbrook Terrace, IL 60181	Trustee/Director/ Managing General Partner of funds in the Fund Complex.
Wayne W. Whalen* (64) 333 West Wacker Drive Chicago, IL 60606	Trustee/Director/ Managing General Partner of funds in the Fund Complex.

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\* Such trustee is an "interested person" (within the meaning of Section 2(a)(19) of the 1940 Act). Mr. Whalen is an interested person of certain funds in the Fund Complex by reason of his firm currently acting as legal counsel to such funds in the Fund Complex. Mr. Powers is an interested person of funds in the Fund Complex and the Adviser by reason of his former positions with Morgan Stanley or its affiliates.

OFFICERS

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NAME, AGE AND ADDRESS OF OFFICER	POSITION(S) HELD WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST 5 YEARS
Mitchell Merin (50) 1221 Avenue of the Americas New York, NY 10020	President and Chief Executive Officer	Officer since 2002	President and Chief Executive Officer of the Fund Complex since November 2002. Trustee and General Partner of certain funds in the Fund Complex since 1999. Chairman, President, Chief Executive Officer of the Adviser and Van Kampen Investments since December 2002. Chairman, President and Chief Executive Officer of Van Kampen Investments since December 2002. Director of Van Kampen Investments since December 2002. Chairman and Chief Executive Officer of Van Kampen Funds Inc. since December 2002. President and Chief Operating Officer of Morgan Stanley Investment Management since December 1998. President of Morgan Stanley from April 1997 and Chief Executive Officer of Morgan Stanley Investment Advisors Services Company Inc. Chairman, Chief Executive Officer and Director of Morgan Stanley Distributors Inc. since 1998. Chairman since June 1998, and Chairman of Morgan Stanley Trust. Director of Morgan Stanley subsidiaries and President of Morgan Stanley Funds since May 1999. Chief Executive Officer of Morgan Stanley from 2002 to April 2003 and Vice President of Morgan Stanley from 1999 of the Morgan Stanley Funds. Chairman of Morgan Stanley Investment Advisors Services Company Inc. and Executive Vice President of Morgan Stanley Distributors Inc. from April 1998 to April 1999.

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NAME, AGE AND ADDRESS OF OFFICER	POSITION(S) HELD WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST 5 YEARS
Stephen L. Boyd (63) 2800 Post Oak Blvd. 45th Floor Houston, TX 77056	Vice President	Officer since 1998	Managing Director of Global Research and Vice President of funds in the Fund Complex since December 2002, Chief Investment Officer of Van Kampen Investments and President and Chief Executive Officer of the Adviser and Van Kampen Advisors Inc. Executive Vice President and Chief Executive Officer of funds in the Fund Complex. Prior to 2002, Director and Chief Investment Officer of Morgan Stanley Investments, and Managing Director of Morgan Stanley Adviser and Van Kampen Advisors Inc. Executive Vice President and Chief

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			Kampen Investments, and President and Chief Investment Officer of the Adviser. Prior to April 2003, President and Chief Investment Officer of Van Kampen Investments of the Adviser. Prior to April 2003, President and Senior Portfolio Manager of Van Kampen Management, Inc. Prior to February 2003, President and Portfolio Manager of Van Kampen Capital Asset Management, Inc., Van Kampen Investment Advisory Corp. and Van Kampen Management, Inc.
Stefanie V. Chang (37) 1221 Avenue of the Americas New York, NY 10020	Vice President	Officer since 2003	Executive Director of Morgan Stanley and Vice President of funds in the Fund Complex.
Joseph J. McAlinden (61) 1221 Avenue of the Americas New York, NY 10020	Executive Vice President and Chief Investment Officer	Officer since 2002	Managing Director and Chief Investment Officer of Stanley Investment Advisors Inc., Morgan Stanley Management Inc. and Morgan Stanley Trust for the Fund Complex. Director of Morgan Stanley Trust for the Fund Complex. Vice President and Chief Investment Officer of Morgan Stanley Trust for the Fund Complex. Managing Director and Chief Investment Officer of Van Kampen Investments, the Adviser and Stanley Investment Advisors Inc. since December 2002.
John R. Reynoldson (50) 1 Parkview Plaza P.O. Box 5555 Oakbrook Terrace, IL 60181	Vice President	Officer since 2000	Executive Director and Portfolio Specialist of Van Kampen Advisors Inc. Vice President of the Fund Complex. Prior to July 2001, Vice President of the Fixed Income Department of the Fund Complex. Prior to December 2000, Senior Vice President of the Fund Complex of the Adviser and Van Kampen Advisors Inc. Prior to December 2000, Senior Vice President of the Fund Complex of the Adviser and Van Kampen Advisors Inc. Prior to July 2000, Senior Vice President of the Fund Complex of the Advisers. Prior to July 2000, Senior Vice President of the Fund Complex of the Advisers. Prior to July 2000, Senior Vice President of the government securities group for the Advisers. Prior to July 2000, Senior Vice President of the government securities Management.
Ronald E. Robison (65) 1221 Avenue of the Americas New York, NY 10020	Executive Vice President and Principal Executive Officer	Officer since 2003	Chief Executive Officer and Chairman of the Board of Van Kampen Executive Vice President and Principal Executive Officer of funds in the Fund Complex. Chief Global Executive Vice President and Principal Executive Officer of Morgan Stanley Management Inc. Managing Director of Morgan Stanley Management Inc. Managing Director of Morgan Stanley Management Inc. Managing Director and Director of Morgan Stanley Management Inc. and Morgan Stanley Securities Inc. Executive Officer and Director of Morgan Stanley Management Inc. President of the Morgan Stanley Fund Complex.
A. Thomas Smith III (47) 1221 Avenue of the Americas New York, NY 10020	Vice President and Secretary	Officer since 1999	Managing Director of Morgan Stanley Management Inc. Director of Van Kampen Investments, Morgan Stanley Management Inc., the Distributor and certain other subsidiaries of Van Kampen Investments. Managing Director and General Counsel of Morgan Stanley Investment Advisors, Inc. Vice President and Secretary of funds in the Fund Complex. Managing Director, General Counsel, Secretary and Director of Van Kampen Investments, the Adviser, Van Kampen Investor Services, and certain other subsidiaries of Van Kampen Investments. Prior to December 1999, President, General Counsel, Secretary and Director of Van Kampen Investments, the Adviser, Van Kampen Investor Services, the Distributor, Investor Services and certain other subsidiaries of Van Kampen Investments. Prior to December 1999, Vice President and Associate Secretary of New York Life Insurance Company ("New York Life").

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March 1997, Associate General Counsel  
 Prior to December 1993, Assistant General Counsel  
 Dreyfus Corporation. Prior to August 1993,  
 Willke Farr & Gallagher. Prior to July 1993,  
 Attorney at the Securities and Exchange Commission  
 of Investment Management, Office of

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NAME, AGE AND ADDRESS OF OFFICER	POSITION(S) HELD WITH FUND	TERM OF OFFICE AND LENGTH OF TIME SERVED	PRINCIPAL OCCUPATION(S) DURING PAST 5 YEARS
John L. Sullivan (48) 1 Parkview Plaza P.O. Box 5555 Oakbrook Terrace, IL 60181	Vice President, Chief Financial Officer and Treasurer	Officer since 1996	Director and Managing Director of V the Adviser, Van Kampen Advisors In subsidiaries of Van Kampen Investme Chief Financial Officer and Treasur Complex. Head of Fund Accounting fo Investment Management. Prior to Dec Director of Van Kampen Investments, Kampen Advisors Inc.

Each trustee who is not an affiliated person (as defined in the 1940 Act) of Van Kampen Investments, the Adviser or the Distributor (each a "Non-Affiliated Trustee") is compensated by an annual retainer and meeting fees for services to funds in the Fund Complex. Each fund in the Fund Complex (except Van Kampen Exchange Fund) provides a deferred compensation plan to its Non-Affiliated Trustees that allows trustees to defer receipt of their compensation until retirement and earn a return on such deferred amounts. Amounts deferred are retained by the Fund and earn a rate of return determined by reference to the return on the common shares of the Fund or other funds in the Fund Complex as selected by the respective Non-Affiliated Trustee. To the extent permitted by the 1940 Act, the Fund may invest in securities of those funds selected by the Non-Affiliated Trustees in order to match the deferred compensation obligation. The deferred compensation plan is not funded and obligations thereunder represent general unsecured claims against the general assets of the Fund. Deferring compensation has the same economic effect as if the Non-Affiliated Trustee reinvested his compensation into the funds. Each fund in the Fund Complex (except Van Kampen Exchange Fund) provides a retirement plan to its Non-Affiliated Trustees that provides Non-Affiliated Trustees with compensation after retirement, provided that certain eligibility requirements are met. Under the retirement plan, a Non-Affiliated Trustee who is receiving compensation from the Fund prior to such Non-Affiliated Trustee's retirement, has at least 10 years of service (including years of service prior to adoption of the retirement plan) and retires at or after attaining the age of 60 is eligible to receive a retirement benefit per year for each of the 10 years following such retirement from the Fund. Non-Affiliated Trustees retiring prior to the age of 60 or with fewer than 10 years but more than 5 years of service may receive reduced retirement benefits from the Fund.

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Additional information regarding compensation and benefits for trustees is set forth below for the periods described in the notes accompanying the table.

### COMPENSATION TABLE

Name (1) -----	Aggregate Compensation from the Fund (2) -----	Aggregate Pension or Retirement Benefits Accrued as Part of Expenses (3) -----	Fund Complex	
			Aggregate Estimated Maximum Annual Benefits from the Fund Complex Upon Retirement (4) -----	Tot Compens befo Deferra Fun Comple -----
David C. Arch	17,977	\$18,589	\$147,500	\$193,
Rod Dammeyer	17,977	31,814	147,500	177,
Howard J Kerr	17,977	58,713	147,500	193,
Hugo F. Sonnenschein	17,977	32,178	147,500	193,
Wayne W. Whalen	17,977	63,604	147,500	251,

(1) Trustees not eligible for compensation are not included in the Compensation Table.

(2) The amounts shown in this column represent the aggregate compensation before deferral with respect to the Fund's fiscal year ended July 31, 2003. The following trustees deferred compensation from the Fund during the fiscal year ended July 31, 2003: Mr. Dammeyer, \$17,977; Mr. Sonnenschein, \$17,977; and

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Mr. Whalen, \$17,977. The cumulative deferred compensation (including interest) accrued with respect to each trustee, including former trustees, from the Fund as of the Fund's fiscal year ended July 31, 2003 is as follows: Mr. Dammeyer, \$74,882; Mr. Kerr, \$8,033; Mr. Sonnenschein, \$72,263; and Mr. Whalen, \$82,459. The deferred compensation plan is described above the Compensation Table.

(3) The amounts shown in this column represent the sum of the retirement benefits accrued by the operating funds in the Fund Complex for each of the trustees for the funds' respective fiscal years ended in 2003. The retirement plan is described above the Compensation Table. In 2003, the boards of the various Van Kampen-related funds in the Fund Complex were combined. Prior to 2003, only Messrs. Whalen and Powers served as trustees/directors/managing general partners of all of the various Van

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Kampen-related funds in the Fund Complex; and during 2003, other trustees/directors/managing general partners were elected or appointed, as appropriate, to most of the respective boards of the underlying Van Kampen-related funds. The amounts in this column represent amounts for each trustee based on funds he oversaw for the period mentioned above; and thus it is anticipated that the amounts will increase in future compensation tables based on the increased number of funds overseen by such trustees going forward.

- (4) For each trustee, this is the sum of the estimated maximum annual benefits payable by the funds in the Fund Complex for each year of the 10-year period commencing in the year of such trustee's anticipated retirement. The retirement plan is described above the Compensation Table.
- (5) The amounts shown in this column represent the aggregate compensation paid by all of the funds in the Fund Complex as of December 31, 2003, before deferral by the trustees under the deferred compensation plan. Because the funds in the Fund Complex have different fiscal year ends, the amounts shown in this column are presented on a calendar year basis. In 2003, the boards of the various Van Kampen-related funds in the Fund Complex were combined. Prior to 2003, only Messrs. Whalen and Powers served as trustees/directors/managing general partners of all of the various Van Kampen-related funds in the Fund Complex; and during 2003, other trustees/directors/managing general partners were elected or appointed, as appropriate, to most of the respective boards of the underlying Van Kampen-related funds. The amounts in this column represent amounts for each trustee based on funds he oversaw for the period mentioned above; and thus it is anticipated that the amounts will increase in future compensation tables based on the increased number of funds overseen by such trustees going forward.

During the Fund's last fiscal year, the Board of Trustees had two standing committees (an audit committee and a retirement plan committee) and one ad hoc committee (a nominating committee). The Fund's audit committee consists of Messrs. Arch, Dammeyer, Kerr and Sonnenschein, all of whom are not interested persons of the Fund. The audit committee makes recommendations to the Board of Trustees concerning the selection of the Fund's independent public accountants, reviews with such accountants the scope and results of the Fund's annual audit and considers any comments which the accountants may have regarding the Fund's financial statements, books of account or internal controls. The Fund's audit committee financial expert is Mr. Dammeyer. The Board's retirement plan committee consists of Messrs. Arch, Dammeyer and Sonnenschein, all of whom are not interested persons of the Fund. The retirement plan committee is responsible for reviewing the terms of the Fund's retirement plan and reviews any administrative matters which arise with respect thereto. During the Fund's last fiscal year, the audit committee of the Board held two meetings. The retirement plan committee of the Board does not meet on a regular basis, but does meet on an ad hoc basis as necessary to administer the retirement plan.

The non-interested trustees of the Fund select and nominate any other non-interested trustees of the Fund. While the non-interested trustees of the Fund expect to be able to continue to identify from their own resources an ample number of qualified candidates for the Board of Trustees as they deem appropriate, they will review nominations from shareholders to fill any vacancies. Nominations from shareholders should be in writing and addressed to the non-interested trustees at the Fund's office.

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In addition to deferred compensation balances as described in the Compensation Table, as of December 31, 2003, the most recently completed calendar year prior to the date of this SAI, each trustee of the Fund

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beneficially owned equity securities of the Fund and of all of the funds in the Fund Complex overseen by the trustee in the dollar range amounts specified below.

### 2003 TRUSTEE BENEFICIAL OWNERSHIP OF SECURITIES

#### INDEPENDENT TRUSTEES

NAME OF TRUSTEE	DOLLAR RANGE OF EQUITY SECURITIES IN THE FUND	AGGREGATE DOLLAR RANGE OF EQUITY SECURITIES IN ALL REGISTERED INVESTMENT COMPANIES OVERSEEN BY TRUSTEE IN THE FUND COMPLEX
David C. Arch	\$1 - \$10,000	\$50,001 - \$100,000
Rod Dammeyer	\$1 - \$10,000	Over \$100,000
Howard J Kerr	\$1 - \$10,000	\$1 - \$10,000
Hugo F. Sonnenschein	\$1 - \$10,000	Over \$100,000

#### INTERESTED TRUSTEES

NAME OF TRUSTEE	DOLLAR RANGE OF EQUITY SECURITIES IN THE FUND	AGGREGATE DOLLAR RANGE OF EQUITY SECURITIES IN ALL REGISTERED INVESTMENT COMPANIES OVERSEEN BY TRUSTEE IN THE FUND COMPLEX
Richard F. Powers, III	\$1 - \$10,000	Over \$100,000
Wayne W. Whalen	\$1 - \$10,000	Over \$100,000

As of December 31, 2003, the trustees and officers of the Fund as a group owned less than 1% of the shares of the Fund.

CODE OF ETHICS

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The Fund and the Adviser have adopted a code of ethics (the "Code of Ethics") that sets forth general and specific standards relating to the securities trading activities of their employees. The Code of Ethics does not prohibit employees from acquiring securities that may be purchased or held by the Fund, but is intended to ensure that all employees conduct their personal transactions in a manner that does not interfere with the portfolio transactions of the Fund or other Van Kampen funds, or that such employees take unfair advantage of their relationship with the Fund. Among other things, the Code of Ethics prohibits certain types of transactions absent prior approval, imposes various trading restrictions (such as time periods during which personal transactions may or may not be made) and requires quarterly reporting of securities transactions and other reporting matters. All reportable securities transactions and other required reports are to be reviewed by appropriate personnel for compliance with the Code of Ethics. Additional restrictions apply to portfolio managers, traders, research analysts and others who may have access to nonpublic information about the trading activities of the Fund or other Van Kampen funds or who otherwise are involved in the investment advisory process. Exceptions to these and other provisions of the Code of Ethics may be granted in particular circumstances after review by appropriate personnel.

The Code of Ethics can be reviewed and copied at the Securities and Exchange Commission's public reference room in Washington, DC (call 1-202-942-8090 for information on the operation of the public reference room); on the EDGAR Database on the SEC's Internet site (<http://www.sec.gov>); or payment of copying fees, by writing the SEC's public reference section, Washington, DC 20549-0102, or by electronic mail at [publicinfo@sec.gov](mailto:publicinfo@sec.gov).

### PORTFOLIO TRANSACTIONS

With respect to interests in Senior Loans, the Fund generally will engage in privately negotiated transactions for purchase or sale in which the Adviser will negotiate on behalf of the Fund, although a more

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developed market may exist for certain Senior Loans. The Fund may be required to pay fees, or forgo a portion of interest and any fees payable to the Fund, to the lender selling participations or assignments to the Fund. The Adviser will determine the lenders from whom the Fund will purchase assignments and participations by considering their professional ability, level of service, relationship with the Borrower, financial condition, credit standards and quality of management. Although the Fund intends generally to hold interests in Senior Loans until maturity or prepayment of the Senior Loan, the illiquidity of many Senior Loans may restrict the ability of the Adviser to locate in a timely manner persons willing to purchase the Fund's interests in Senior Loans at a fair price should the Fund desire to sell such interests. See sections entitled "Investment Objective and Investment Policies and "Risk Factors" in the Prospectus.

With respect to investments other than in Senior Loans, the Adviser will place orders for portfolio transactions for the Fund with broker-dealer firms giving consideration to the quality, quantity and nature of each firm's professional services. These services include execution, clearance procedures,

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wire service quotations and statistical and other research information provided to the Fund and the Adviser, including quotations necessary to determine the value of the Fund's net assets. Any research benefits so obtained are available for all clients of the Adviser. Because statistical and other research information only supplements the research efforts of the Adviser and still must be analyzed and reviewed by its staff, the receipt of research information is not expected to reduce materially its expenses. In selecting among the firms believed to meet the criteria for handling a particular transaction, the Adviser may take into consideration the fact that certain firms have sold common shares of the Fund and that certain firms provide market, statistical or other research information to the Fund and the Adviser and may select firms that are affiliated with the Fund, the Adviser or Van Kampen Investments.

If it is believed to be in the best interest of the Fund, the Adviser may place portfolio transactions with brokers who provide the types of services described above, even if the Fund will have to pay a higher commission (or, if the broker's profit is part of the cost of the security, will have to pay a higher price for the security) than would be the case if the Adviser did not consider the broker's furnishing of such services. This will be done, however, only if, in the opinion of the Adviser, the amount of additional commission or increased cost is reasonable in relation to the value of the services.

If purchases or sales of financial instruments for the Fund and for one or more other investment companies or clients advised by the Adviser are considered at or about the same time, transactions in such financial instruments will be allocated among the several investment companies and clients, in a manner deemed equitable by the Adviser, to each such investment company or client, taking into account their respective sizes and the aggregate amount of financial instruments to be purchased or sold. In this regard allocations of Senior Loans by the Adviser will be made taking into account a variety of factors, including the assets of such clients then available for investment in Senior Loans, such clients' relative net assets and such clients' investment objectives, policies and limitations. Although in some cases this procedure could have a detrimental effect on the price paid by the Fund for the financial instrument or the volume of the financial instrument purchased by the Fund, the ability to participate in volume transactions and to negotiate lower commissions, fees and expenses possibly could benefit the Fund.

Although the Adviser will be responsible for the management of the Fund's portfolio, the policies and practices in this regard must be consistent with the foregoing and will be subject at all times to review by the Board of Trustees of the Fund. The Fund anticipates that the annual portfolio turnover rate will not exceed 100%.

The Board of Trustees has adopted certain policies incorporating the standards of Rule 17e-1 issued by the SEC under the 1940 Act, which requires that the commissions paid to affiliates of the Fund, or to affiliates of such persons, be reasonable and fair compared to the commissions, fees or other remuneration received or to be received by other brokers in connection with comparable transactions involving similar financial instruments during a comparable period of time. The rule and procedures also contain review requirements and require the Adviser to furnish reports to the Board of Trustees and to maintain records in connection with such reviews. After review of all factors deemed relevant, the Board of Trustees will consider from time to

time whether the advisory fee will be reduced by all or a portion of the brokerage commissions given to brokers that are affiliated with the Fund.

#### INVESTMENT MANAGEMENT AND OTHER SERVICES

##### THE ADVISER

The Adviser is a wholly-owned subsidiary of Van Kampen Investments. Van Kampen Investments is an indirect wholly-owned subsidiary of Morgan Stanley. The Adviser's principal office is located at 1 Parkview Plaza, Oakbrook Terrace, Illinois 60181.

Van Kampen Investments is a diversified asset management company that administers more than three million retail investor accounts, has extensive capabilities for managing institutional portfolios, and has more than \$84 billion under management or supervision as of December 31, 2003. Van Kampen Investments has more than 50 open-end and 30 closed-end funds and more than 2,700 unit investment trusts that are distributed by authorized dealers nationwide.

Morgan Stanley is a preeminent global financial services firm that maintains leading market positions in each of its three primary businesses: securities, asset management and credit services.

##### INVESTMENT ADVISORY AGREEMENT

The investment advisory agreement (the "Advisory Agreement") between the Adviser and the Fund will continue in effect from year to year, unless terminated as described below, if approved annually (a) by the Board of Trustees of the Fund or by a majority of the Fund's common shares and (b) by a majority of the trustees who are not parties to the agreement or interested persons of any such party, in compliance with the requirements of the 1940 Act. The Advisory Agreement may be terminated without penalty upon 60 days written notice by either party (in the case of the Fund, such termination may be effected by the Board of Trustees or by a majority of the common shares) and will automatically terminate in the event of assignment. The Adviser may in its sole discretion from time to time waive all or a portion of the advisory fee or reimburse the Fund for all or a portion of its other expenses.

In approving the Advisory Agreement, the Board of Trustees, including the non-interested trustees, considered the nature, quality and scope of the services provided by the Adviser, the performance, fees and expenses of the Fund compared to other similar investment companies, the Adviser's expenses in providing the services and the profitability of the Adviser and its affiliated companies. The Board of Trustees also reviewed the benefit to the Adviser of receiving third party research paid for by Fund assets and the propriety of such an arrangement and evaluated other benefits the Adviser derives from its relationship with the Fund. The Board of Trustees considered the extent to which any economies of scale experienced by the Adviser are shared with the Fund's shareholders. The Board of Trustees considered comparative advisory fees of the Fund and other investment companies. The Board of Trustees reviewed reports from

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third parties about the foregoing factors. The Board of Trustees discussed the financial strength of the Adviser and its affiliated companies and the capability of the personnel of the Adviser. The Board of Trustees reviewed the statutory and regulatory requirements for approval of advisory agreements. The Board of Trustees, including the non-interested trustees, evaluated all of the foregoing and determined, in the exercise of its business judgment, that approval of the Advisory Agreement was in the best interests of the Fund and its shareholders.

The Advisory Agreement provides that the Adviser will supply investment research and portfolio management, including the selection of securities for the Fund to purchase, hold or sell and the selection of financial institutions through whom the Fund's portfolio transactions are executed. For the services provided by the Adviser under the Advisory Agreement, the Fund pays the Adviser a monthly fee (accrued daily and paid monthly) computed based upon an annual rate equal to 0.85% applied to the average daily managed assets of the Fund (which for purposes of determining such fee, shall mean the average daily gross asset value of the Fund, minus the sum of accrued liabilities other than the aggregate amount of any borrowings undertaken by the Fund). Because leverage will increase the amount of total assets, the Fund will pay a

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greater amount of advisory fees when leverage is utilized. Under the Advisory Agreement, the Adviser also furnishes offices and necessary facilities and equipment, and permits its officers and employees to serve without compensation as trustees and officers of the Fund if duly elected to such positions. The Fund pays all other expenses incurred in the operation of the Fund including, but not limited to, direct charges relating to the purchase and sale of financial instruments in its portfolio, interest charges, fees and expenses of legal counsel and independent auditors, taxes and governmental fees, cost of share certificates, expenses (including clerical expenses) of issuance, sale or repurchase of any of the Fund's portfolio holdings, expenses in connection with the Fund's dividend reinvestments, membership fees in trade associations, expenses of registering and qualifying the common shares of the Fund for sale under federal and state securities laws, expenses of printing and distributing reports, notices and proxy materials to existing holders of common shares, expenses of filing reports and other documents filed with governmental agencies, expenses of annual and special meetings of holders of common shares, fees and disbursements of the transfer agents, custodians and sub-custodians, expenses of disbursing dividends and distributions, fees, expenses and out-of-pocket costs of trustees of the Fund who are not affiliated with the Adviser, insurance premiums, indemnification and other expenses not expressly provided for in the Advisory Agreement or the administration agreement and any extraordinary expenses of a nonrecurring nature. The Adviser may in its sole discretion from time to time waive all or a portion of the advisory fee or reimburse the Fund for all or a portion of its other expenses.

The Advisory Agreement provides that the Adviser shall not be liable for any error of judgment or of law, or for any loss suffered by the Fund in connection with the matters to which the Advisory Agreement relates, except a loss resulting from willful misfeasance, bad faith or gross negligence on the part of the Adviser in the performance of its obligations and duties, or by reason of its reckless disregard of its obligations and duties under the Advisory Agreement.

The trustees are responsible for the overall management and supervision of

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the Fund's affairs. The Adviser's activities are subject to the review and supervision of the trustees to whom the Adviser renders periodic reports of the Fund's investment activities.

### THE ADMINISTRATOR

The administrator for the Fund is Van Kampen Investments.

### OTHER AGREEMENTS

**LEGAL SERVICES AGREEMENT.** The Fund has entered into a Legal Services Agreements pursuant to which Van Kampen Investments provides legal services, including without limitation: accurate maintenance of the Funds' minute books and records, preparation and oversight of the Funds' regulatory reports, and other information provided to shareholders, as well as responding to day-to-day legal issues on behalf of the funds. Payment by the Fund for such services is made on a cost basis for the salary and salary related benefits, including but not limited to bonuses, group insurances and other regular wages for the employment of personnel, as well as overhead and the expenses related to the office space and the equipment necessary to render the legal services. Certain other funds advised by the Adviser are distributed by the Distributors, an indirect affiliate of the Fund, and also receive legal services from Van Kampen Investments. Of the total costs for legal services provided to funds distributed by the Distributors one half of such costs are allocated equally to each fund and the remaining one half of such costs are allocated to specific funds based on monthly time records.

### REPURCHASE OF SHARES

Shares of closed-end management investment companies frequently trade at a discount to their NAVs but in some cases trade at a premium. In recognition of the possibility that the Fund's common shares might similarly trade at a discount, the Fund's Board of Trustees has determined that from time to time it may be in the interest of common shareholders for the Fund to take action to attempt to reduce or eliminate a market value discount from NAV. The Board of Trustees, in consultation with the Adviser, will review on a quarterly basis the possibility of open market repurchases and/or tender offers for the common shares and will consider

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such factors as the market price of the common shares, the NAV of the common shares, the liquidity of the assets of the Fund, whether such transactions would impair the Fund's status as a regulated investment company or result in a failure to comply with applicable asset coverage requirements, general economic conditions and such other events or conditions which may have a material effect on the Fund's ability to consummate such transactions. There are no assurances that the Board of Trustees will, in fact, decide to undertake either of these actions or if undertaken, that such actions will result in the Fund's common shares trading at a price which is equal to or approximates their NAV. In addition, the Board of Trustees will not necessarily announce when it has given consideration to these matters. common shares will not be repurchased unless after such repurchase the Fund would continue to satisfy the 1940 Act asset coverage requirements with respect to the Preferred Shares or any borrowing and any asset coverage requirements which may be imposed by any rating service as a condition of its rating of the Preferred Shares or by any lender with respect to any borrowing.

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Even if a tender offer has been made, the announced policy of the Board of Trustees, which may be changed by the Board of Trustees, is that the Fund cannot accept tenders if (1) in the reasonable judgment of the Board of Trustees, there is not sufficient liquidity of the assets of the Fund; (2) such transactions, if consummated, would (a) impair the Fund's status as a regulated investment company under the Internal Revenue Code (the "Code") (which would make the Fund a taxable entity, causing the Fund's taxable income to be taxed at the Fund level, as more fully described in "Taxation") or (b) result in a failure to comply with applicable asset coverage requirements; or (3) there is, in the Board of Trustees' reasonable judgment, any (a) material legal action or proceeding instituted or threatened challenging such transactions or otherwise materially adversely affecting the Fund, (b) suspension of or limitation on prices for trading securities generally on any United States national securities exchange or in the over-the-counter market, (c) declaration of a banking moratorium by federal or state authorities or any suspension of payment by banks in the United States or New York State, (d) limitation affecting the Fund or the issuers of its portfolio securities imposed by federal or state authorities on the extension of credit by lending institutions, (e) commencement of war, armed hostilities or other international or national calamity directly or indirectly involving the United States or (f) other event or condition which would have a material adverse effect on the Fund or the holders of its common shares if common shares were repurchased. The Board of Trustees may modify these conditions in light of experience.

Any tender offer made by the Fund for its common shares will be at a price equal to the NAV of the common shares determined at the close of business on the day the offer ends. During the pendency of any tender offer by the Fund, the Fund will calculate daily the NAV of the common shares and will establish procedures which will be specified in the tender offer documents, to enable common shareholders to ascertain readily such NAV. The relative illiquidity of some of the Fund's portfolio securities could adversely impact the Fund's ability to calculate NAV in connection with determinations of pricing for tender offers, if any. Each offer will be made and common shareholders notified in accordance with the requirements of the Securities Exchange Act of 1934, as amended, and the 1940 Act, either by publication or mailing or both. Each offering document will contain such information as is prescribed by such laws and the rules and regulations promulgated thereunder.

Tendered common shares that have been accepted and repurchased by the Fund will be held in treasury and may be retired by the Board of Trustees. Treasury common shares will be recorded and reported as an offset to shareholders' equity and accordingly will reduce the Fund's total assets. If Treasury common shares are retired, common shares issued and outstanding and capital in excess of par value will be reduced accordingly.

If the Fund must liquidate portfolio securities in order to repurchase common shares tendered, the Fund may realize gains and losses.

### FUND STRUCTURE

The Fund's fundamental investment policies and restrictions give the Fund the flexibility to pursue its investment objective through the future conversion to a fund structure commonly known as a "master-feeder"

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structure. If the Fund converts to a master-feeder structure, the existing shareholders of the Fund would continue to hold their shares of the Fund and the Fund would become a feeder-fund of the master-fund. The value of a shareholder's shares would be the same immediately after any conversion as the value immediately before such conversion. Use of this master-feeder structure potentially would result in increased assets invested among the collective investment vehicle of which the Fund would be a part, thus allowing operating expenses to be spread over a larger asset base, potentially achieving economies of scale. The Fund's Board of Trustees presently does not intend to effect any conversion of the Fund to a master-feeder structure. In addition, the Fund's Board of Trustees presently does not intend to effect any conversion in which (i) the master fund does not have substantially the same management team, investment objective, investment policies and investment restrictions as the Fund just prior to the conversion, (ii) the value of the shareholder's investment in Fund would not be the same immediately after the conversion as it was immediately before such conversion or (iii) an increase in the Fund's expense ratios is expected as a result of the conversion.

### PORTFOLIO TURNOVER RATE

The annual rates of the Fund's total portfolio turnover for the periods ended July 31, 2000, July 31, 2001, July 31, 2002 and July 31, 2003, were 57%, 55%, 65% and 78%, respectively. The annual turnover rate of the Fund is generally expected to be between 50% and 100%, although as part of its investment policies, the Fund places no restrictions on portfolio turnover and the Fund may sell any portfolio security without regard to the period of time it has been held. The annual turnover rate of the Fund also includes Senior Loans for which the full payment on the Senior Loan has been prepaid by the borrower.

### ADDITIONAL INFORMATION CONCERNING THE AUCTIONS FOR PREFERRED SHARES

#### GENERAL

The Certificate provides that the Applicable Rate for each Dividend Period of shares of each series shall be equal to the rate per annum that the Auction Agent advises has resulted on the Business Day preceding the first day of a Dividend Period for each such series (an "Auction Date") from implementation of the Auction Procedures set forth in the Certificate and summarized below, in which persons determine to hold or offer to sell or, based on dividend rates bid by them, offer to purchase or sell shares of such series. Each periodic implementation of the Auction Procedures is referred to herein as an "Auction." The following summary is qualified by reference to the Auction Procedures set forth in the Certificate. Capitalized terms used but not defined have the definitions set forth in the Certificate.

**AUCTION AGENCY AGREEMENT.** The Fund has entered into an auction agency agreement (the "Auction Agency Agreement") with the Auction Agent (currently, The Bank of New York), which provides, among other things, that the Auction Agent will follow the Auction Procedures for purposes of determining the Applicable Rate for shares of each series of Preferred Shares so long as the Applicable Rate for shares of such series is to be based on the results of the Auction.

**BROKER-DEALER AGREEMENTS.** Each Auction requires the participation of one or more Broker-Dealers. The Auction Agent has entered into agreements

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(collectively, the "Broker-Dealer Agreements") with several Broker-Dealers selected by the Fund, which provides for the participation of those Broker-Dealers in Auctions for shares of a series of Preferred Shares. See "Broker-Dealers" below.

SECURITIES DEPOSITORY. The Depository Trust Company ("DTC") will act as the Securities Depository for the Agent Members with respect to shares of each series of Preferred Shares. One certificate for all of the shares of each series of Preferred Shares will be registered in the name of Cede & Co., as nominee of the Securities Depository. Such certificate will bear a legend to the effect that such certificate is issued subject to the provisions restricting transfers of Preferred Shares contained in the Certificate. The Fund will also issue stop-transfer instructions to the transfer agent for shares of each series of Preferred Shares. Prior to the commencement of the right of Holders of preferred shares to elect a majority of the Fund's Trustees, as described under "Description of Preferred Shares -- Voting Rights" in the Prospectus, Cede & Co. will be the

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Holder of all shares of each series of Preferred Shares and owners of such shares will not be entitled to receive certificates representing their ownership interest in such shares.

DTC, a New York chartered limited purpose trust company, performs services for its participants (including Agent Members), some of whom (and/or their representatives) own DTC. DTC maintains lists of its participants and will maintain the positions (ownership interests) held by each such Agent Member in shares of each series of Preferred Shares, whether for its own account or as a nominee for another person.

### ORDERS BY EXISTING HOLDERS AND POTENTIAL HOLDERS

On or prior to the Submission Deadline on each Auction Date for shares of a series of Preferred Shares:

(a) each Beneficial Owner of shares of such series may submit to its Broker-Dealer by telephone or otherwise a:

(i) "Hold Order" -- indicating the number of Outstanding shares, if any, of such series that such Beneficial Owner desires to continue to hold without regard to the Applicable Rate for such shares of such series for the next succeeding Dividend Period of such shares;

(ii) "Bid" -- indicating the number of Outstanding shares, if any, of such series that such Beneficial Owner offers to sell if the Applicable Rate for such shares of such series for the next succeeding Dividend Period shall be less than the rate per annum specified by such Beneficial Owner in such Bid; and/or

(iii) "Sell Order" -- indicating the number of Outstanding shares, if any, of such that such Beneficial Owner offers to sell without regard to the Applicable Rate for such shares of such series for the next succeeding Dividend Period; and

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(b) Broker-Dealers shall contact customers who are Potential Beneficial Owners by telephone or otherwise to determine whether such customers desire to submit Bids, in which they will indicate the number of shares, if any, of such series that they offer to purchase if the Applicable Rate for shares of such series for the next succeeding Dividend Period is not less than the rate per annum specified in such Bids.

The communication to a Broker-Dealer of the foregoing information is herein referred to as an "Order" and collectively as "Orders." A Beneficial Owner or a Potential Beneficial Owner placing an Order with its Broker-Dealer is herein referred to as a "Bidder" and collectively as "Bidders." The submission by a Broker-Dealer of an Order to the Auction Agent shall likewise be referred to herein as an "Order" and collectively as "Orders," and an Existing Holder or Potential Holder who places an Order with the Auction Agent or on whose behalf an Order is placed with the Auction Agent shall likewise be referred to herein as a "Bidder" and collectively as "Bidders."

A Beneficial Owner may submit different types of Orders to its Broker-Dealer with respect to shares of a series of Preferred Shares then held by such Beneficial Owner. A Bid placed by a Beneficial Owner specifying a rate higher than the Applicable Rate determined in the Auction shall constitute an irrevocable offer to sell the shares subject thereto. A Beneficial Owner that submits a Bid to its Broker-Dealer having a rate higher than the Maximum Rate on the Auction Date thereof will be treated as having submitted a Sell Order to its Broker-Dealer. A Beneficial Owner that fails to submit to its Broker-Dealer prior to the Submission Deadline for shares of such series an Order or Orders covering all the Outstanding shares of such series held by such Beneficial Owner will be deemed to have submitted a Hold Order to its Broker-Dealer covering the number of Outstanding shares of such series held by such Beneficial Owner and not subject to Orders submitted to its Broker-Dealer; provided, however, that if a Beneficial Owner fails to submit to its Broker-Dealer prior to the Submission Deadline for shares of a series of Preferred Shares an Order or Orders covering all of the Outstanding shares of such series held by such Beneficial Owner for an Auction relating to a Special Dividend Period consisting of more than 7 Days, such Beneficial Owner will be deemed to have submitted a Sell Order to its Broker-Dealer covering the number of Outstanding shares of such series held by such Beneficial Owner and not subject to Orders submitted to its Broker-Dealer. A Sell Order shall constitute an irrevocable offer to sell the shares of such series of Preferred Shares subject thereto at a price per share equal to \$25,000. A

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Beneficial Owner of shares of a series of Preferred Shares that offers to become the Beneficial Owner of additional shares of such series of Preferred Shares is, for purposes of such offer, a Potential Beneficial Owner.

A Potential Beneficial Owner of shares of a series of Preferred Shares may submit to its Broker-Dealer Bids in which it offers to purchase shares of a series if the Applicable Rate for the next Dividend Period is not less than the rate specified in such Bid. A Bid placed by a Potential Beneficial Owner specifying a rate not higher than the Maximum Rate shall constitute an irrevocable offer to purchase the number of shares of a series of Preferred Shares specified in such Bid if the rate determined in the Auction is equal to or greater than the rate specified in such Bid.

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As described more fully below under "-- Submission of Orders by Broker-Dealers to Auction Agent," the Broker-Dealers will submit the Orders of their respective customers who are Beneficial Owners and Potential Beneficial Owners to the Auction Agent, designating themselves (unless otherwise permitted by the Fund) as Existing Holders in respect of shares of such series of Preferred Shares subject to Orders submitted or deemed submitted to them by Beneficial Owners and as Potential Holders in respect of shares of such series subject to Orders submitted to them by Potential Beneficial Owners. However, neither the Fund nor the Auction Agent will be responsible for a Broker-Dealer's failure to comply with the foregoing. Any Order placed with the Auction Agent by a Broker-Dealer as or on behalf of an Existing Holder or a Potential Holder will be treated in the same manner as an Order placed with a Broker-Dealer by a Beneficial Owner or a Potential Beneficial Owner, as described in the preceding paragraph. Similarly, any failure by a Broker-Dealer to submit to the Auction Agent an Order in respect of any shares of a series of Preferred Shares held by it or its customers who are Beneficial Owners will be treated in the same manner as a Beneficial Owner's failure to submit to its Broker-Dealer an Order in respect of shares of a series of Preferred Shares held by it, as described in the second preceding paragraph. For information concerning the priority given to different types of Orders placed by Existing Holders, see "-- Submission of Orders by Broker-Dealers to Auction Agent" below.

Neither the Fund nor an affiliate may submit an Order in any Auction, except that any Broker-Dealer that is an affiliate of the Fund may submit Orders in an Auction, but only if such Orders are not for its own account.

The Auction Procedures include a pro rata allocation of shares for purchase and sale, which may result in an Existing Holder continuing to hold or selling, or a Potential Holder purchasing, a number of shares of a series of Preferred Share that is fewer than the number of shares of such series specified in its Order. See "-- Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares" below. To the extent the allocation procedures have that result, Broker-Dealers that have designated themselves as Existing Holders or Potential Holders in respect of customer Orders will be required to make appropriate pro rata allocations among their respective customers. Each purchase or sale shall be made for settlement on the Business Day next succeeding the Auction Date at a price per share equal to \$25,000. See "-- Notification of Results; Settlement" below.

As described above, any Bid specifying a rate higher than the Maximum Rate will (i) be treated as a Sell Order if submitted by a Beneficial Owner or an Existing Holder and (ii) not be accepted if submitted by a Potential Beneficial Owner or a Potential Holder. Accordingly, the Auction Procedures establish the Maximum Rate as a maximum rate per annum that can result from an Auction. See "-- Determination of Sufficient Clearing Bids, Winning Bid Rate and Applicable Rate" and "-- Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares" below.

### CONCERNING THE AUCTION AGENT

The Auction Agent is acting as agent for the Fund in connection with Auctions. In the absence of bad faith or negligence on its part, the Auction Agent will not be liable for any action taken, suffered, or omitted or for any error of judgment made by it in the performance of its duties under the Auction Agency Agreement and will not be liable for any error of judgment made in good faith unless the Auction Agent will have been negligent in ascertaining the

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pertinent facts.

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The Auction Agent may rely upon, as evidence of the identities of the Existing Holders of shares of a series of Preferred Shares, the Auction Agent's registry of Existing Holders, the results of Auctions and notices from any Broker-Dealer (or other person, if permitted by the Fund) with respect to transfers described under "Description of Preferred Shares -- Secondary Market Trading and Transfer of Preferred Shares" in the Prospectus and notices from the Fund. The Auction Agent is not required to accept any such notice for an Auction unless it is received by the Auction Agent by 3:00 p.m., New York City time, on the Business Day preceding such Auction.

The Auction Agent may terminate the Auction Agency Agreement upon notice to the Fund on a date no earlier than 60 days after such notice. If the Auction Agent should resign, the Fund will use its best efforts to enter into an agreement with a successor Auction Agent containing substantially the same terms and conditions as the Auction Agency Agreement. The Fund may remove the Auction Agent, provided that prior to such removal, the Fund shall have entered into such an agreement with a successor Auction Agent.

### BROKER-DEALERS

The Auction Agent after each Auction for shares of a series of Preferred Shares will pay to each Broker-Dealer, from funds provided by the Fund, a service charge at the annual rate of 1/4 of 1% in the case of any Auction immediately preceding a Dividend Period of less than one year, or a percentage agreed to by the Fund and the Broker-Dealers in the case of any Auction immediately preceding a Dividend Period of one year or longer, of the purchase price of shares of such series of Preferred Shares placed by such Broker-Dealer at such Auction. For the purposes of the preceding sentence, shares of a series of Preferred Shares will be placed by a Broker-Dealer if such shares were (a) the subject of Hold Orders deemed to have been submitted to the Auction Agent by the Broker-Dealer and were acquired by such Broker-Dealer for its customers who are Beneficial Owners or (b) the subject of an Order submitted by such Broker-Dealer that is (i) a Submitted Bid of an Existing Holder that resulted in such Existing Holder continuing to hold such shares as a result of the Auction or (ii) a Submitted Bid of a Potential Holder that resulted in such Potential Holder purchasing such shares as a result of the Auction or (iii) a valid Hold Order.

The Fund may request the Auction Agent to terminate one or more Broker-Dealer Agreements at any time, provided that at least one Broker-Dealer Agreement is in effect after such termination.

The Broker-Dealer Agreement provides that a Broker-Dealer (other than an affiliate of the Fund) may submit Orders in Auctions for its own account, unless the Fund notifies all Broker-Dealers that they may no longer do so, in which case Broker-Dealers may continue to submit Hold Orders and Sell Orders for their own accounts. Any Broker-Dealer that is an affiliate of the Fund may submit Orders in Auctions, but only if such Orders are not for its own account. If a Broker-Dealer submits an Order for its own account in any Auction, it might have an advantage over other Bidders because it would have knowledge of all Orders submitted by it in that Auction. Such Broker-Dealer, however, would not have knowledge of Orders submitted by other Broker-Dealers in that Auction.

### SUBMISSION OF ORDERS BY BROKER-DEALERS TO AUCTION AGENT

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Prior to 1:00 P.M., New York City time, on each Auction Date, or such other time on the Auction Date specified by the Auction Agent (i.e., the Submission Deadline), each Broker-Dealer will submit to the Auction Agent in writing all Orders obtained by it for the Auction to be conducted on such Auction Date, designating itself (unless otherwise permitted by the Fund) as the Existing Holder or Potential Holder, as the case may be, in respect of the shares of a series of Preferred Shares subject to such Orders. Any Order submitted by a Beneficial Owner or a Potential Beneficial Owner to its Broker-Dealer, or by a Broker-Dealer to the Auction Agent, prior to the Submission Deadline on any Auction Date, shall be irrevocable.

If any rate specified in any Bid contains more than three figures to the right of the decimal point, the Auction Agent will round such rate to the next highest one-thousandth (0.001) of 1%.

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If one or more Orders of an Existing Holder is submitted to the Auction Agent covering in the aggregate more than the number of Outstanding Preferred Shares of a series subject to an Auction held by such Existing Holder, such Orders will be considered valid in the following order of priority:

(a) all Hold Orders for shares of such series will be considered valid, but only up to and including in the aggregate the number of Outstanding shares of such series held by such Existing Holder, and, if the number of shares of such series subject to such Hold Orders exceeds the number of Outstanding shares of such series held by such Existing Holder, the number of shares subject to each such Hold Order shall be reduced pro rata to cover the number of Outstanding shares held by such Existing Holder;

(b) (i) any Bid for shares of such series will be considered valid up to and including the excess of the number of shares of Outstanding shares of such series held by such Existing Holder over the number of shares of such series subject to any Hold Orders referred to in clause (a) above;

(ii) subject to subclause (i), if more than one Bid of an Existing Holder for shares of such series is submitted to the Auction Agent with the same rate and the number of Outstanding shares of such series subject to such Bids is greater than such excess, such Bids will be considered valid up to and including the amount of such excess, and the number of shares of such series subject to each Bid with the same rate will be reduced pro rata to cover the number of shares of such series equal to such excess;

(iii) subject to subclauses (i) and (ii), if more than one Bid of an Existing Holder for shares of such series is submitted to the Auction Agent with different rates, such Bids shall be considered valid in the ascending order of their respective rates up to and including the amount of such excess; and

(iv) in any such event, the number, if any, of such Outstanding shares of such series subject to any portion of Bids considered not valid in whole or in part under this clause (b) will be treated as the subject of a Bid for shares of such series by or on behalf of a Potential Holder at the rate specified therein; and

(c) all Sell Orders for shares of such series will be considered valid up to and including the excess of the number of Outstanding shares of such series held by such Existing Holder over the sum of shares of such series subject to valid Hold Orders referred to in clause (a) above and valid Bids referred to in clause (b) above.

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If more than one Bid of a Potential Holder for shares of a series of Preferred Shares is submitted to the Auction Agent by or on behalf of any Potential Holder, each such Bid submitted will be a separate Bid with the rate and number of shares of such series therein specified.

### DETERMINATION OF SUFFICIENT CLEARING BIDS, WINNING BID RATE AND APPLICABLE RATE

Not earlier than the Submission Deadline on each Auction Date for shares of a series of Preferred Shares, the Auction Agent will assemble all valid Orders submitted or deemed submitted to it by the Broker-Dealers (each such Hold Order, Bid or Sell Order as submitted or deemed submitted by a Broker-Dealer being herein referred to as a "Submitted Hold Order," a "Submitted Bid" or a "Submitted Sell Order," as the case may be, or as a "Submitted Order" and collectively as "Submitted Hold Orders," "Submitted Bids" or "Submitted Sell Orders," as the case may be, or as "Submitted Orders") and will determine the excess of the number of Outstanding shares of such series over the number of Outstanding shares of such series subject to Submitted Hold Orders (such excess being herein referred to as the "Available Preferred Shares") and whether Sufficient Clearing Bids have been made in the Auction. "Sufficient Clearing Bids" will have been made if the number of Outstanding shares of such series that are the subject of Submitted Bids of Potential Holders specifying rates not higher than the Maximum Rate for all Dividend Periods equals or exceeds the number of outstanding shares of such series that are the subject of Submitted Sell Orders (including the number of shares of such series subject to Bids of Existing Holders specifying rates higher than the Maximum Rate).

If Sufficient Clearing Bids for shares of a series of Preferred Shares have been made, the Auction Agent will determine the lowest rate specified in such Submitted Bids (the "Winning Bid Rate" for shares of such series) which, taking into account the rates in the Submitted Bids of Existing Holders, would result in Existing

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Holders continuing to hold an aggregate number of Outstanding shares of such series which, when added to the number of outstanding shares of such series to be purchased by Potential Holders, based on the rates in their Submitted Bids, would equal not less than the Available Preferred Shares. In such event, the Winning Bid Rate will be the Applicable Rate for the next Dividend Period for all shares of such series.

If Sufficient Clearing Bids have not been made (other than because all of the outstanding shares of a series of Preferred Shares are subject to Submitted Hold Orders), the Applicable Rate for the next Dividend Period for all shares of such series will be equal to the Maximum Rate. If Sufficient Clearing Bids have not been made, Beneficial Owners that have submitted or that are deemed to have submitted Sell Orders may not be able to sell in the Auction all shares of such series subject to such Sell Orders but will continue to own shares of such series for the next Dividend Period. See "-- Acceptance and Rejection of Submitted Bids and Submitted Sell Orders and Allocation of Shares" below.

If all of the outstanding shares of a series of Preferred Shares are subject to Submitted Hold Orders, the Applicable Rate for all shares of such

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series for the next succeeding Dividend Period shall be the All Hold Rate.

### ACCEPTANCE AND REJECTION OF SUBMITTED BIDS AND SUBMITTED SELL ORDERS AND ALLOCATION OF SHARES

Based on the determinations made under "-- Determination of Sufficient Clearing Bids, Winning Bid Rate and Applicable Rate" above and, subject to the discretion of the Auction Agent to round and allocate certain shares as described below, Submitted Bids and Submitted Sell Orders will be accepted or rejected in the order of priority set forth in the Auction Procedures, with the result that Existing Holders and Potential Holders of shares of a series of Preferred Shares will sell, continue to hold and/or purchase such shares as set forth below. Existing Holders that submitted or were deemed to have submitted Hold Orders (or on whose behalf Hold Orders were submitted or deemed to have been submitted) will continue to hold the shares of such series subject to such Hold Orders.

If Sufficient Clearing Bids for shares of a series of Preferred Shares have been made:

(a) Each Existing Holder that placed or on whose behalf was placed a Submitted Sell Order or Submitted Bid specifying any rate higher than the Winning Bid Rate will sell the outstanding shares of such series subject to such Submitted Sell Order or Submitted Bid;

(b) Each Existing Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate lower than the Winning Bid Rate will continue to hold the Outstanding shares of such series subject to such Submitted Bid;

(c) Each Potential Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate lower than the Winning Bid Rate will purchase the number of outstanding shares of such series subject to such Submitted Bid;

(d) Each Existing Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate equal to the Winning Bid Rate will continue to hold the shares of such series subject to such Submitted Bid, unless the number of Outstanding Preferred Shares of such series subject to all such Submitted Bids is greater than the number of Preferred Shares ("remaining shares") in excess of the Available Preferred Shares over the number of Preferred Shares accounted for in clauses (b) and (c) above, in which event each Existing Holder with such a Submitted Bid will continue to hold Preferred Shares of such series subject to such Submitted Bid determined on a pro rata basis based on the number of Outstanding Preferred Shares subject to all such Submitted Bids of such Existing Holders; and

(e) Each Potential Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate equal to the Winning Bid Rate for shares of such series will purchase any shares of Available Preferred Shares not accounted for in clauses (b) through (d) above on a pro rata basis based on the Outstanding Preferred Shares subject to all such Submitted Bids.

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If Sufficient Clearing Bids for shares of a series of Preferred Shares have not been made (unless this results because all Outstanding shares of such series are subject to Submitted Hold Orders):

(a) Each Existing Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate equal to or lower than the Maximum Rate for shares of such series will continue to hold the Preferred Shares subject to such

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Submitted Bid;

(b) Each Potential Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate equal to or lower than the Maximum Rate for shares of such series will purchase the number of Preferred Shares subject to such Submitted Bid; and

(c) Each Existing Holder that placed or on whose behalf was placed a Submitted Bid specifying a rate higher than the Maximum Rate for shares of such series or a Submitted Sell Order will sell a number of shares of such series subject to such Submitted Bid or Submitted Sell Order determined on a pro rata basis based on the number of Outstanding shares of such series subject to all such Submitted Bids and Submitted Sell Orders.

If, as a result of the pro rata allocation described in clauses (d) or (e) of the second preceding paragraph or clause (c) of the next preceding paragraph, any Existing Holder would be entitled or required to sell, or any Potential Holder would be entitled or required to purchase, a fraction of a share of Preferred Shares of a series, the Auction Agent will, in such manner as, in its sole discretion, it will determine, round up or down to the nearest whole share the number of Preferred Shares of such series being sold or purchased on such Auction Date so that the number of shares of such series sold or purchased by each Existing Holder or Potential Holder will be whole shares of such series. If as a result of the pro rata allocation described in clause (e) of the second preceding paragraph, any Potential Holder would be entitled or required to purchase less than a whole share of a series of Preferred Shares, the Auction Agent will, in such manner as, in its sole discretion, it will determine, allocate shares of such series for purchase among Potential Holders so that only whole shares of such series are purchased by any such Potential Holder, even if such allocation results in one or more of such Potential Holders not purchasing shares of such series.

### NOTIFICATION OF RESULTS; SETTLEMENT

The Auction Agent will be required to advise each Broker-Dealer that submitted an Order of the Applicable Rate for the next Dividend Period and, if the Order was a Bid or Sell Order, whether such Bid or Sell Order was accepted or rejected, in whole or in part, by telephone by approximately 3:00 P.M., New York City time, on each Auction Date. Each Broker-Dealer that submitted an Order for the account of a customer will then be required to advise such customer of the Applicable Rate for the next Dividend Period and, if such Order was a Bid or a Sell Order, whether such Bid or Sell Order was accepted or rejected, in whole or in part, will be required to confirm purchases and sales with each customer purchasing or selling shares of such series as a result of the Auction and will be required to advise each customer purchasing or selling Preferred Shares as a result of the Auction to give instructions to its Agent Member of the Securities Depository to pay the purchase price against delivery of such shares or to deliver such shares against payment therefor, as appropriate. The Auction Agent will be required to record each transfer of shares of a series of Preferred Shares on the registry of Existing Holders to be maintained by the Auction Agent.

In accordance with the Securities Depository's normal procedures, on the Business Day after the Auction Date, the transactions described above will be executed through the Securities Depository and the accounts of the respective Agent Members at the Securities Depository will be debited and credited and shares delivered as necessary to effect the purchases and sales of shares of a series of Preferred Shares as determined in the Auction. Purchasers will make payment through their Agent Members in same-day funds to the Securities Depository against delivery through their Agent Members; the Securities Depository will make payment in accordance with its normal procedures, which now provide for payment against delivery by their Agent Members in same-day funds.

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If any Existing Holder selling shares of a series of Preferred Shares in an Auction fails to deliver such shares, the Broker-Dealer of any person that was to have purchased such shares in such Auction may deliver to such person a number of whole shares of such series that is less than the number of shares of such series

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that otherwise was to be purchased by such person. In such event, the number of shares of such series to be so delivered shall be determined by such Broker-Dealer. Delivery of such lesser number of shares of such series shall constitute good delivery.

### DESCRIPTION OF PREFERRED SHARES

The descriptions of the Preferred Shares contained in this SAI do not purport to be complete and are subject to and qualified in their entireties by reference to the Declaration of Trust and the Certificate. A form of the Certificate is attached as Appendix B to this SAI. A copy of the Declaration of Trust is filed as an exhibit to the registration statement of which the Prospectus and this SAI are a part and may be inspected, and a copy thereof may be obtained, as described under "Further Information" in the Prospectus.

#### GENERAL

The Preferred Shares will rank on a parity with each other and with shares of any other series of Preferred Shares as to the payment of dividends and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Fund.

#### DIVIDENDS AND DIVIDEND PERIODS

GENERAL. Holders of Preferred Shares will be entitled to receive, when, as and if declared by the Board of Trustees, out of funds legally available therefor, cumulative cash dividends on their shares, at the Applicable Rate determined as described under "-- Determination of Dividend Rate," payable on the respective dates set forth below. Dividends so declared and payable shall be paid to the extent permitted under the Code, and to the extent available and in preference to and priority over any dividend declared and payable on the common shares.

On the Business Day next preceding each Dividend Payment Date, the Fund is required to deposit with the Paying Agent sufficient funds for the payment of declared dividends. The Fund does not intend to establish any reserves for the payment of dividends.

Each dividend will be paid by the Paying Agent to the Holder, which Holder is expected to be the nominee of the Securities Depository. The Securities Depository will credit the accounts of the Agent Members of the beneficial owners in accordance with the Securities Depository's normal procedures. The Securities Depository's current procedures provide for it to distribute dividends in same-day funds to Agent Members who are in turn expected to distribute such dividends to the persons for whom they are acting as agents. The Agent Member of a beneficial owner will be responsible for holding or disbursing such payments on the applicable Dividend Payment Date to such beneficial owner in accordance with the instructions of such beneficial owner.

Holders will not be entitled to any dividends, whether payable in cash,

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property or shares, in excess of full cumulative dividends except as described under "-- Determination of Dividend Rate." No interest will be payable in respect of any dividend payment or payments which may be in arrears. See "-- Default Period."

The amount of dividends per outstanding share payable (if declared) on each Dividend Payment Date of each Dividend Period (or in respect of dividends on another date in connection with a redemption during such Dividend Period) shall be computed by multiplying the Applicable Rate (or the Default Rate) for such Dividend Period (or a portion thereof) by a fraction, the numerator of which will be the number of days in such Dividend Period (or portion thereof) such share was outstanding and for which the Applicable Rate or the Default Rate was applicable and the denominator of which will be 360, multiplying the amount so obtained by the liquidation value, and rounding the amount so obtained to the nearest cent.

DETERMINATION OF DIVIDEND RATE. The dividend rate for the initial Dividend Period (i.e. the period from and including the Date of Original Issue to and including the initial Auction Date) and the initial Auction Date for each Series are set forth on the inside cover page of the Prospectus. For each subsequent Dividend Period, subject to certain exceptions, the dividend rate will be the Applicable Rate that the Auction Agent advises the Fund has resulted from an Auction.

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Dividend Periods after the initial Dividend Period shall either be Standard Dividend Periods (7 days) or, subject to certain conditions and with notice to Holders, Special Dividend Periods.

A Special Dividend Period will not be effective unless Sufficient Clearing Bids exist at the Auction in respect of such Special Dividend Period (that is, in general, the number of shares subject to Bids by Potential Beneficial Owners is at least equal to the number of shares subject to Sell Orders by Existing Holders). If Sufficient Clearing Bids do not exist at any Auction in respect of a Special Dividend Period, the Dividend Period commencing on the Business Day succeeding such Auction will be the Standard Dividend Period, and the Holders of the shares of the affected series will be required to continue to hold such shares for such Standard Dividend Period.

Dividends will accumulate at the Applicable Rate from the Date of Original Issue and shall be payable on each Dividend Payment Date thereafter. Dividends will be paid through the Securities Depository on each Dividend Payment Date.

The Applicable Rate resulting from an Auction will not be greater than the Maximum Rate. The Maximum Rate is subject to upward but not downward adjustment in the discretion of the Board of Trustees after consultation with the Broker-Dealers, provided that immediately following any such increase the Fund would be in compliance with the Preferred Shares Basic Maintenance Amount and with confirmation from each rating agency then rating the Preferred Shares that such action will not impair such agency's then-current rating of the Preferred Shares.

The Maximum Rate for the Preferred Shares will apply automatically following an Auction for such shares in which Sufficient Clearing Bids have not

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been made (other than because all Preferred Shares were subject to Submitted Hold Orders) or following the failure to hold an Auction for any reason on the Auction Date scheduled to occur (except for circumstances in which the Dividend Rate is the Default Rate, as described below). The All Hold Rate will apply automatically following an Auction in which all of the Outstanding Preferred Shares for a particular Series are subject (or are deemed to be subject) to Hold Orders.

Prior to each Auction, Broker-Dealers will notify Holders of the term of the next succeeding Dividend Period as soon as practicable after the Broker-Dealers have been so advised by the Fund. After each Auction, on the Auction Date, Broker-Dealers will notify Holders of the Applicable Rate for the next succeeding Dividend Period and of the Auction Date of the next succeeding Auction.

NOTIFICATION OF DIVIDEND PERIOD. The Fund will designate the duration of Dividend Periods of the Preferred Shares; provided, however, that no such designation is necessary for a Standard Dividend Period and that any designation of a Special Dividend Period shall be effective only if (i) notice thereof shall have been given as provided herein, (ii) any failure to pay in the timely manner to the Auction Agent the full amount of any dividend on, or the redemption price of, the Preferred Shares shall have been cured as set forth under "-- Default Period," (iii) Sufficient Clearing Bids shall have existed in an Auction held on the Auction Date immediately preceding the first day of such proposed Special Dividend Period, (iv) if the Fund shall have mailed a notice of redemption with respect to any shares, as described under "-- Redemption," the Redemption Price with respect to such shares shall have been deposited with the Paying Agent, and (v) the Fund has confirmed that, as of the Auction Date next preceding the first day of such Special Dividend Period, it has Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount and has consulted with the Broker-Dealers and has provided notice and a Preferred Shares Basic Maintenance Certificate to each Rating Agency which is then rating the Preferred Shares and so requires.

If the Fund proposes to designate any Special Dividend Period, not fewer than 7 Business Days (or two Business Days in the event the duration of the Special Dividend Period is fewer than 8 days) nor more than 30 Business Days prior to the first day of such Special Dividend Period, notice shall be (i) made by press release and (ii) communicated by the Fund by telephonic or other means to the Auction Agent and confirmed in writing promptly thereafter. Each such notice shall state (A) that the Fund proposes to exercise its option to designate a succeeding Special Dividend Period, specifying the first and last days thereof and (B) that the Fund will, by 3:00 p.m. New York City time, on the second Business Day next preceding the first day of such Special Dividend Period, notify the Auction Agent, who will promptly notify the Broker-Dealers, of either

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(x) its determination, subject to certain conditions, to proceed with such Special Dividend Period, in which case the Fund may specify the terms of any Specific Redemption Provisions, or (y) its determination not to proceed with such Special Dividend Period in which latter event the succeeding Dividend Period shall be a Standard Dividend Period.

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No later than 3:00 p.m., New York City time, on the second Business Day next preceding the first day of any proposed Special Dividend Period, the Fund shall deliver to the Auction Agent, who will promptly deliver to the Broker-Dealers and Existing Holders, either:

(i) a notice stating (A) that the Fund has determined to designate the next succeeding Dividend Period as a Special Dividend Period, specifying the first and last days thereof and (B) the terms of the Specific Redemption Provisions, if any; or

(ii) a notice stating that the Fund has determined not to exercise its option to designate a Special Dividend Period.

If the Fund fails to deliver either such notice with respect to any designation of any proposed Special Dividend Period to the Auction Agent or is unable to make the confirmation described above by 3:00 p.m., New York City time, on the second Business Day next preceding the first day of such proposed Special Dividend Period, the Fund shall be deemed to have delivered a notice to the Auction Agent with respect to such Dividend Period to the effect set forth in clause (ii) above, thereby resulting in a Standard Dividend Period.

DEFAULT PERIOD. A "Default Period" with respect to a particular Series will commence on any date the Fund fails to deposit irrevocably in Fund in same-day funds, with the Paying Agent by 12:00 noon, New York City time, (A) the full amount of any declared dividend on that Series payable on the Dividend Payment Date (a "Dividend Default") or (B) the full amount of any redemption price (the "Redemption Price") payable on the date fixed for redemption (the "Redemption Date") (a "Redemption Default") and, (together, a Dividend Default and a Redemption Default are hereinafter referred to as "Default").

A Default Period with respect to a Dividend Default or a Redemption Default shall end on the Business Day on which, by 12:00 noon, New York City time, all unpaid dividends and any unpaid Redemption Price shall have been deposited irrevocably in Fund in same-day funds with the Paying Agent.

In the case of a Dividend Default, no Auction will be held during a Default Period applicable to that Series and the Applicable Rate for each Dividend Period commencing during a Default Period, will be equal to the Default Rate.

Each subsequent Dividend Period commencing after the beginning of a Default Period shall be a Standard Dividend Period; provided, however, that the commencement of a Default Period will not by itself cause the commencement of a new Dividend Period. No Auction shall be held during a Default Period applicable to that Series.

No Default Period with respect to a Dividend Default or Redemption Default shall be deemed to commence if the amount of any dividend or any Redemption Price due (if such default is not solely due to the willful failure of the Fund) is deposited irrevocably in trust, in same-day funds with the Paying Agent by 12:00 noon, New York City time within three Business Days after the applicable Dividend Payment Date or Redemption Date, together with an amount equal to the Default Rate applied to the amount of such non-payment based on the actual

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number of days comprising such period divided by 360. The Default Rate shall be equal to the Reference Rate multiplied by three (3).

### RESTRICTIONS ON DIVIDENDS, REDEMPTION AND OTHER PAYMENTS

Under the 1940 Act, the Fund may not (i) declare any dividend with respect to the Preferred Shares if, at the time of such declaration (and after giving effect thereto), asset coverage with respect to the Fund's senior securities representing indebtedness, including all outstanding senior indebtedness of the Fund, including the Fund's obligations under any credit facility program, would be less than 200% (or such other percentage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities representing stock of a closed-end investment company as a condition of declaring dividends on its preferred stock) or (ii) declare any

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other distribution on the Preferred Shares or purchase or redeem Preferred Shares if at the time of the declaration (and after giving effect thereto), asset coverage with respect to the Fund's senior securities representing indebtedness would be less than 300% (or such higher percentage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities representing stock of a closed-end investment company as a condition of declaring distributions, purchases or redemptions of its capital stock). A declaration of a dividend or other distribution on or purchase or redemption of Preferred Shares is prohibited unless there is no event of default under indebtedness senior to the Preferred Shares, if any, and immediately after such transaction, the Fund would have Eligible Assets with an aggregated Discounted Value at least equal to the asset coverage requirements under indebtedness senior to the Preferred Shares.

For so long as the Preferred Shares are Outstanding, except as otherwise provided in the Certificate, the Fund will not declare, pay or set apart for payment any dividend or other distribution (other than a dividend or distribution paid in shares of, or options, warrants or rights to subscribe for or purchase, common shares or other shares, ranking junior to the Preferred Shares as to dividends or upon liquidation) with respect to common shares or any other shares of the Fund ranking junior to the Preferred Shares as to dividends or upon liquidation, or call for redemption, redeem, purchase or otherwise acquire for consideration any common shares or other shares ranking junior to the Preferred Shares (except by conversion into or exchange for shares of the Fund ranking junior to the Preferred Shares as to dividends and upon liquidation), unless (i) immediately after such transaction, the Fund would have Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount and the 1940 Act Preferred Shares Asset Coverage would be achieved, (ii) all cumulative and unpaid dividends due on or prior to the date of the transaction have been declared and paid in full with respect to the Fund's preferred shares, including the Preferred Shares, and (iii) the Fund has redeemed the full number of preferred shares required to be redeemed by any mandatory provision for redemption including shares of the Preferred Shares required to be redeemed by any provision for mandatory redemption contained in the Certificate.

For so long as the Preferred Shares are Outstanding, except as set forth in the next sentence, the Fund will not declare, pay or set apart for payment on any series of shares of the Fund ranking, as to the payment of dividends, on a parity with the Preferred Shares for any period unless full cumulative dividends have been or contemporaneously are declared and paid on the Preferred Shares through their most recent Dividend Payment Date. When dividends are not paid in

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full upon the Preferred Shares through their most recent Dividend Payment Date or upon any other series of shares ranking on a parity as to the payment of dividends with Preferred Shares through their most recent respective Dividend Payment Dates, all dividends declared upon Preferred Shares and any other such series of shares ranking on a parity as to the payment of dividends with Preferred Shares shall be declared pro rata so that the amount of dividends declared per share on Preferred Shares and such other series of preferred shares shall in all cases bear to each other the same ratio that accumulated dividend per share on the Preferred Shares and such other series of preferred shares bear to each other.

### REDEMPTION

OPTIONAL REDEMPTION. To the extent permitted under the 1940 Act and Massachusetts law, the Fund at its option may redeem Preferred Shares having a Dividend Period of one year or less, in whole or in part, on the Dividend Payment Date upon not less than 15 days' and not more than 40 days' prior notice. The optional redemption price per share shall be \$25,000 per share, plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared) to the date fixed for redemption. Preferred Shares having a Dividend Period of more than one year are redeemable at the option of the Fund, in whole or in part, prior to the end of the relevant Dividend Period, subject to any Specific Redemption Provisions, which may include the payment of redemption premiums to the extent required under any applicable Specific Redemption Provisions. The Fund shall not effect any optional redemption unless after giving effect thereto (i) the Fund has available certain Deposit Securities with maturity or tender dates not later than the day preceding the applicable redemption date and having a value not less than the amount (including any applicable premium) due to Holders of Preferred Shares by reason of the redemption of Preferred Shares on such date fixed for the redemption and (ii) the Fund would have Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount.

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MANDATORY REDEMPTION. If the Fund fails as of any Valuation Date to meet the Preferred Shares Basic Maintenance Amount Test or, as of the last Business Day of any month, the 1940 Act Preferred Shares Asset Coverage, and such failure is not cured within five Business Days following the relevant Valuation Date in the case of a failure to meet the Preferred Shares Basic Maintenance Amount Test or the last Business Day of the following month in the case of a failure to meet the 1940 Act Preferred Shares Asset Coverage (each an "Asset Coverage Cure Date"), the Preferred Shares will be subject to mandatory redemption out of funds legally available therefor. The number of Preferred Shares to be redeemed in such circumstances will be equal to the lesser of (A) the minimum number of Preferred Shares the redemption of which, if deemed to have occurred immediately prior to the opening of business on the relevant Asset Coverage Cure Date, would result in the Fund meeting the Preferred Shares Basic Maintenance Amount Test, and the 1940 Act Preferred Shares Asset Coverage, as the case may be, in either case as of the relevant Asset Coverage Cure Date (provided that, if there is no such minimum number of shares the redemption of which would have such result, all Preferred Shares then Outstanding will be redeemed), and (B) the maximum number of Preferred Shares that can be redeemed out of funds expected to be available therefor on the Mandatory Redemption Date at the Mandatory Redemption Price.

Preferred shares may be subject to mandatory redemption in accordance with the foregoing redemption provisions notwithstanding the terms of any Specific Redemption Provision.

The Fund shall effect any required mandatory redemption pursuant to: (A)

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the Preferred Shares Basic Maintenance Amount Test, no later than 30 days after the Fund last met the Preferred Shares Basic Maintenance Amount Test or (B) the 1940 Act Preferred Shares Asset Coverage, no later than 30 days after the Asset Coverage Cure Date (the "Mandatory Redemption Date"), except that if the Fund does not have funds legally available for the redemption of, or is not otherwise legally permitted to redeem, all of the required number of Preferred Shares which are subject to mandatory redemption, or the Fund otherwise is unable to effect such redemption on or prior to such Mandatory Redemption Date, the Fund will redeem those Preferred Shares on the earliest practicable date on which the Fund will have such funds available, upon notice to record owners of Preferred Shares and the Paying Agent. The Fund's ability to make a mandatory redemption may be limited by the provisions of the 1940 Act or Massachusetts law.

The redemption price per share in the event of any mandatory redemption will be \$25,000 per share, plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared) to the date fixed for redemption, plus (in the case of a Dividend Period of more than one year) any redemption premium, if any, determined by the Board of Trustees after consultation with the Broker-Dealers and set forth in any applicable Specific Redemption Provisions (the "Mandatory Redemption Price").

REDEMPTION PROCEDURE. Pursuant to Rule 23c-2 under the 1940 Act, the Fund will file a notice of its intention to redeem with the SEC so as to provide at least the minimum notice required by such Rule or any successor provision (notice currently must be filed with the SEC generally at least 30 days prior to the redemption date). The Auction Agent will use its reasonable efforts to provide telephonic notice to each Holder of Preferred Shares called for redemption not later than the close of business on the Business Day immediately following the Business Day on which the Auction Agent determines the shares to be redeemed (or, during a Default Period with respect to such shares, not later than the close of business on the Business Day immediately following the day on which the Auction Agent receives notice of redemption from the Fund). Such telephonic notice will be confirmed promptly in writing not later than the close of business on the third Business Day preceding the redemption date by providing the notice sent by the Paying Agent to each Holder of Preferred Shares called for redemption, the Paying Agent (if different from the Auction Agent) and the Securities Depository ("Notice of Redemption"). Notice of Redemption will be addressed to the registered owners of the Preferred Shares at their addresses appearing on the share records of the Fund. Such notice will set forth (i) the redemption date, (ii) the number and identity of Preferred Shares to be redeemed, (iii) the redemption price (specifying the amount of accumulated dividends to be included therein), (iv) that dividends on the shares to be redeemed will cease to accumulate on such redemption date, and (v) the provision under which redemption shall be made.

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If fewer than all of the shares of a series of Preferred Shares are redeemed on any date, the shares to be redeemed on such date will be selected by the Fund on a pro rata basis in proportion to the number of shares held by such Holders, by lot or by such other method as is determined by the Fund to be fair and equitable, subject to the terms of any Specific Redemption Provisions.

Preferred Shares may be subject to mandatory redemption as described herein notwithstanding the terms of any Specific Redemption Provisions. The Auction Agent will give notice to the Securities Depository, whose nominee will be the Holder of all of the Preferred Shares, and the Securities Depository will determine the number of shares to be redeemed from the account of the Agent Member of each beneficial owner. Each Agent Member will determine the number of shares to be redeemed from the account of each beneficial owner for which it acts as agent. An Agent Member may select for redemption shares from the

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accounts of some beneficial owners without selecting for redemption any shares from the accounts of other beneficial owners. Notwithstanding the foregoing, if neither the Securities Depository nor its nominee is Holder of all of the shares, the particular shares to be redeemed shall be selected by the Fund by lot, on a pro rata basis between each series or by such other method as the Fund shall deem fair and equitable, as contemplated above.

If Notice of Redemption has been given, then upon the deposit of funds sufficient to effect such redemption, all rights of the owners of the shares so called for redemption will cease, except the right of the owners of such shares to receive the redemption price, but without interest, and such shares will no longer be deemed to be outstanding for any purpose. The Fund shall be entitled to receive from the Paying Agent, promptly after the date fixed for redemption, any cash deposited with the Paying Agent in excess of (i) the aggregate redemption price of the Preferred Shares called for redemption on such date and (ii) such other amounts, if any, to which Holders of Preferred Shares called for redemption may be entitled. The Fund will be entitled to receive, from time to time, from the Paying Agent the interest, if any, earned on such funds deposited with the Paying Agent and the owners of shares so redeemed will have no claim to any such interest. Any funds so deposited which are unclaimed two years after such redemption date will be paid by the Paying Agent to the Fund upon its request; provided, however, the Paying Agent shall notify all owners of the shares whose funds are unclaimed by placing a notice in the Wall Street Journal concerning the availability of such funds for three consecutive weeks. Thereupon the Paying Agent will be relieved of all responsibility to the owners of such shares and such owners may look only to the Fund for payment.

So long as any Preferred Shares are held of record by the nominee of the Securities Depository, the redemption price for such shares will be paid on the redemption date to the nominee of the Securities Depository. The Securities Depository's normal procedures provide for it to distribute the amount of the redemption price to Agent Members who, in turn, are expected to distribute such funds to the person for whom they are acting as agent.

Notwithstanding the provisions for redemption described above, no Preferred Shares may be redeemed at the option of the Fund unless all dividends in arrears on the outstanding Preferred Shares, and all shares of beneficial interest of the Fund ranking on a parity with the Preferred Shares with respect to the payment of dividends or upon liquidation, have been or are being contemporaneously paid or set aside for payment, except in connection with the liquidation of the Fund in which case all Preferred Shares and all shares ranking in a parity with the Preferred Shares must receive proportionate amounts.

Except for the provisions described above, nothing contained in the Certificate limits any legal right of the Fund to purchase or otherwise acquire any Preferred Shares outside of an Auction at any price, whether higher or lower than the price that would be paid in connection with an optional or mandatory redemption, so long as, at the time of any such purchase, there is no arrearage in the payment of dividends on or the mandatory or optional redemption price with respect to, any Preferred Shares for which Notice of Redemption has been given and the Fund is in compliance with the 1940 Act Preferred Shares Asset Coverage and has Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount after giving effect to such purchase or acquisition on the date thereof. Any shares which are purchased, redeemed or otherwise acquired by the Fund shall have no voting rights. If fewer than all the outstanding Preferred Shares are redeemed or otherwise acquired by the Fund, the Fund shall give notice of such transaction to the Auction Agent, in accordance with the procedures agreed upon by the Board of Trustees.

## ASSET MAINTENANCE

The Fund is required to satisfy two separate asset maintenance requirements in respect of the Preferred Shares: (i) the Fund must maintain assets in its portfolio that have a value, discounted in accordance with Rating Agency guidelines, at least equal to the aggregate liquidation preference of the Preferred Shares plus specified liabilities, payment obligations and other amounts; and (ii) the Fund must maintain asset coverage for Preferred Shares of at least 200%.

PREFERRED SHARES BASIC MAINTENANCE AMOUNT. The Fund will be required under Rating Agency guidelines to maintain, as of each Business Day on which the Preferred Shares are outstanding, assets having in the aggregate a Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount established by the rating agency or agencies then rating the Preferred Shares. If the Fund fails to meet such requirement on any Valuation Date and such failure is not cured by the Asset Coverage Cure Date, the Fund will be required under certain circumstances to redeem certain of the Preferred Shares.

"Preferred Shares Basic Maintenance Amount" as of any Valuation Date means the dollar amount equal to the sum of (i) (A) the product of the number of Outstanding shares of each Series of Preferred Shares on such date by the Liquidation Preference (and redemption premium, if any) per share of such Series; (B) the aggregate amount of dividends that will have accumulated at the respective Applicable Rates (whether or not earned or declared) to (but not including) the first respective Dividend Payment Dates for each Series of Preferred Shares outstanding that follows such Valuation Date; (C) the aggregate amount of dividends that would accumulate on Outstanding Preferred Shares from such first Dividend Payment Dates therefor referenced in (B) of this paragraph through the 45th day after such Valuation Date at the respective Applicable Rates referenced in (B) of this paragraph; (D) the amount of anticipated non-interest expenses of the Trust for the 90 days subsequent to such Valuation Date; (E) the amount of the current outstanding balances of any indebtedness or obligations of the Trust senior in right of payment to the Preferred Shares plus interest actually accrued together with 30 days additional interest on the current outstanding balances calculated at the current rate; and (F) any other current liabilities payable during the 30 days subsequent to such Valuation Date, including, without limitation, indebtedness due within one year and any redemption premium due with respect to the Preferred Shares for which a Notice of Redemption has been sent, as of such Valuation Date, to the extent not reflected in any of (i) (A) through (i) (E) (including, without limitation, any liabilities incurred for the purpose of clearing securities transactions) less (ii) the sum of any cash plus the value of any of the Trust's assets irrevocably deposited by the Trust for the payment of any of (i) (A) through (i) (F) ("value," for purposes of this clause (ii), means the Discounted Value of the security, except that if the security matures prior to the relevant redemption payment date and is either fully guaranteed by the U.S. Government or is rated P2 by Moody's and A2 by Fitch, it will be valued at its face value).

The Discount Factors, the criteria used to value the Eligible Assets in the Fund's portfolio for purposes of determining compliance with the Preferred Shares Basic Maintenance Amount, and guidelines for determining the market value of the Fund's portfolio holdings for purposes of determining compliance with the Preferred Shares Basic Maintenance Amount, are based on the criteria established

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in connection with the rating the Preferred Shares. The Moody's Discount Factor and the Fitch Discount Factor relating to any asset of the Fund, the Preferred Shares Basic Maintenance Amount, the assets eligible for inclusion in the calculation of the Moody's Discount Factor and Fitch Discount Factor of the Fund's portfolio and certain definitions and methods of calculation relating thereto may be changed from time to time by the Fund, without shareholder approval, but only in event that the Fund receives written confirmation from each Rating Agency which is then rating the Preferred Shares and which so requires that any such changes would not impair the "Aaa" credit rating from Moody's or the "AAA" credit rating from Fitch.

A Rating Agency's guidelines will apply to the Preferred Shares only so long as such Rating Agency is rating such shares. The Fund will pay certain fees to Moody's and Fitch for rating the Preferred Shares. The ratings assigned to Preferred Shares are not recommendations to buy, sell or hold Preferred Shares. Such ratings may be subject to revision or withdrawal by the assigning Rating Agency at any time. Any rating of Preferred Shares should be evaluated independently of any other rating.

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Upon any failure to maintain the required Discounted Value of the Fund's Eligible Assets, the Fund will seek to alter the composition of its portfolio to reattain the Preferred Shares Basic Maintenance Amount on or prior to the Preferred Shares Basic Maintenance Cure Date, thereby incurring additional transaction costs and possible losses and/or gains on dispositions of portfolio securities.

1940 ACT PREFERRED SHARES ASSET COVERAGE. The Fund is also required to maintain, as of the last Business Day on any month in which the Preferred Shares are outstanding, asset coverage of at least 200% (or such other percentage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities representing shares of a closed-end company as a condition of declaring dividends on its common shares). If the Fund fails to maintain the 1940 Act Preferred Shares Asset Coverage as of the last Business Day of any month and such failure is not cured as of the related Asset Coverage Cure Date, the Fund will be required to redeem certain Preferred Shares.

### VOTING

All voting rights (as described in the Prospectus under "Description of Capital Structure" and "Description of Preferred Shares -- Voting Rights") will not apply with respect to Preferred Shares if, at or prior to the time when a vote is required, such shares have been (i) redeemed or (ii) called for redemption and sufficient funds have been deposited in Fund to effect such redemption.

The Board of Trustees may without shareholder approval, amend, alter or repeal any or all of the definitions and related provisions required to be contained in the Certificate or Declaration of Trust by the Rating Agencies in the event the Fund receives written confirmation from Moody's or Fitch, or both, as appropriate, that any such amendment, alteration or repeal would not impair the ratings then assigned by Moody's or Fitch, as the case may be, to the Preferred Shares.

### RESTRICTIONS ON TRANSFER

Preferred Shares may be transferred only (a) pursuant to an Order placed in

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an Auction, or (b) to or through a Broker-Dealer. Notwithstanding the foregoing, a transfer other than pursuant to an Auction will not be effective unless the selling Existing Holder or the Agent Member of such Existing Holder, in the case of an Existing Holder whose shares are listed in its own name on the books of the Auction Agent, or the Broker-Dealer or Agent Member of such Broker-Dealer, in the case of a transfer between persons holding Preferred Shares through different Broker-Dealers, advises the Auction Agent of such transfer.

### FEDERAL TAXATION

The following is intended to be a generally summary of certain federal income tax considerations regarding the purchase, ownership and disposition of Preferred Shares of the Fund. It is not intended as a complete discussion of all of the potential federal income tax consequences that may be applicable to the Fund or to all categories of investors, some of which may be subject to special tax rules. Investors are therefore advised to consult with their tax advisors before making an investment in the Fund. The summary is based on the laws in effect on the date of this Statement of Additional Information and existing judicial and administrative interpretations thereof, all of which are subject to change, possible with retroactive effect.

### FEDERAL TAXATION OF THE FUND

The Fund has elected to be, and intends to qualify each year for treatment as, a regulated investment company, under the Internal Revenue Code of 1986, as amended (the "Code"). To qualify as a regulated investment company, the Fund must comply with certain requirements of the Code relating to, among other things, the sources of its income and diversification of its assets.

If the Fund so qualifies and distributes each year to its shareholders at least 90% of its investment company taxable income (generally including ordinary income and net short-term capital gain, but not net capital gain, which is the excess of net long-term capital gain over net short-term capital loss), it will generally not be required to pay federal income taxes on any income (including any net capital gain) it distributes to shareholders. The Fund intends to distribute at least the minimum amount necessary to satisfy the 90% distribution requirement.

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In order to qualify as a regulated investment company, the Fund must derive at least 90% of its annual gross income from dividends, interest, payments with respect to securities loans, gains from the sale or other disposition of stock or securities or foreign currencies, or other income (including but not limited to gains from options, futures and forward contracts) derived with respect to its business of investing in such stock, securities or currencies. The Fund must also diversify its holdings so that, at the end of each quarter of its taxable year, (i) at least 50% of the market value of the Fund's assets is represented by cash and cash items, U.S. government securities, securities of other

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regulated investment companies, and other securities limited in respect of any one issuer to a value not greater than 5% of the value of the Fund's total assets and to not more than 10% of the outstanding voting securities of such issuer, and (ii) not more than 25% of the value of its assets is invested in the securities (other than those of the U.S. government or other regulated investment companies) of any one issuer or of two or more issuers that the Fund controls and that are engaged in the same, similar or related trades or businesses.

To avoid a nondeductible 4% excise tax, the Fund will be required to distribute, by December 31st of each year, at least an amount equal to the sum of (i) 98% of its ordinary income for such year and (ii) 98% of its capital gain net income (the latter of which generally is computed on the basis of the one-year period ending on October 31st of such year), plus any amounts that were not distributed in previous taxable years. For purposes of the excise tax, any ordinary income or capital gain net income retained by, and subject to federal income tax in the hands of, the Fund will be treated as having been distributed.

If the Fund failed to qualify as a regulated investment company or failed to satisfy the 90% distribution requirement in any taxable year, the Fund would be taxed as an ordinary corporation on its taxable income (even if such income were distributed to its shareholders) and all distributions out of earnings and profits would be taxed to shareholders as ordinary dividends. Such distributions, however, would be eligible (i) to be treated as "qualified dividend income" in the case of shareholders taxed as individuals who satisfy certain holding period and other requirements and (ii) for the dividends received deduction in the case of corporate shareholders who satisfy certain holding period and other requirements. In addition, the Fund could be required to recognize unrealized gains, pay substantial taxes and make distributions (which could be subject to interest charges) before requalifying for taxation as a regulated investment company.

If the Fund does not meet the asset coverage requirements of the 1940 Act, the Fund intends to repurchase or redeem (to the extent permitted under the 1940 Act) Preferred Shares in order to maintain or restore the asset coverage and avoid failure to remain qualified as a regulated investment company. The determination to repurchase or redeem Preferred Shares and the amounts to be repurchased or redeemed, if any, will be made in the sole discretion of the Fund.

Investments of the Fund in securities issued at a discount or providing for deferred interest or payment of interest in kind are subject to special tax rules that will affect the amount, timing and character of distributions to shareholders. For example, with respect to securities issued at a discount, the Fund will be required to accrue as income each year a portion of the discount and to distribute such income each year to maintain its qualification as a regulated investment company and to avoid income and excise taxes. To generate sufficient cash to make distributions necessary to satisfy the 90% distribution requirement and to avoid income and excise taxes, the Fund may have to dispose of securities that it would otherwise have continued to hold.

Some of the Fund's investment practices are subject to special provisions

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of the Code 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 into higher taxed short-term capital gain or ordinary income, (iii) convert an ordinary loss or a deduction into 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 as to when a purchase or sale of stock or securities is deemed to occur and/or (vi) adversely alter the characterization of certain complex financial transactions. These rules could therefore affect the character, amount and timing of distributions to shareholders. The Fund will monitor its transactions and may make certain tax elections in order to mitigate the effect of these provisions.

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### FEDERAL INCOME TAXATION OF HOLDERS OF PREFERRED SHARES

The Fund believes that the Preferred Shares will constitute stock of the Fund and distributions of the Fund's investment company taxable income will generally be taxable to shareholders as ordinary income to the extent of the Fund's earnings and profits. It is possible, however, that the Internal Revenue Service (the "IRS") might take a contrary position asserting, for example, that the Preferred Shares constitute debt of the Fund. If this position were upheld, distributions by the Fund to holders of Preferred Shares would constitute interest, whether or not they exceeded the Fund's earnings and profits, and would be taxed as ordinary income. The Fund believes, however, that such a position, if asserted by the IRS, would be unlikely to prevail if the issuer were properly litigated. On May 28, 2003, President Bush signed into the law the Jobs and Growth Tax Relief Reconciliation Act of 2003, which contains provisions that reduce the U.S. federal income tax rates on (1) long-term capital gains received by individuals and (2) "qualified dividend income" received by individuals from certain domestic and foreign corporations. The reduced rates apply to long-term capital gains from sales or exchanges in taxable years ending on or after May 6, 2003 and cease to apply for taxable years beginning after December 31, 2008. Because the Fund intends to invest primarily in Senior Loans and other senior debt securities, ordinary income dividends paid by the Fund generally will not be eligible for the reduced rates applicable to "qualified dividend income" and generally will not qualify for the dividends received deduction available to corporations. Distributions from the Fund designated as capital gain dividends will be eligible for the rate applicable to long-term capital gains. Distributions of the Fund's net capital gain as capital gain dividends, if any, are taxable to shareholders as long-term capital gains regardless of the length of time shares of the Fund have been held by such shareholders. Distributions in excess of the Fund's earnings and profits will first reduce the adjusted tax basis of a shareholder's shares and, after such adjusted tax basis is reduced to zero, will constitute capital gains to such shareholder (assuming such shares are held as a capital asset).

The Fund will inform shareholders of the source and tax status of all distributions promptly after the close of each calendar year.

Although dividends generally will be treated as distributed when paid, dividends declared in October, November or December, payable to shareholders of

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record on a specified date in such a month and paid during January of the following year will be treated as having been distributed by the Fund and received by the shareholders on the December 31st prior to the date of payment. In addition, certain other distributions made after the close of a taxable year of the Fund may be "spilled back" and treated as paid by the Fund (except for purposes of the nondeductible 4% excise tax) during such taxable year. In such case, shareholders will be treated as having received such dividends in the taxable year in which the distribution was actually made.

The sale of shares (including transfers in connection with a redemption or repurchase of shares) may be a taxable transaction for federal income tax purposes. Selling shareholders will generally recognize a gain or loss in an amount equal to the difference between the amount received in exchange for the shares and their adjusted tax basis in the shares sold. If the shares sold are held as a capital asset, the gain or loss will be a capital gain or loss. Such gain or loss generally will be treated as long-term gain or loss if the shares were held for more than one year and otherwise generally will be treated as short-term gain or loss. Any loss recognized upon a taxable disposition of shares held for six months or less will be treated as a long-term capital loss to the extent of any capital gain dividends received with respect to such shares. Any loss realized on a sale or exchange will be disallowed to the extent the shares disposed of are replaced within a 61-day period beginning 30 days before and ending 30 days after the disposition of the shares. If disallowed, the loss will be reflected by an upward adjustment to the basis of the shares acquired.

For federal income tax purposes, the IRS currently requires that a regulated investment company that has two or more classes of shares allocated to each such class proportionate amounts of each type of its income (such as ordinary income and net capital gain) for each tax year. A class's proportionate share of a particular type of income is determined according to the percentage of total dividends paid by the regulated investment company during the year to such class. Accordingly, the Fund intends to designate distributions made to holders of common shares and holders of Preferred Shares in accordance with each such class's proportionate share of the total dividends paid to both classes.

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Income from investments in foreign securities received by the Fund may be subject to income, withholding or other taxes imposed by foreign countries and U.S. possessions. Such taxes will not be deductible or creditable by shareholders. Tax conventions between certain countries and the United States may reduce or eliminate such taxes.

Certain foreign currency gains or losses attributable to currency exchange rate fluctuations are treated as ordinary income or loss. Such income or loss may increase or decrease (or possibly eliminate) the Fund's income available for distribution. If, under the rules governing the tax treatment of foreign currency gains and losses, the Fund's income available for distribution is decreased or eliminated, all or a portion of the dividends declared by the Fund may be treated for federal income tax purposes as a return of capital, or in some circumstances, as capital gains. Generally, a shareholder's tax basis in Fund shares will be reduced to the extent that an amount distributed to such

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shareholder is treated as a return of capital.

### WITHHOLDING ON PAYMENTS TO NON-U.S. SHAREHOLDERS

Ordinary income dividends (but not capital gain dividends) paid to shareholders who are non-resident aliens or foreign entities ("Non-U.S. Shareholders") will be subject to a 30% United States withholding tax under existing provisions of the Code applicable to foreign individuals and entities, unless a reduced rate of withholding or a withholding exemption is provided under applicable treaty law. Non-U.S. Shareholders are urged to consult their own tax advisers concerning the applicability of the United States withholding tax.

### BACKUP WITHHOLDING

The Fund may be required to withhold federal income tax ("backup withholding") from dividends and gross proceeds paid to non-corporate shareholders. This tax may be withheld from dividends if (i) the shareholder fails to properly furnish the Fund with its correct taxpayer identification number, (ii) the IRS notifies the Fund that the shareholder has failed to properly report certain interest and dividend income to the IRS and to respond to notices to that effect or (iii) when required to do so, the shareholder fails to certify that the taxpayer identification number provided is correct, that the shareholder is not subject to backup withholding and that the shareholder is a U.S. person (as defined for U.S. federal income tax purposes). Redemption proceeds may be subject to backup withholding under the circumstances described in (i) above.

Generally, dividends paid to Non-U.S. Shareholders that are subject to the 30% federal income tax withholding described above under "Withholding on Payments to Non-U.S. Shareholders" are not subject to backup withholding. To avoid backup withholding, Non-U.S. Shareholders must generally provide a properly completed IRS Form W-8BEN (or other applicable form) certifying their non-United States status.

Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from payments made to a shareholder may be refunded or credited against such shareholder's U.S. federal income tax liability, if any, provided that the required information is furnished to the IRS.

### INFORMATION REPORTING

The Fund must report annually to the IRS and to each shareholder the amount of dividends, capital gain dividends or gross proceeds paid to such shareholder and the amount, if any, of tax withheld pursuant to backup withholding rules with respect to such amounts. In the case of a Non-U.S. Shareholder, the Fund

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must report to the IRS and such Non-U.S. shareholder the amount of dividends, capital gain dividends or gross proceeds paid that are subject to withholding (including backup withholding, if any) and the amount of tax withheld with respect to such amounts. This information may also be made available to the tax authorities in the Non-U.S. Shareholder's country of residence.

The federal income tax discussion set forth above is for general information only. Shareholders and prospective investors should consult their advisers regarding the specific federal tax consequences of purchasing, holding and disposing of shares of the Fund, as well as the effects of state, local and foreign tax law and any proposed tax law changes.

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### APPENDIX A -- RATINGS OF INVESTMENTS

#### DESCRIPTION OF MOODY'S DEBT RATINGS

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

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

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

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

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

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

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

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or interest.

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

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

Note -- Those bonds in the "Aa", "A", "Baa", "Ba" and "B" categories which Moody's believes possess the strongest credit attributes within those categories are designated by the symbols "Aa1", "A1", "Baa1", "Ba1" and "B1."

Short-term Notes -- The four ratings of Moody's for short-term notes are "MIG 1/VMIG1", "MIG 2/VMIG2", "MIG 3/VMIG3" and "MIG 4/VMIG4." "MIG 1/VMIG1" denotes "best quality . . . strong protection by established cash flows." "MIG2/VMIG2" denotes "high quality" with ample margins of protection. "MIG3/VMIG3" notes are of "favorable quality . . . but . . . lacking the undeniable strength of the preceding grades." "MIG 4/VMIG4" notes are of "adequate quality . . . [p]rotection commonly regarded as required of an investment security is present . . . there is specific risk."

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### DESCRIPTION OF MOODY'S COMMERCIAL PAPER RATINGS

Moody's Commercial Paper ratings are opinions of the ability of issuers to repay punctually promissory obligations not having an original maturity in excess of nine months. Moody's employs the following three designations, all judged to be investment grade, to indicate the relative repayment ability of rated issuers:

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

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

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

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

### DESCRIPTION OF STANDARD & POOR'S DEBT RATINGS

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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 rating and may, on occasion, rely on unaudited financial information. Credit ratings may be changed, suspended or withdrawn as a result of changes in, or unavailability of, such information, or based on other circumstances.

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

### LONG-TERM ISSUE CREDIT RATINGS

Issue ratings are based, in varying degrees, on the following considerations:

1. Likelihood of payment-capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of obligation;
2. Nature of and provisions of the obligation; and

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3. 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 ratings 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.

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

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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 debt in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

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

BB, B, CCC, CC and C -- Obligations rated "BB", "B", "CCC", "CC" and "C" is regarded as having significant speculative characteristics. "BB" indicates the least degree of speculation and "C" the highest degree of speculation. While such bonds will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

BB -- An obligation rated "BB" is less vulnerable to non-payment 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 non-payment 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 non-payment 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. 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 non-payment.

C -- A subordinated debt or preferred stock obligation rated "C" is currently highly vulnerable to non-payment. The "C" rating may be used to cover a situation where a bankruptcy petition has been filed or similar action has been taken, but payments on this obligation are being continued. A "C" rating will also 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 applicable grace period has not expired, unless Standard & Poor's believes that

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such payments will be made during such grace period. The "D" rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.

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

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

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.

### DESCRIPTION OF STANDARD & POOR'S SHORT-TERM 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 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 the 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. The obligor currently has the capacity to meet its financial commitment on the obligation; however, it faces major ongoing uncertainties which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

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

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APPENDIX B -- FORM OF CERTIFICATE OF VOTE

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VAN KAMPEN SENIOR INCOME TRUST

FORM OF CERTIFICATE OF VOTE ESTABLISHING

A CLASS OF PREFERRED SHARES (THE "CERTIFICATE")

Van Kampen Senior Income Trust, a Massachusetts business trust (the "Trust"), certifies that:

FIRST: Article VI of the Trust's Declaration of Trust (which, as hereafter restated or amended from time to time, is together with this Certificate herein called the "Declaration") empowers the Board of Trustees of the Trust (the "Board") to authorize the issuance of one or more series of a class of preferred shares, provided that to the extent required by the Investment Company Act of 1940, as amended (the "1940 Act"), no such series shall have priority over any other series within its class upon the distribution of assets or in respect of the payment of dividends.

SECOND: Pursuant to the authority so vested in the Board of Trustees of the Trust, the Board has, by resolution, authorized the creation of 28,000 Auction Rate Cumulative Preferred Shares, \$0.01 par value, liquidation preference \$25,000 per share, classified as Series M, T, W, TH and F (collectively, the "Series") Auction Rate Cumulative Preferred Shares (collectively, the "Preferred Shares").

THIRD: The preferences, rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption of the shares of each series of Preferred Shares are as follows:

DESIGNATION

SERIES M: A series of 5,600 Preferred Shares, liquidation preference \$25,000 per share, is hereby designated "Series M Auction Rate Cumulative Preferred Shares" ("Series M"). Each share of Series M may be issued on a date to be determined by the Board or pursuant to their delegated authority; have an initial Applicable Rate and an initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board or pursuant to their delegated authority; and have such other preferences, rights, voting powers,

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restrictions, limitations as to dividends, qualifications and terms and conditions of redemption, in addition to those required by applicable law or set forth in the Declaration applicable to preferred shares of the Trust, as are set forth in Part I and Part II of this Certificate. The Series M shall constitute a separate series of Preferred Shares of the Trust.

SERIES T: A series of 5,600 Preferred Shares, liquidation preference \$25,000 per share, is hereby designated "Series T Auction Rate Cumulative Preferred Shares" ("Series T"). Each share of Series T may be issued on a date to be determined by the Board or pursuant to their delegated authority; have an initial Applicable Rate and an initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board or pursuant to their delegated authority; and have such other preferences, rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption, in addition to those required by applicable law or set forth in the Declaration applicable to preferred shares of the Trust, as are set forth in Part I and Part II of this Certificate. The Series T shall constitute a separate series of Preferred Shares of the Trust.

SERIES W: A series of 5,600 Preferred Shares, liquidation preference \$25,000 per share, is hereby designated "Series W Auction Rate Cumulative Preferred Shares" ("Series W"). Each share of Series W may be issued on a date to be determined by the Board or pursuant to their delegated authority; have an initial Applicable Rate and an initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board or pursuant to their delegated authority; and have such other preferences, rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption, in addition to those required by applicable law or set forth in the Declaration applicable to preferred shares of the Trust, as are set forth in Part I and Part II of this Certificate. The Series W shall constitute a separate series of Preferred Shares of the Trust.

SERIES TH: A series of 5,600 Preferred Shares, liquidation preference \$25,000 per share, is hereby designated "Series TH Auction Rate Cumulative Preferred Shares" ("Series TH"). Each share of Series TH may be issued on a date to be determined by the Board or pursuant to their delegated authority; have an initial

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Applicable Rate and an initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board or pursuant to their delegated authority; and have such other preferences, rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption, in addition to those required by applicable law or set forth in the Declaration applicable to preferred shares of the Trust, as are set forth in Part I and Part II of this Certificate. The Series TH shall constitute a separate series of Preferred Shares of the Trust.

SERIES F: A series of 5,600 Preferred Shares, liquidation preference \$25,000 per share, is hereby designated "Series F Auction Rate Cumulative Preferred Shares" ("Series F"). Each share of Series F may be issued on a date

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to be determined by the Board or pursuant to their delegated authority; have an initial Applicable Rate and an initial Dividend Payment Date as shall be determined in advance of the issuance thereof by the Board or pursuant to their delegated authority; and have such other preferences, rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption, in addition to those required by applicable law or set forth in the Declaration applicable to preferred shares of the Trust, as are set forth in Part I and Part II of this Certificate. The Series F shall constitute a separate series of Preferred Shares of the Trust.

Subject to the provisions of Section 3(j) of Part I of this Certificate, the Board may, in the future, authorize the issuance of additional series of the Trust's preferred shares, including additional Series of Preferred Shares, as long as any additional series of preferred shares has the same preferences, rights, voting powers, restrictions, limitations as to dividends, qualifications and terms and conditions of redemption and other terms of each of the respective Series herein described, except that the Applicable Rate for its initial Dividend Period, its initial Dividend Payment Date and any other changes in the terms herein set forth shall be as set forth in an amendment to this Certificate.

As used in Part I and Part II of this Certificate, capitalized terms shall have the meanings provided in Section 19 of Part I of this Certificate.

### PART I:

#### TERMS OF THE PREFERRED SHARES

##### 1. NUMBER OF SHARES; RANKING.

(a) The initial number of authorized shares constituting Series M is 5,600 shares. The initial number of authorized shares constituting Series T is 5,600 shares. The initial number of authorized shares constituting Series W is 5,600 shares. The initial number of authorized shares constituting Series TH is 5,600 shares. The initial number of authorized shares constituting Series F is 5,600 shares. No fractional shares of any Series shall be issued.

(b) Shares of each Series which at any time have been redeemed or purchased by the Trust shall, after such redemption or purchase, have the status of authorized but unissued preferred shares.

(c) Shares of each Series shall rank on a parity with shares of any other series of preferred shares (including any other Preferred Shares) as to the payment of dividends to which such shares are entitled and the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Trust.

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(d) No Holder of shares of any Series shall have, solely by reason of being such a Holder, any preemptive or other right to acquire, purchase or subscribe for any shares of any Series, any Common Shares of the Trust or any other securities of the Trust which it may hereafter issue or sell.

### 2. DIVIDENDS.

(a) The Holders of shares of each Series shall be entitled to receive, when, as and if declared by the Board, out of funds legally available therefor, cumulative cash dividends on their shares at the Applicable Rate, determined as set forth in paragraph (c) of this Section 2, and no more, payable on the respective dates determined as set forth in paragraph (b) of this Section 2. Dividends on the Outstanding shares of each Series issued on the Date of Original Issue shall accumulate from the Date of Original Issue.

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(b) (i) Dividends shall be payable when, as and if declared by the Board following the initial Dividend Payment Date, subject to subparagraph (b)(ii) of this Section 2, on the shares of each Series, as follows:

(A) with respect to any Dividend Period of one year or less, on the Business Day following the last day of such Dividend Period; provided however, if the Dividend Period is more than 91 days, then on the 91st, 181st and 271st days within such period, if applicable, and on the Business Day following the last day of such Dividend Period; and

(B) with respect to any Dividend Period of more than one year, on a quarterly basis on each January 1, April 1, July 1 and October 1 within such Dividend Period and on the Business Day following the last day of such Dividend Period.

(ii) If a day for payment of dividends resulting from the application of subparagraph (b)(i) above is not a Business Day, then the Dividend Payment Date shall be the first Business Day following such day for payment of dividends.

(iii) The Trust shall pay to the Paying Agent not later than 12:00 p.m., New York City time, on the Business Day next preceding each Dividend Payment Date for a Series, an aggregate amount of funds available on the next Business Day in the City of New York, New York, equal to the dividends to be paid to all Holders of shares of such Series on such Dividend Payment Date. The Trust shall not be required to establish any reserves for the payment of dividends.

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(iv) All moneys paid to the Paying Agent for the payment of dividends shall be held in trust for the payment of such dividends by the Paying Agent for the benefit of the Holders specified in subparagraph (b) (v) of this Section 2. Any moneys paid to the Paying Agent in accordance with the foregoing but not applied by the Paying Agent to the payment of dividends, including interest earned on such moneys, will, to the extent permitted by law, be repaid to the Trust at the end of 90 days from the date on which such moneys were to have been so applied.

(v) Each dividend on each Series shall be paid on the Dividend Payment Date therefor to the Holders of shares of that Series as their names appear on the share ledger or share records of the Trust on the Business Day next preceding such Dividend Payment Date; provided, however, if dividends are in arrears, they may be declared and paid at any time to Holders as their names appear on the share ledger or share records of the Trust on such date not exceeding 15 days preceding the payment date thereof, as may be fixed by the Board. No interest will be payable in respect of any dividend payment or payments which may be in arrears.

(c) (i) The dividend rate on Outstanding shares of each Series during the period from and after the Date of Original Issue to and including the last day of the initial Dividend Period therefor shall be equal to the rate per annum set forth under "Designation" above. For each subsequent Dividend Period, the dividend rate shall be equal to the rate per annum that results from an Auction; provided, however, that if an Auction for any subsequent Dividend Period of a Series is not held for any reason or if Sufficient Clearing Orders have not been made in an Auction (other than as a result of all shares of any Series being the subject of Submitted Hold Orders), then the dividend rate on the shares of that Series for any such Dividend Period shall be the Maximum Rate (except (i) during a Default Period when the dividend rate shall be the Default Rate, as set forth in Section 2(c)(ii) below) or (ii) after a Default Period and prior to the beginning of the next Dividend Period when the dividend rate shall be the Maximum Rate at the close of business on the last day of such Default Period). The rate per annum at which dividends are payable on shares of each Series as determined pursuant to this Section 2(c)(i) shall be the "Applicable Rate."

(ii) Subject to the cure provisions in Section 2(c)(iii) below, a "Default Period" with respect to a particular Series will commence on any date the Trust fails to deposit irrevocably in trust in same-day funds with the Paying Agent by 12:00 noon, New York City time, (A) the full amount of any declared dividend on that Series payable on the Dividend Payment Date (a "Dividend Default") or (B) the full amount of any redemption price (the "Redemption Price") payable on the date fixed for redemption (the "Redemption Date") (a "Redemption Default" and, together with a Dividend Default, a "Default").

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Subject to the cure provisions of Section 2(c)(iii) below, a Default Period shall end on the Business Day on which, by 12:00 noon, New York City

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time, all unpaid dividends and any unpaid Redemption Price shall have been deposited irrevocably in trust in same-day funds with the Paying Agent. In the case of a Dividend Default, no Auction shall be held during a Default Period applicable to that Series, and the Applicable Rate for each Dividend Period commencing during a Default Period will be equal to the Default Rate, and each subsequent Dividend Period commencing after the beginning of a Default Period shall be a Standard Dividend Period; provided, however, that the commencement of a Default Period will not by itself cause the commencement of a new Dividend Period.

(iii) No Default Period shall be deemed to commence if the amount of any dividend or any Redemption Price due (if such default is not solely due to the willful failure of the Trust) is deposited irrevocably in trust in same-day funds with the Paying Agent by 12:00 noon, New York City time, within three Business Days after the applicable Dividend Payment Date or Redemption Date, together with an amount equal to the Default Rate applied to the amount of such non-payment based on the actual number of days comprising such period divided by 360. The Default Rate shall be equal to the Reference Rate multiplied by three (3).

(iv) The amount of dividends per share payable (if declared) on each Dividend Payment Date of each Dividend Period (or in respect of dividends on another date in connection with a redemption during such Dividend Period) shall be computed by multiplying the Applicable Rate (or the Default Rate) for such Dividend Period (or a portion thereof) by a fraction, the numerator of which will be the number of days in such Dividend Period (or portion thereof) that such share was Outstanding and for which the Applicable Rate or the Default Rate was applicable and the denominator of which will be 360, multiplying the amount so obtained by \$25,000, and rounding the amount so obtained to the nearest cent.

(d) Any dividend payment made on shares of any Series shall first be credited against the earliest accumulated but unpaid dividends due with respect to such Series.

(e) For so long as the Preferred Shares are Outstanding, except as otherwise contemplated by Part I of this Certificate, the Trust will not declare, pay or set apart for payment any dividend or other distribution (other than a dividend or distribution paid in shares of, or options, warrants or rights to subscribe for or purchase, Common Shares or other shares, ranking junior to the Preferred Shares as to dividends or upon liquidation) with respect to Common Shares or any other shares of the Trust ranking junior to the Preferred Shares as to dividends or upon liquidation, or call for redemption, redeem, purchase or otherwise acquire for consideration any Common Shares or other shares ranking junior to the Preferred Shares (except by conversion into or exchange for shares of the Trust ranking junior to the Preferred Shares as to dividends and upon liquidation), unless (i) immediately after such transaction, the Trust would have Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount and the 1940 Act Preferred Shares Asset Coverage, (ii) all cumulative and unpaid dividends due on or prior to the date of the transaction have been declared and paid in full with respect to the Trust's preferred shares, including the Preferred Shares, and (iii) the Trust has redeemed the full number of preferred shares required to be redeemed by any mandatory provision for redemption, including any Preferred

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Shares required to be redeemed by any provision for mandatory redemption contained in Section 3(a)(ii) of Part I of this Certificate.

(f) For so long as the Preferred Shares are Outstanding, except as set forth in the next sentence, the Trust will not declare, pay or set apart for payment on any series of shares of the Trust ranking, as to the payment of dividends, on a parity with the Preferred Shares for any period unless full cumulative dividends have been or contemporaneously are declared and paid on the Preferred Shares through their most recent Dividend Payment Date. When dividends are not paid in full upon the Preferred Shares through their most recent Dividend Payment Date or upon any other series of shares ranking on a parity as to the payment of dividends with Preferred Shares through their most recent respective dividend payment dates, all dividends declared upon Preferred Shares and any other such series of shares ranking on a parity as to the payment of dividends with Preferred Shares shall be declared pro rata so that the amount of dividends declared per share on Preferred Shares and such other series of preferred shares shall in all cases bear to each other the same ratio that accumulated dividends per share on the Preferred Shares and such other series of preferred shares bear to each other.

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(g) The Trust will not declare, pay or set apart for payment any dividend or other distribution in respect to any Series (i) if there is any event of payment default which has occurred and is continuing under indebtedness senior to such Series (such senior indebtedness including but not limited to indebtedness under any commercial paper program) or (ii) unless immediately after such transaction, the Trust would have Eligible Assets with an aggregate Discounted Value at least equal to the asset coverage requirements under the indebtedness senior to such Series.

### 3. REDEMPTION.

(a) (i) After the initial Dividend Period, subject to the provisions of this Section 3 and to the extent permitted under the 1940 Act and Massachusetts law, the Trust may, at its option, redeem in whole or in part, out of funds legally available therefor, shares of any Series herein designated as (A) having a Dividend Period of one year or less, on the Business Day after the last day of such Dividend Period, by delivering a notice of redemption not less than 15 calendar days and not more than 40 calendar days prior to the Redemption Date, at a redemption price per share equal to \$25,000 plus an amount equal to accumulated but unpaid dividends thereon (whether or not earned or declared) to the Redemption Date ("Redemption Price"), or (B) having a Dividend Period of more than one year, on any Business Day prior to the end of the relevant Dividend Period, by delivering a notice of redemption not less than 15 calendar days and not more than 40 calendar days prior to the Redemption Date, at the Redemption Price, plus a redemption premium, if any, determined by the Board after consultation with the Broker-Dealers and set forth in any applicable Specific Redemption Provisions at the time of the designation of such Dividend Period as set forth in Section 4 of Part I of this Certificate; provided, however, that during a Dividend Period of more than one year no shares of any Series will be subject to optional redemption except in accordance with any Specific Redemption Provisions approved by the Board after consultation with the Broker-Dealers at the time of the designation of such Dividend Period.

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Notwithstanding the foregoing, the Trust shall not give a notice of or effect any redemption pursuant to this Section 3(a)(i) unless, on the date on which the Trust gives such notice and on the Redemption Date, (A) the Trust has available Deposit Securities with maturity or tender dates not later than the day preceding the applicable Redemption Date and having a value not less than the amount (including any applicable premium) due to Holders of shares of each Series by reason of the redemption of each Series on the Redemption Date and (B) the Trust would have Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount immediately subsequent to such redemption, if such redemption were to occur on such date, it being understood that the provisions of paragraph (d) of this Section 3 shall be applicable in such circumstances in the event the Trust makes the deposit and takes the other action required thereby.

(ii) If the Trust fails as of any Valuation Date to meet the Preferred Shares Basic Maintenance Amount Test or, as of the last Business Day of any month, the 1940 Act Preferred Shares Asset Coverage, and such failure is not cured within five Business Days following the relevant Valuation Date in the case of a failure to meet the Preferred Shares Basic Maintenance Amount Test or the last Business Day of the following month in the case of a failure to meet the 1940 Act Preferred Shares Asset Coverage (each an "Asset Coverage Cure Date"), the Preferred Shares will be subject to mandatory redemption out of funds legally available therefor. The number of Preferred Shares to be redeemed in such circumstances will be equal to the lesser of (A) the minimum number of Preferred Shares the redemption of which, if deemed to have occurred immediately prior to the opening of business on the relevant Asset Coverage Cure Date, would result in the Trust meeting the Preferred Shares Basic Maintenance Amount Test or the 1940 Act Preferred Shares Asset Coverage, as the case may be, in either case as of the relevant Asset Coverage Cure Date (provided that, if there is no such minimum number of shares the redemption of which would have such result, all Preferred Shares then Outstanding will be redeemed), and (B) the maximum number of Preferred Shares that can be redeemed out of funds expected to be available therefor on the Mandatory Redemption Date at the Mandatory Redemption Price set forth in subparagraph (a)(iv) of this Section 3.

(iii) [Reserved]

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(iv) In determining the Preferred Shares required to be redeemed in accordance with the foregoing Section 3(a)(ii), the Trust shall allocate the number of shares required to be redeemed to satisfy the Preferred Shares Basic Maintenance Amount Test or the 1940 Act Preferred Shares Asset Coverage, as the case may be, pro rata among the Holders of the Preferred Shares in proportion to the number of shares they hold and other preferred shares subject to mandatory redemption provisions similar to those contained in this Section 3, subject to the further provisions of this subparagraph (iv). The Trust shall effect any required mandatory redemption pursuant to: (A) the Preferred Shares Basic Maintenance Amount Test, as described in subparagraph (a)(ii) of this Section 3, no later than 30 days after the Trust last met the Preferred Shares Basic Maintenance Amount Test or (B) the 1940 Act Preferred Shares Asset Coverage, as described in subparagraph (a)(ii) of this Section 3, no later than 30 days after the

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Asset Coverage Cure Date (each a "Mandatory Redemption Date"), except that if the Trust does not have funds legally available for the redemption of, or is not otherwise legally permitted to redeem, the number of Preferred Shares which would be required to be redeemed by the Trust under clause (A) of subparagraph (a)(ii) of this Section 3 if sufficient funds were available, together with other preferred shares which are subject to mandatory redemption under provisions similar to those contained in this Section 3, or if the Trust otherwise is unable to effect such redemption on or prior to such Mandatory Redemption Date, the Trust shall redeem those Preferred Shares and other preferred shares which it was unable to redeem on the earliest practicable date on which the Trust will have such funds available upon notice pursuant to Section 3(b) to record owners of the Preferred Shares to be redeemed and the Paying Agent. The Trust will deposit with the Paying Agent funds sufficient to redeem the specified number of Preferred Shares with respect to a redemption required under subparagraph (a)(ii) of this Section 3, by 1:00 p.m., New York City time, of the Business Day immediately preceding the Mandatory Redemption Date. If fewer than all of the Outstanding Preferred Shares are to be redeemed pursuant to this Section 3(a)(iv), the number of shares to be redeemed shall be redeemed pro rata from the Holders of such shares in proportion to the number of such shares held by such Holders, by lot or by such other method as the Trust shall deem fair and equitable, subject, however, to the terms of any applicable Specific Redemption Provisions. "Mandatory Redemption Price" means the Redemption Price plus (in the case of a Dividend Period of one year or more only) a redemption premium, if any, determined by the Board of Trustees after consultation with the Broker-Dealers and set forth in any applicable Specific Redemption Provisions.

(b) In the event of a redemption pursuant to the foregoing Section 3(a), the Trust will file a notice of its intention to redeem with the Securities and Exchange Commission (the "Commission") so as to provide at least the minimum notice required under Rule 23c-2 under the 1940 Act or any successor provision. In addition, the Trust shall deliver a notice of redemption to the Auction Agent (the "Notice of Redemption") containing the information set forth below (i) in the case of an optional redemption pursuant to Section 3(a)(i) above, one Business Day prior to the giving of notice to the Holders, (ii) in the case of a mandatory redemption pursuant to Section 3(a)(ii) above, on or prior to the 10th day preceding the Mandatory Redemption Date. The Auction Agent will use its reasonable efforts to provide telephonic notice to each Holder of shares of any Series called for redemption not later than the close of business on the Business Day immediately following the day on which the Auction Agent determines the shares to be redeemed (or, during a Default Period with respect to such shares, not later than the close of business on the Business Day immediately following the day on which the Auction Agent receives Notice of Redemption from the Trust). The Auction Agent shall confirm such telephonic notice in writing not later than the close of business on the third Business Day preceding the date fixed for redemption by providing the Notice of Redemption to each Holder of shares called for redemption, the Paying Agent (if different from the Auction Agent) and the Securities Depository. Notice of Redemption will be addressed to the registered owners of shares of any Series at their addresses appearing on the share records of the Trust. Such Notice of Redemption will set forth (i) the date fixed for redemption, (ii) the number and identity of shares of each Series to be redeemed, (iii) the redemption price (specifying the amount of accumulated dividends to be included therein), (iv) that dividends on the shares to be redeemed will cease to accumulate on such date fixed for redemption and (v) the provision under which redemption shall be made. No defect in the Notice of Redemption or in the transmittal or mailing thereof will affect the validity of the redemption proceedings, except as required by

applicable law. If fewer than all shares held by any Holder are to be redeemed, the Notice of Redemption mailed to such Holder shall also specify the number of shares to be redeemed from such Holder.

(c) Notwithstanding the provisions of paragraph (a) of this Section 3, no preferred shares, including the Preferred Shares, may be redeemed at the option of the Trust unless all dividends in arrears on the Outstanding Preferred Shares and any other preferred shares have been or are being contemporaneously paid or set aside for payment; provided, however, that the foregoing shall not prevent the purchase or acquisition of outstanding preferred shares pursuant to the successful completion of an otherwise lawful purchase or exchange offer made on the same terms to holders of all outstanding preferred shares.

(d) Upon the deposit of funds sufficient to redeem shares of any Series with the Paying Agent and the giving of the Notice of Redemption to the Auction Agent under paragraph (b) of this Section 3, dividends on such shares shall cease to accumulate and such shares shall no longer be deemed to be Outstanding for any purpose (including, without limitation, for purposes of calculating whether the Trust has met the Preferred Shares Basic Maintenance Amount Test or the 1940 Act Preferred Shares Asset Coverage), and all rights of the Holders of the shares so called for redemption shall cease and terminate, except the right of such Holder to receive the Redemption Price specified herein, but without any interest or other additional amount. Such Redemption Price shall be paid by the Paying Agent to the nominee of the Securities Depository. The Trust shall be entitled to receive from the Paying Agent, promptly after the date fixed for redemption, any cash deposited with the Paying Agent in excess of (i) the aggregate Redemption Price of the shares of any Series called for redemption on such date and (ii) such other amounts, if any, to which Holders of shares of any Series called for redemption may be entitled. Any funds so deposited that are unclaimed at the end of two years from such Redemption Date shall, to the extent permitted by law, be paid to the Trust, after which time the Holders of shares of each Series so called for redemption may look only to the Trust for payment of the Redemption Price and all other amounts, if any, to which they may be entitled; provided, however, that the Paying Agent shall notify all Holders whose funds are unclaimed by placing a notice in the Wall Street Journal concerning the availability of such funds for three consecutive weeks. The Trust shall be entitled to receive, from time to time after the date fixed for redemption, any interest earned on the funds so deposited.

(e) To the extent that any redemption for which Notice of Redemption has been given is not made by reason of the absence of legally available funds therefor, or is otherwise prohibited, such redemption shall be made as soon as practicable to the extent such funds become legally available or such redemption is no longer otherwise prohibited. A failure to redeem shares of any Series shall be deemed to exist at any time after the date specified for redemption in a Notice of Redemption when the Trust shall have failed, for any reason whatsoever, to deposit in trust with the Paying Agent the Redemption Price with respect to any shares for which such Notice of Redemption has been given. Notwithstanding the fact that the Trust may not have redeemed shares of each Series for which a Notice of Redemption has been given, dividends may be declared and paid on shares of any Series and shall include those shares of any

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Series for which Notice of Redemption has been given but for which deposit of funds has not been made.

(f) All moneys paid to the Paying Agent for payment of the Redemption Price of shares of any Series called for redemption shall be held in trust by the Paying Agent for the benefit of Holders of shares so to be redeemed.

(g) So long as any shares of any Series are held of record by the nominee of the Securities Depository, the Redemption Price for such shares will be paid on the date fixed for redemption to the nominee of the Securities Depository for distribution to Agent Members for distribution to the persons for whom they are acting as agent.

(h) Except for the provisions described above, nothing contained in this Certificate limits any right of the Trust to purchase or otherwise acquire any shares of any Series outside of an Auction at any price, whether higher or lower than the price that would be paid in connection with an optional or mandatory redemption, so long as, at the time of any such purchase, there is no arrearage in the payment of dividends on, or the mandatory or optional redemption price with respect to, any shares of any Series for which Notice of Redemption has been given and the Trust meets the 1940 Act Preferred Shares Asset Coverage and the Preferred Shares Basic Maintenance Amount Test after giving effect to such purchase or acquisition on the

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date thereof. Any shares of any Series which are purchased, redeemed or otherwise acquired by the Trust shall have no voting rights. If fewer than all the Outstanding shares of any Series are redeemed or otherwise acquired by the Trust, the Trust shall give notice of such transaction to the Auction Agent, in accordance with the procedures agreed upon by the Board.

(i) In the case of any redemption pursuant to this Section 3, only whole shares of each Series shall be redeemed, and in the event that any provision of the Declaration would require redemption of a fractional share, the Auction Agent shall be authorized to round up so that only whole shares are redeemed.

(j) Notwithstanding anything herein to the contrary, including, without limitation, Section 6(i) of Part I of this Certificate, the Board may authorize, create or issue other series of preferred shares, including other series of Preferred Shares and other series of preferred shares ranking on a parity with the Preferred Shares with respect to the payment of dividends or the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Trust, to the extent permitted by the 1940 Act, as amended, if upon issuance, the net proceeds from the sale of such preferred shares (or such portion thereof needed to redeem or repurchase the Outstanding Preferred Shares) are deposited with the Auction Agent in accordance with Section 3(d) of Part I of this Certificate, Notice of Redemption as contemplated by Section 3(b) of Part I of this Certificate has been delivered prior thereto or is sent promptly thereafter, and such proceeds are used to redeem all Outstanding Preferred

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Shares or, if upon the issuance of any such series, the Trust would meet the 1940 Act Preferred Shares Asset Coverage, the Preferred Shares Basic Maintenance Amount Test and the requirements of Section 12 of Part I of this Certificate.

(k) Notwithstanding anything herein to the contrary, redemptions of preferred shares pursuant to this Section 3 shall comply with the terms and covenants of any commercial paper program and no such redemptions shall be permitted to the extent they will cause an event of default under such agreements.

#### 4. DESIGNATION OF DIVIDEND PERIOD.

(a) The initial Dividend Period for each Series is as set forth under "Designation" above. The Trust will designate the duration of subsequent Dividend Periods of each Series; provided, however, that no such designation is necessary for a Standard Dividend Period and, provided further, that any designation of a Special Dividend Period shall be effective only if (i) notice thereof shall have been given as provided herein, (ii) any failure to pay in a timely manner to the Auction Agent the full amount of any dividend on, or the Redemption Price of, each Series shall have been cured as provided above, (iii) Sufficient Clearing Orders shall have existed in an Auction held on the Auction Date immediately preceding the first day of such proposed Special Dividend Period, (iv) if the Trust shall have mailed a Notice of Redemption with respect to any shares of any Series, the redemption price with respect to such shares shall have been deposited with the Paying Agent, and (v) in the case of the designation of a Special Dividend Period, the Trust has confirmed that as of the Auction Date next preceding the first day of such Special Dividend Period, it has Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount, and the Trust has consulted with the Broker-Dealers and has provided notice of such designation and a Preferred Shares Basic Maintenance Certificate to each Rating Agency.

(b) If the Trust proposes to designate any Special Dividend Period, not fewer than 7 Business Days (or two Business Days in the event the duration of the Dividend Period prior to such Special Dividend Period is fewer than 8 days) nor more than 30 Business Days prior to the first day of such Special Dividend Period, notice shall be (i) made by press release and (ii) communicated by the Trust by telephonic or other means to the Auction Agent and confirmed in writing promptly thereafter. Each such notice shall state (A) that the Trust proposes to exercise its option to designate a succeeding Special Dividend Period, specifying the first and last days thereof, and (B) that the Trust will, by 3:00 p.m., New York City time, on the second Business Day next preceding the first day of such Special Dividend Period, notify the Auction Agent, who will promptly notify the Broker-Dealers, of either (x) its determination, subject to certain conditions, to proceed with such Special Dividend Period, subject to the terms of any Specific Redemption Provisions, or (y) its determination not to proceed with such Special Dividend Period, in which latter event the succeeding Dividend Period shall be a Standard Dividend Period. No later than 3:00 p.m., New York City time, on the second Business Day

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next preceding the first day of any proposed Special Dividend Period, the Trust shall deliver to the Auction Agent, who will promptly deliver to the Broker-Dealers and Existing Holders, either:

(i) a notice stating (A) that the Trust has determined to designate the next succeeding Dividend Period as a Special Dividend Period, specifying the first and last days thereof, and (B) the terms of any Specific Redemption Provisions; or

(ii) a notice stating that the Trust has determined not to exercise its option to designate a Special Dividend Period.

If the Trust fails to deliver either such notice with respect to any designation of any proposed Special Dividend Period to the Auction Agent or is unable to make the confirmation provided in clause (v) of Paragraph (a) of this Section 4 by 3:00 p.m., New York City time, on the second Business Day next preceding the first day of such proposed Special Dividend Period, the Trust shall be deemed to have delivered a notice to the Auction Agent with respect to such Dividend Period to the effect set forth in clause (ii) above, thereby resulting in a Standard Dividend Period.

### 5. RESTRICTIONS ON TRANSFER.

Shares of each Series may be transferred only (a) pursuant to an order placed in an Auction, (b) to or through a Broker-Dealer or (c) to the Trust or any Affiliate. Notwithstanding the foregoing, a transfer other than pursuant to an Auction will not be effective unless the selling Existing Holder or the Agent Member of such Existing Holder, in the case of an Existing Holder whose shares are listed in its own name on the books of the Auction Agent, or the Broker-Dealer or Agent Member of such Broker-Dealer, in the case of a transfer between persons holding shares of any Series through different Broker-Dealers, advises the Auction Agent of such transfer. The certificates representing the shares of each Series issued to the Securities Depository will bear legends with respect to the restrictions described above and stop-transfer instructions will be issued to the Transfer Agent and/or Registrar.

### 6. VOTING RIGHTS.

(a) Except as otherwise provided in the Declaration or as otherwise required by applicable law, (i) each Holder of shares of any Series shall be entitled to one vote for each share of any Series held on each matter submitted to a vote of shareholders of the Trust, and (ii) the holders of preferred shares, including shares of each Series, and Common Shares shall vote together as a single class on all matters submitted to shareholders; provided, however, that, at any meeting of the shareholders of the Trust held for the election of trustees, the holders of preferred shares, including shares of each Series, represented in person or by proxy at said meeting, shall be entitled, as a

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class, to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Trust, to elect two trustees of the Trust, with each preferred share entitling the holder thereof to one vote. Except as set forth in paragraph (b) of this Section 6, the class of preferred shares, including shares of each Series, shall not be entitled to participate in the election of any other trustees of the Trust.

(b) During any period in which any one or more of the conditions described below shall exist (such period being referred to herein as a "Voting Period"), the number of trustees constituting the Board shall be automatically increased by the smallest number that, when added to the two trustees elected exclusively by the holders of preferred shares, including shares of each Series, would constitute a majority of the Board as so increased by such smallest number; and the holders of preferred shares, including shares of each Series, shall be entitled, voting as a class on a one-vote-per-share basis (to the exclusion of the holders of all other securities and classes of shares of beneficial interest of the Trust), to elect such smallest number of additional trustees, together with the two trustees that such holders are in any event entitled to elect. A Voting Period shall commence:

(i) If, at the close of business on any Dividend Payment Date, accumulated dividends (whether or not earned or declared) on preferred shares, including shares of each Series, equal to at least two full years' dividends shall be due and unpaid; or

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(ii) if at any time holders of any other preferred shares are entitled under the 1940 Act to elect a majority of the trustees of the Trust.

Upon the termination of a Voting Period, the voting rights described in this paragraph (b) of Section 6 shall cease, subject always, however, to the reversion of such voting rights in the holders of preferred shares, including shares of each Series, upon the further occurrence of any of the events described in this paragraph (b) of Section 6.

(c) As soon as practicable after the accrual of any right of the holders of preferred shares, including shares of each Series, to elect additional trustees as described in paragraph (b) of this Section 6, the Trust shall notify the Auction Agent, and the Auction Agent shall call a special meeting of such holders, by mailing a notice of such special meeting to such holders, such meeting to be held not less than 10 nor more than 90 days after the date of mailing of such notice. If the Trust fails to send such notice to the Auction Agent or if the Auction Agent does not call such a special meeting, it may be called by any such holder on like notice. The record date for determining the holders entitled to notice of and to vote at such special meeting shall be the close of business on the fifth Business Day preceding the day on which such notice is mailed. At any such special meeting and at each meeting of holders of preferred shares, including shares of each Series, held during a Voting Period at which trustees are to be elected, such holders, voting together as a class (to the exclusion of the holders of all other securities and classes of shares

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of beneficial interest of the Trust), shall be entitled to elect the number of trustees prescribed in paragraph (b) of this Section 6 on a one-vote-per-share basis.

(d) The holders of preferred shares, including shares of each Series, may also have such other voting rights as are contemplated by Article III of the Trust's Declaration.

(e) For purposes of determining any rights of the holders of preferred shares, including shares of each Series, to vote on any matter, whether such right is created by the Certificate, by statute or otherwise, if redemption of some or all of the preferred shares, including shares of each Series, is required, no holder of preferred shares, including shares of each Series, shall be entitled to vote and no preferred shares, including shares of each Series, shall be deemed to be "outstanding" for the purpose of voting or determining the number of shares required to constitute a quorum, if, prior to or concurrently with the time of determination, sufficient Deposit Securities for the redemption of such shares have been deposited, in the case of Preferred Shares, in trust with the Paying Agent for that purpose and the requisite Notice of Redemption with respect to such shares shall have been given as provided in Section 3(b) of Part I of this Certificate and, in the case of other preferred shares, the Trust has otherwise met the conditions for redemption applicable to such preferred shares.

(f) The terms of office of all persons who are trustees of the Trust at the time of a special meeting of Holders of the Preferred Shares and holders of other preferred shares to elect trustees pursuant to paragraph (b) of this Section 6 shall continue, notwithstanding the election at such meeting by the holders of the number of trustees that they are entitled to elect and the persons so elected by such holders, together with the two incumbent trustees elected by such holders and the remaining incumbent trustees, shall constitute the duly elected trustees of the Trust.

(g) Simultaneously with the termination of a Voting Period, the terms of office of the additional trustees elected by the Holders of the Preferred Shares and holders of other preferred shares pursuant to paragraph (b) of this Section 6 shall terminate, the remaining trustees shall constitute the trustees of the Trust and the voting rights of such holders to elect additional trustees pursuant to paragraph (b) of this Section 6 shall cease, subject to the provisions of the last sentence of paragraph (b) of this Section 6.

(h) Unless otherwise required by law or in the Trust's charter documents, the Holders of Preferred Shares shall not have any relative rights or preferences or other special rights other than those specifically set forth herein. In the event that the Trust fails to pay any dividends on the Preferred Shares of the Trust or fails to redeem any Preferred Shares which it is required to redeem, or any other event occurs which requires the mandatory redemption of Preferred Shares, and the required Notice of Redemption has not been given, other than the rights set forth in paragraph (a) of Section 3 of Part I of this Certificate, the exclusive remedy of the

Holders of Preferred Shares shall be the right to vote for trustees pursuant to the provisions of paragraph (b) of this Section 6. In no event shall the Holders of Preferred Shares have any right to sue for, or bring a proceeding with respect to, such dividends or redemptions or damages for the failure to receive the same.

(i) So long as any of preferred shares are outstanding, the Trust will not, without the affirmative vote of the holders of a majority of the outstanding preferred shares, (i) amend, alter or repeal any of the preferences, rights or powers of such class so as to affect materially and adversely such preferences, rights or powers; (ii) increase the authorized number of Preferred Shares; (iii) create, authorize or issue shares of any class of shares ranking senior to or on parity with the Preferred Shares or any other series of preferred shares with respect to the payment of dividends or the distribution of assets on liquidation; (iv) institute any proceedings to be adjudicated bankrupt or insolvent, or consent to the institution of bankruptcy or insolvency proceedings against it, or file a petition seeking or consenting to reorganization or relief under any applicable federal or state law relating to bankruptcy or insolvency, or consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or other similar official) of the Trust or a substantial part of its property, or make any assignment for the benefit of creditors, or, except as may be required by applicable law, admit in writing its inability to pay its debts generally as they become due or take any corporate action in furtherance of any such action; (v) create, incur or suffer to exist, or agree to create, incur or suffer to exist, or consent to cause or permit in the future (upon the happening of a contingency or otherwise) the creation, incurrence or existence of any material lien, mortgage, pledge, charge, security interest, security agreement, conditional sale or trust receipt or other material encumbrance of any kind upon any of the Trust's assets as a whole, except (A) liens the validity of which are being contested in good faith by appropriate proceedings, (B) liens for taxes that are not then due and payable or that can be paid thereafter without penalty, (C) liens, pledges, charges, security interests, security agreements or other encumbrances arising in connection with any indebtedness senior to the preferred shares, (D) liens, pledges, charges, security interests, security agreements or other encumbrances arising in connection with any indebtedness permitted under clause (vi) below and (E) liens to secure payment for services rendered including, without limitation, services rendered by the Trust's Paying Agent and the Auction Agent; or (vi) create, authorize, issue, incur or suffer to exist any indebtedness for borrowed money or any direct or indirect guarantee of such indebtedness for borrowed money or any direct or indirect guarantee of such indebtedness, except the Trust may borrow as may be permitted by the Trust's investment restrictions; provided, however, that transfers of assets by the Trust subject to an obligation to repurchase shall not be deemed to be indebtedness for purposes of this provision to the extent that after any such transaction the Trust has Eligible Assets with an aggregate Discounted Value at least equal to the Preferred Shares Basic Maintenance Amount as of the immediately preceding Valuation Date.

(j) The affirmative vote of the holders of a majority of the outstanding preferred shares, including shares of each Series, voting as a separate class, shall be required to approve any plan of reorganization (as such term is used in the 1940 Act) adversely affecting such shares or any action requiring a vote of security holders of the Trust under Section 13(a) of the 1940 Act. In the event a vote of holders of preferred shares is required pursuant to the provisions of

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Section 13(a) of the 1940 Act, the Trust shall, not later than ten Business Days prior to the date on which such vote is to be taken, notify each Rating Agency that such vote is to be taken and the nature of the action with respect to which such vote is to be taken and shall, not later than ten Business Days after the date on which such vote is taken, notify each Rating Agency of the results of such vote.

(k) The affirmative vote of the holders of a majority of the outstanding preferred shares of any series, voting separately from any other series, shall be required with respect to any matter that materially and adversely affects the rights, preferences or powers of that series in a manner different from that of other series or classes of the Trust's shares of beneficial interest. For purposes of the foregoing, no matter shall be deemed to adversely affect any right, preference or power unless such matter (i) alters or abolishes any preferential right of such series; (ii) creates, alters or abolishes any right in respect of redemption of such series; or (iii) creates or alters (other than to abolish) any restriction on transfer applicable to such series. The vote of holders of any series described in this Section 6(k) will in each case be in addition to a separate vote of the requisite percentage of Common Shares and/or preferred shares, if any, necessary to authorize the action in question.

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(l) The Board, without the vote or consent of any holder of preferred shares, including shares of each series, or any other shareholder of the Trust, may from time to time amend, alter or repeal any or all of the definitions contained herein, add covenants and other obligations of the Trust or confirm the applicability of covenants and other obligations set forth herein, all in connection with obtaining or maintaining the rating of any Rating Agency with respect to each Series, and any such amendment, alteration or repeal will not be deemed to affect the preferences, rights or powers of Preferred Shares or the Holders thereof, provided that the Board receives written confirmation from each relevant Rating Agency (with such confirmation in no event being required to be obtained from a particular Rating Agency with respect to definitions or other provisions relevant only to and adopted in connection with another Rating Agency's rating of any Series) that any such amendment, alteration or repeal would not adversely affect the rating then assigned by such Rating Agency.

In addition, subject to compliance with applicable law, the Board may amend the definition of Maximum Rate to increase the percentage amount by which the Reference Rate is multiplied to determine the Maximum Rate shown therein without the vote or consent of the holders of preferred shares, including shares of each Series, or any other shareholder of the Trust, and without receiving any confirmation from any Rating Agency, after consultation with the Broker-Dealers, provided that immediately following any such increase the Trust would meet the Preferred Shares Basic Maintenance Amount Test.

(m) Unless otherwise required by law, Holders of shares of each Series shall not have any relative rights or preferences or other special rights other than those specifically set forth herein. The Holders of shares of each Series shall have no rights to cumulative voting. In the event that the Trust fails to pay any dividends on the shares of any Series, the exclusive remedy of the Holders shall be the right to vote for trustees pursuant to the provisions of

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this Section 6.

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

### 7. LIQUIDATION RIGHTS.

(a) In the event of any liquidation, dissolution or winding up of the affairs of the Trust, whether voluntary or involuntary, the holders of all outstanding preferred shares, including shares of each Series, shall be entitled to receive out of the assets of the Trust (or the proceeds thereof) available for distribution to shareholders, after claims of creditors but before any distribution or payment shall be made in respect of the Common Shares or any other shares of the Trust ranking junior to the preferred shares, as to liquidation payments, a liquidation distribution in the amount of \$25,000 per share (the "Liquidation Preference"), plus an amount equal to all unpaid dividends accrued to and including the date fixed for such distribution or payment (whether or not declared by the Trust, but excluding interest thereon), but such holders shall be entitled to no further participation in any distribution or payment in connection with any such liquidation, dissolution or winding up.

(b) If, upon any such liquidation, dissolution or winding up of the affairs of the Trust, whether voluntary or involuntary, the assets of the Trust available for distribution among the holders of all outstanding preferred shares, including shares of each Series, shall be insufficient to permit the payment in full to such holders of the amounts to which they are entitled, then such available assets shall be distributed among the holders of preferred shares, including shares of each Series, ratably in any such distribution of assets according to the respective amounts which would be payable on all such shares if all amounts thereon were paid in full. Unless and until payment in full of the liquidation distributions to which they are entitled has been made to the holders of preferred shares, including shares of each Series, no dividends or distributions will be made to holders of Common Shares or any shares of the Trust ranking junior to the preferred shares as to liquidation.

(c) Upon the dissolution, liquidation or winding up of the affairs of the Trust, whether voluntary or involuntary, until payment in full is made to the Holders of the Preferred Shares of the liquidation distribution to which they are entitled, no dividend or other distribution shall be made to the holders of shares of Common Shares or any other class of shares of beneficial interest of the Trust ranking junior to the Preferred Shares

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upon dissolution, liquidation or winding up of the affairs of the Trust and no purchase, redemption or other acquisition for any consideration by the Trust shall be made in respect of the shares of Common Shares or any other class of

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shares of beneficial interest of the Trust ranking junior to the Preferred Shares upon dissolution, liquidation or winding up of the affairs of the Trust.

(d) Neither the consolidation nor merger of the Trust with or into any other corporation or corporations, nor the sale, lease, exchange or transfer by the Trust of all or substantially all of its property and assets, shall be deemed to be a liquidation, dissolution or winding up of the Trust for purposes of this Section 7.

(e) After the payment to Holders of Preferred Shares of the full preferential amounts provided for in this Section 7, the Holders of the Preferred Shares as such shall have no right or claim to any of the remaining assets of the Trust.

(f) In the event the assets of the Trust or proceeds thereof available for distribution to the Holders of Preferred Shares, upon dissolution, liquidation or winding up of the affairs of the Trust, whether voluntary or involuntary, shall be insufficient to pay in full all amounts to which such Holders are entitled pursuant to paragraph (a) of this Section 7, no such distribution shall be made on account of any shares of any other series of preferred shares unless proportionate distributive amounts shall be paid on account of the Preferred Shares, ratably, in proportion to the full distributable amounts to which holders of all preferred shares are entitled upon such dissolution, liquidation or winding up.

(g) Subject to the rights of the holders of other preferred shares or after payment shall have been made in full to the Holders of Preferred Shares as provided in paragraph (a) of this Section 7, but not prior thereto, any other series or class of shares ranking junior to the Preferred Shares with respect to the distribution of assets upon dissolution, liquidation or winding up of the affairs of the Trust shall, subject to any respective terms and provisions (if any) applying thereto, be entitled to receive any and all assets remaining to be paid or distributed, and the Holders of the Preferred Shares shall not be entitled to share therein.

### 8. AUCTION AGENT.

For so long as any Preferred Shares are Outstanding, the Auction Agent, duly appointed by the Trust to so act, shall be in each case a commercial bank, trust company or other financial institution independent of the Trust and its Affiliates (which, however, may engage or have engaged in business transactions with the Trust or its Affiliates), and at no time shall the Trust or any of its Affiliates act as the Auction Agent in connection with the Auction Procedures. If the Auction Agent resigns or for any reason its appointment is terminated during any period that any shares of any Series are Outstanding, the Trust shall use its best efforts promptly thereafter to appoint another qualified commercial bank, trust company or financial institution to act as the Auction Agent.

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9. 1940 ACT PREFERRED SHARES ASSET COVERAGE.

The Trust shall maintain, as of the last Business Day of each month in which any Preferred Shares are Outstanding, the 1940 Act Preferred Shares Asset Coverage; provided, however, that Section 3(a)(ii) shall be the sole remedy in the event the Trust fails to do so.

10. PREFERRED SHARES BASIC MAINTENANCE AMOUNT.

So long as any Preferred Shares are Outstanding and any Rating Agency so requires, the Trust shall maintain, as of each Valuation Date, Moody's Eligible Assets and Fitch Eligible Assets, as applicable, having an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount; provided, however, that Section 3(a)(ii) shall be the sole remedy in the event the Trust fails to do so.

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11. [RESERVED]

12. CERTAIN OTHER RESTRICTIONS.

So long as any Preferred Shares are Outstanding and any Rating Agency so requires, the Trust will not, unless it has received written confirmation from such Rating Agency that any such action would not impair the rating then assigned by such Rating Agency to the Preferred Shares, engage in any one or more of the following transactions:

(a) purchase or sell futures contracts or options thereon with respect to portfolio securities or write put or call options on portfolio securities;

(b) except in connection with a refinancing of the Preferred Shares, issue additional shares of any series of preferred shares, including any Series, or reissue any preferred shares, including any Series previously purchased or redeemed by the Trust;

(c) engage in any short sales of securities;

(d) lend portfolio securities;

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(e) merge or consolidate into or with any other corporation;

(f) engage in any reverse repurchase agreement; or

(g) change the Pricing Service to a service other than an Approved Pricing Service.

13. COMPLIANCE PROCEDURES FOR ASSET MAINTENANCE TESTS.

For so long as any Preferred Shares are Outstanding and any Rating Agency so requires:

(a) As of each Valuation Date, the Trust shall determine (i) the Market Value of each Eligible Asset owned by the Trust on that date, (ii) the Discounted Value of each such Eligible Asset, (iii) whether the Preferred Shares Basic Maintenance Amount Test is met as of that date, (iv) the value (as used in the 1940 Act) of the total assets of the Trust, less all liabilities, and (v) whether the 1940 Act Preferred Shares Asset Coverage is met as of that date.

(b) Upon any failure to meet the Preferred Shares Basic Maintenance Amount Test or 1940 Act Preferred Shares Asset Coverage on any Valuation Date, the Trust may use reasonable commercial efforts (including, without limitation, altering the composition of its portfolio, purchasing Preferred Shares outside of an Auction or, in the event of a failure to file a certificate on a timely basis, submitting the requisite certificate), to meet (or certify in the case of a failure to file a certificate on a timely basis, as the case may be) the Preferred Shares Basic Maintenance Amount Test or 1940 Act Preferred Shares Asset Coverage on or prior to the Asset Coverage Cure Date.

(c) [Reserved]

(d) The Trust shall deliver to the Auction Agent and each Rating Agency a certificate which sets forth a determination of items (i)-(iii) of paragraph (a) of this Section 13 (a "Preferred Shares Basic Maintenance Certificate") as of (A) the Date of Original Issue, (B) the last Valuation Date of each month on or before the third Business day after such day, (C) any date requested by any Rating Agency, in each case on or before the third Business Day after such day, (D) a Business Day on or before any Asset Coverage Cure Date relating to the Trust's cure of a failure to meet the Preferred Shares Basic Maintenance Amount Test, (E) any day in which the Fund shall fail to have Moody's Eligible Assets or Fitch Eligible Assets with an aggregate Discounted Value at least equal to 105% of the

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Preferred Shares Basic Maintenance Amount, and (F) any day that Common or Preferred Shares are repurchased. Such Preferred Shares Basic Maintenance Certificate shall be delivered in the case of clause (i) (A) on the Date of Original Issue and in the case of all other clauses, except as otherwise noted above, on or before the seventh Business Day after the relevant Valuation Date or Asset Coverage Cure Date.

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(e) The Trust shall deliver to the Auction Agent and each Rating Agency a certificate which sets forth a determination of items (iv) and (v) of paragraph (a) of this Section 13 (a "1940 Act Preferred Shares Asset Coverage Certificate") (i) as of the Date of Original Issue, and (ii) as of (A) the last Valuation Date of each fiscal year thereafter, and (B) as of a Business Day on or before any Asset Coverage Cure Date relating to the failure to meet the 1940 Act Preferred Shares Asset Coverage. Such 1940 Act Preferred Shares Asset Coverage Certificate shall be delivered in the case of clause (i) on the Date of Original Issue and in the case of clause (ii) on or before the seventh Business Day after the relevant Valuation Date or the Asset Coverage Cure Date. The certificates required by paragraphs (d) and (e) of this Section 13 may be combined into a single certificate.

(f) [Reserved]

(g) Within ten Business Days of the Date of Original Issue, the Trust shall deliver to the Auction Agent and each Rating Agency a letter prepared by the Trust's independent auditors (an "Auditor's Certificate") regarding the accuracy of the calculations made by the Trust in the Preferred Shares Basic Maintenance Certificate and the 1940 Act Preferred Shares Asset Coverage Certificate required to be delivered by the Trust on the Date of Original Issue. Within ten Business Days after delivery of the Preferred Shares Basic Maintenance Certificate and the 1940 Act Preferred Shares Asset Coverage Certificate relating to the last Valuation Date of each fiscal year of the Trust, the Trust will deliver to the Auction Agent and each Rating Agency an Auditor's Certificate regarding the accuracy of the calculations made by the Trust in such Certificates. In addition, the Trust will deliver to the persons specified in the preceding sentence an Auditor's Certificate regarding the accuracy of the calculations made by the Trust on each Preferred Shares Basic Maintenance Certificate and 1940 Act Preferred Shares Asset Coverage Certificate delivered in relation to an Asset Coverage Cure Date within ten days after the relevant Asset Coverage Cure Date. If an Auditor's Certificate shows that an error was made in any such report, the calculation or determination made by the Trust's independent auditors will be conclusive and binding on the Trust.

(h) The Auditor's Certificates referred to in paragraph (g) above will confirm, based upon the independent auditors review of portfolio data provided by the Trust, (i) the mathematical accuracy of the calculations reflected in the related Preferred Shares Basic Maintenance Amount Certificates and 1940 Act Preferred Shares Asset Coverage Certificates, (ii) that, based upon such calculations, the Trust had, at such Valuation Date, met the Preferred Shares Basic Maintenance Amount Test, and (iii) that the Trust met the Moody's General Portfolio Requirements and the Fitch

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General Portfolio Requirements, as applicable.

(i) In the event that a Preferred Shares Basic Maintenance Certificate or 1940 Act Preferred Shares Asset Coverage Certificate with respect to an applicable Valuation Date is not delivered within the time periods specified in this Section 13, the Trust shall be deemed to have failed to meet the Preferred Shares Basic Maintenance Amount Test or the 1940 Act Preferred Shares Asset Coverage, as the case may be, on such Valuation Date for purposes of Section 13(b) of Part I of this Certificate. In the event that a Preferred Shares Basic Maintenance Certificate, a 1940 Act Preferred Shares Asset Coverage Certificate or an applicable Auditor's Certificate with respect to an Asset Coverage Cure Date is not delivered within the time periods specified herein, the Trust shall be deemed to have failed to meet the Preferred Shares Basic Maintenance Amount Test or the 1940 Preferred Shares Asset Coverage, as the case may be, as of the related Valuation Date.

14. [RESERVED]

15. NOTICE.

All notices or communications hereunder, unless otherwise specified in this Certificate, shall be sufficiently given if in writing and delivered in person, by telecopier or mailed by first-class mail, postage prepaid. Notices delivered pursuant to this Section 15 shall be deemed given on the earlier of the date received or the date five days after which such notice is mailed.

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16. WAIVER.

To the extent permitted by Massachusetts law, holders of at least two-thirds of the Outstanding Preferred Shares, acting collectively, or each Series, acting as a separate series, may waive any provision hereof intended for their respective benefit in accordance with such procedures as may from time to time be established by the Board.

17. TERMINATION.

In the event that no Preferred Shares are Outstanding, all rights and preferences of such shares established and designated hereunder shall cease and terminate, and all obligations of the Trust under this Certificate shall terminate.

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### 18. AMENDMENT.

Subject to the provisions of this Certificate, the Board may, by resolution duly adopted without shareholder approval (except as otherwise provided by this Certificate or required by applicable law), amend this Certificate to (1) reflect any amendments hereto which the Board is entitled to adopt pursuant to the terms of Section 6(1) of Part I of this Certificate without shareholder approval or (2) add additional shares of each Series (and terms relating thereto). All such additional shares shall be governed by the terms of this Certificate. To the extent permitted by applicable law, the Board may interpret, amend or adjust the provisions of this Certificate to resolve any inconsistency or ambiguity or to remedy any patent defect.

### 19. DEFINITIONS.

As used in Part I and Part II of this Certificate, the following terms shall have the following meanings (with terms defined in the singular having comparable meanings when used in the plural and vice versa), unless the context otherwise requires:

"1940 Act" means the Investment Company Act of 1940, as amended.

"1940 Act Preferred Shares Asset Coverage" means asset coverage, as determined in accordance with Section 18(h) of the 1940 Act, of at least 200% with respect to all outstanding senior securities of the Trust which are shares of beneficial interest, including all Outstanding Preferred Shares (or such other asset coverage as may in the future be specified in or under the 1940 Act as the minimum asset coverage for senior securities which are shares of beneficial interest of a closed-end investment company as a condition of declaring dividends on its common shares), determined on the basis of values calculated as of a time within 48 hours (not including Sundays or holidays) next preceding the time of such determination.

"1940 Act Preferred Shares Asset Coverage Certificate" means the certificate required to be delivered by the Trust pursuant to Section 13(e) of Part I of this Certificate.

"Affiliate" means any person known to the Auction Agent to be controlled by, in control of or under common control with the Trust; provided that Van Kampen Asset Management shall not be deemed to be an Affiliate nor shall any corporation or any person controlled by, in control of or under common control with such corporation, one of the trustees, directors or executive officers of which is also a trustee, director or executive officer of the Trust, be deemed to be an Affiliate.

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"Agent Member" means a member of or a participant in the Securities Depository that will act on behalf of a Bidder.

"All Hold Rate" means 80% of LIBOR.

"Applicable Rate" (the rate per annum at which cash dividends are payable on each Series) means, with respect to each Series for each Dividend Period, (i) if Sufficient Clearing Orders exist for the Auction in respect thereof, the Winning Bid Rate, (ii) if Sufficient Clearing Orders do not exist for the Auction in respect thereof, the Maximum Rate.

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"Approved Price" means the "fair value" as determined by the Trust in accordance with the valuation procedures adopted from time to time by the Board of Trustees and for which the Trust receives a marked-to-market price (which, for the purpose of clarity, shall not mean a Market Value Price) from an independent source at least semi-annually.

"Approved Pricing Service" means Loan Pricing Corporation or any other quotation service designated in writing by the Trust provided that no Rating Agency has objected, in its reasonable discretion, in writing to the Trust within ten business days of receipt of the Trust's written notice of the designation of such quotation service.

"Asset Coverage Cure Date" has the meaning set forth in Section 3(a)(ii) of this Certificate.

"Auction" means each periodic operation of the procedures set forth under "Auction Procedures."

"Auction Agent" means The Bank of New York Company unless and until another commercial bank, trust company or other financial institution appointed by a resolution of the Board enters into an agreement with the Trust to follow the Auction Procedures for the purpose of determining the Applicable Rate.

"Auction Date" means the first Business Day next preceding the first day of a Dividend Period for each Series.

"Auction Procedures" means the procedures for conducting Auctions set forth in Part II hereof.

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"Auditor's Certificate" has the meaning set forth in Section 13(g) of Part I of this Certificate.

"Beneficial Owner," with respect to shares of each Series, means a customer of a Broker-Dealer who is listed on the records of that Broker-Dealer (or, if applicable, the Auction Agent) as a holder of shares of such series.

"Bid" has the meaning set forth in Section 2(a)(ii) of Part II of this Certificate.

"Bidder" has the meaning set forth in Section 2(a)(ii) of Part II of this Certificate; provided, however, that neither the Trust nor any Affiliate shall be permitted to be a Bidder in an Auction.

"Board" means the Board of Trustees of the Trust or any duly authorized committee thereof as permitted by applicable law.

"Broker-Dealer" means any broker-dealer or broker-dealers, or other entity permitted by law to perform the functions required of a Broker-Dealer by the Auction Procedures, that has been selected by the Trust and has entered into a Broker-Dealer Agreement with the Auction Agent that remains effective.

"Broker-Dealer Agreement" means an agreement between the Auction Agent and a Broker-Dealer, pursuant to which such Broker-Dealer agrees to follow the Auction Procedures.

"Business Day" means a day on which the New York Stock Exchange is open for trading and which is not a Saturday, Sunday or other day on which banks in the City of New York, New York are authorized or obligated by law to close.

"Commercial Paper Dealers" means Citigroup Global Markets Inc. and such other commercial paper dealer or dealers as the Trust may from time to time appoint, or, in lieu of any thereof, their respective affiliates or successors.

"Commission" means the Securities and Exchange Commission.

"Common Shares" means the common shares of beneficial interest, par value \$0.01 per share, of the Trust.

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"Date of Original Issue" means the date on which a Series is originally issued by the Trust.

"Default Period" has the meaning set forth in Sections 2(c) (ii) or (iii) of Part I of this Certificate.

"Default Rate" means the Reference Rate multiplied by three (3).

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"Deposit Securities" means cash and any obligations or securities, including Short Term Money Market Instruments that are Eligible Assets, rated at least A2 (having a remaining maturity of 12 months or less), P-1, VMIG-1 or MIG-1 by Moody's or AAA or F-1 by Fitch.

"Discounted Value" means the product of the Market Value (plus accrued interest) of an Eligible Asset multiplied by the applicable Advance Rate.

"Dividend Default" has the meaning set forth in Section 2(c)(ii) of Part I of this Certificate.

"Dividend Payment Date" means (i) with respect to any Dividend Period of one year or less, the Business Day next succeeding the last day thereof and, if any, the 91st, 181st and 271st days thereof, and (ii) with respect to any Dividend Period of more than one year, on a quarterly basis on each January 1, April 1, July 1 and October 1 and on the Business Day following the last day of such Dividend Period.

"Dividend Period" means, with respect to each Series, the period commencing on the Date of Original Issue thereof and ending on the date specified for such series on the Date of Original Issue thereof and thereafter, as to such Series, the period commencing on the day following each Dividend Period for such Series and ending on the day established for such Series by the Trust.

"Eligible Assets" means Moody's Eligible Assets (if Moody's is then rating the Preferred Shares) and Fitch Eligible Assets (if Fitch is then rating the Preferred Shares), whichever is applicable.

"Existing Holder" has the meaning set forth in Section 1 of Part II of this Certificate.

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"Fitch" means Fitch Ratings and its successors at law.

"Fitch Discount Factor" means, for purposes of determining the Discounted Value of any Fitch Eligible Asset, the percentage determined as follows. The Fitch Discount Factor for any Fitch Eligible Asset other than the securities set forth below will be the percentage provided in writing by Fitch.

(i) Senior Loans: The Fitch Discount Factor applied to senior, secured floating rate Loans made to corporate and other business entities ("Senior Loans") shall be the percentage specified in the table below opposite such Fitch Loan Category:

FITCH LOAN CATEGORY -----	DISCOUNT FACTOR -----
A.....	115%
B.....	130%
C.....	152%
D.....	370%

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(ii) Corporate Debt Securities: The percentage determined by reference to the rating on such asset with reference to the remaining term to maturity of such asset, in accordance with the table set forth below.

DISCOUNT FACTORS FOR CORPORATE DEBT SECURITIES INCLUDING NON-INVESTMENT

GRADE BONDS (NON-CONVERTIBLES)

TERMS TO MATURITY OF NON-INVESTMENT GRADE BONDS -----	AAA	AA	A	BBB	BB	B	NR (1)
	---	---	---	---	---	---	-----
1 year or less.....	106%	108%	110%	112%	130%	152%	152%
2 years or less (but longer than 1 year).....	106	108	110	112	130	152	152
3 years or less (but longer than 2 years).....	106	108	110	112	130	152	152
4 years or less (but longer than 3 years).....	111	113	115	117	134	152	152
5 years or less (but longer than 4 years).....	111	113	115	117	134	152	152
7 years or less (but longer than 5 years).....	114	116	118	120	136	152	152
10 years or less (but longer than 7 years).....	116	118	120	122	137	152	152
15 years or less (but longer than 10 years).....	120	122	124	124	139	152	152
30 years or less (but longer than 15 years).....	124	127	129	129	145	152	152

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Greater than 30 years..... 124 127 129 129 145 152 152

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(1) If a security is not rated by Fitch but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the Moody's rating is Baa, a Fitch rating of BBB will be used). If a security is not rated by Fitch but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is a Moody's rating of Ba, a Fitch rating of BB will be used). If a security is not rated by any Rating Agency, the Trust will use the percentage set forth under "not rated" in this table. Securities rated below B by Fitch shall be traded the same as securities not rated by Fitch.

The Fitch Discount Factors presented in the immediately preceding table apply to corporate debt securities that are Performing and have a Market Value determined by a Pricing Service or an Approved Price. The Fitch Discount Factor noted in the table above for a debt security rated B by Fitch shall apply to any non-Performing debt security with a price equal to or greater than \$0.90. The Fitch Discount Factor noted in the table above for a debt security rated CCC by Fitch shall apply to any non-Performing debt security with a price less than \$0.90 but equal to or greater than \$0.20. If a debt security does not have a Market Value determined by a Pricing Service or an Approved Price, a rating two rating categories below the actual rating on the debt security will be used (e.g., where the actual rating is A-, the rating for Debt Securities rated BB- will be used). The Fitch Discount Factor for a debt security issued by a limited partnership that is not a Rule 144A Security shall be the Discount Factor determined in accordance with the table set forth above multiplied by 105%.

The Fitch Discount Factors presented in the immediately preceding table will also apply to corporate obligations backed by a guaranty, a letter of credit or insurance issued by a third party. If the third-party credit rating is the basis for the rating on the obligation, then the rating on the third party will be used to determine the Fitch Discount Factor in the table.

(iii) Common stock: The Fitch Discount Factors for large-cap stocks (i.e., common stocks of companies with a market capitalization of greater than \$10 billion) shall be 200%; for mid-cap stocks (i.e., common stocks of companies with a market capitalization of between \$2 billion and \$10 billion) shall be 233%; for small-cap stocks (i.e., common stocks of companies with a market capitalization of between \$300 million and \$2 billion) shall be 286%; and for all other common stocks shall be 370%.

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(iv) Preferred stock: The percentage determined by references to the rating of a preferred stock in accordance with the table set forth below:

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PREFERRED STOCK(1)	DISCOUNT FACTOR
AAA.....	130%
AA.....	133%
A.....	135%
BBB.....	139%
BB.....	154%
Not rated or below BB.....	161%
Investment Grade DRD.....	164%
Not rated or below Investment Grade DRD.....	200%

(1) If a security is not rated by Fitch but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A and the Moody's rating is Baa, a Fitch rating of BBB will be used). If a security is not rated by Fitch but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA, a Fitch rating of AAA will be used, and where the only rating on a security is a Moody's rating of Ba, a Fitch rating of BB will be used). If a security is not rated by any Rating Agency, the Trust will use the percentage set forth under "not rated" in this table.

(v) Convertible securities: The Fitch Discount Factor applied to convertible securities is (A) 200% for investment grade convertibles and (B) 222% for below investment grade convertibles so long as such convertible debt securities have neither (x) conversion premium greater than 100% nor (y) have a yield to maturity or yield to worst of greater than 15.00% above the relevant Treasury curve.

The Fitch Discount Factor applied to convertible debt securities which have conversion premiums of greater than 100% is (A) 152% for investment grade convertibles and (B) 179% for below investment grade convertibles so long as such convertible debt securities do not have a yield to maturity or yield to worst of greater than 15.00% above the relevant Treasury curve.

The Fitch Discount Factor applied to convertible debt securities which have a yield to maturity or yield to worse of greater than 15.00% above the relevant Treasury curve is 370%.

If a security is not rated by Fitch but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where

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the S&P rating is A and the Moody's rating is Baa, a Fitch rating of BBB will be used). If a security is not rated by Fitch but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA, a Fitch rating of AAA will be used, and where the only rating on a security is a Moody's rating of Ba, a Fitch rating of BB will be used). If a security is not rated by any Rating Agency, the Trust will treat the security as if it were below investment grade.

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(vi) U.S. Government Securities:

TIME REMAINING TO MATURITY -----	DISCOUNT FACTOR -----
1 year or less.....	101.5%
2 years or less (but longer than 1 year).....	103%
3 years or less (but longer than 2 years).....	105%
4 years or less (but longer than 3 years).....	107%
5 years or less (but longer than 4 years).....	109%
7 years or less (but longer than 5 years).....	112%
10 years or less (but longer than 7 years).....	114%
15 years or less (but longer than 10 years).....	122%
20 years or less (but longer than 15 years).....	130%
25 years or less (but longer than 20 years).....	146%
Greater than 30 years.....	154%

(vii) Short-Term Investments and Cash: The Fitch Discount Factor applied to short-term portfolio securities, including without limitation Debt Securities, Short Term Money Market Instruments and municipal debt obligations, will be (A) 100%, so long as such portfolio securities mature or have a demand feature at par exercisable within the Fitch Exposure Period; (B) 115%, so long as such portfolio securities mature or have a demand feature at par not exercisable within the Fitch Exposure Period; and (C) 125%, so long as such portfolio securities neither mature nor have a demand feature at par exercisable within the Fitch Exposure Period. A Fitch Discount Factor of 100% will be applied to cash.

(viii) Rule 144A Securities: The Fitch Discount Factor applied to Rule 144A Securities shall be the Discount Factor determined in accordance with the table above under Corporate Debt Securities in subsection (i) multiplied by 110% until such securities are registered under the Securities Act.

(ix) MBS, asset-backed and other mortgage-backed securities:

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MBS: U.S. Government Agency (FNMA, FHLMC or GNMA) conforming mortgage-backed securities with an original stated maturity of more than 15 years shall have a discount factor of 114% and conforming mortgage-backed securities with an original stated maturity of 15 years or less shall have a discount factor of 111%.

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Asset-backed and other mortgage-backed securities: The percentage determined by reference to the asset type in accordance with the table set forth below.

ASSET TYPE (WITH TIME REMAINING TO MATURITY, IF APPLICABLE) -----	DISCOUNT FACTOR -----
U.S. Treasury/agency securities (10 years or less).....	118%
U.S. Treasury/agency securities (greater than 10 years).....	127%
U.S. agency sequentials (10 years or less).....	120%
U.S. agency sequentials (greater than 10 years).....	142%
U.S. agency principal only securities.....	236%
U.S. agency interest only securities (with Market Value greater than \$0.40).....	696%
U.S. agency interest only securities (with Market Value less than or equal to \$0.40).....	271%
AAA Lock-Out securities, interest only.....	236%
U.S. agency planned amortization class bonds (10 years or less).....	115%
U.S. agency planned amortization class bonds (greater than 10 years).....	136%
AAA sequentials (10 years or less).....	118%
AAA sequentials (greater than 10 years).....	135%
AAA planned amortization class bonds (10 years or less).....	115%
AAA planned amortization class bonds (greater than 10 years).....	140%
Jumbo mortgage rated AAA(1).....	123%
Jumbo mortgage rated AA(1).....	130%
Jumbo mortgage rated A(1).....	136%
Jumbo mortgage rated BBB(1).....	159%
Commercial mortgage-backed securities rated AAA.....	131%
Commercial mortgage-backed securities rated AA.....	139%
Commercial mortgage-backed securities rated A.....	148%
Commercial mortgage-backed securities rated BBB.....	177%
Commercial mortgage-backed securities rated BB.....	283%
Commercial mortgage-backed securities rated B.....	379%
Commercial mortgage-backed securities rated CCC or not rated.....	950%

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- (1) Applies to jumbo mortgages, credit cards, auto loans, home equity loans, manufactured housing and prime mortgage-backed securities not issued by a U.S. agency or instrumentality.

(x) Futures and call options: For purposes of the Preferred Shares Basic Maintenance Amount, futures held by the Trust and call options sold by the Trust shall not be included as Fitch Eligible Assets. However, such assets shall be valued at Market Value by subtracting the good faith margin and the maximum daily trading variance as of a Valuation Date. For call options purchased by the Trust, the Market Value of the call option will be included as Fitch Eligible Asset subject to a Fitch Discount Factor mutually agreed to between the Trust and Fitch based on the characteristics of the option contract such as its maturity and the underlying security of the contract.

(xi) Securities lending: The Trust may engage in securities lending in an amount not to exceed 15% of the Trust's total gross assets. For purposes of calculating the Preferred Shares Basic Maintenance Amount, such securities lent shall be included as Fitch Eligible Assets with the appropriate Fitch Discount Factor applied to such lent security. The obligation to return such collateral shall not be included as an obligation/liability for purposes of calculating the Preferred Shares Basic Maintenance Amount. However, the Fund may reinvest cash collateral for securities lent in conformity with its investment objectives and policies and the provisions of this Certificate of Vote. In such event, to the

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extent that securities lending collateral received is invested by the Fund in assets that otherwise would be Fitch Eligible Assets and the value of such assets exceeds the amount of the Fund's obligation to return the collateral on a Valuation Date, such excess amount shall be included in the calculation of Fitch Eligible Assets by applying the applicable Fitch Discount Factor to this amount and adding the product to total Fitch Eligible Assets. Conversely, if the value of assets in which securities lending collateral has been invested is less than the amount of the Fund's obligation to return the collateral on a Valuation Date, such difference shall be included as an obligation/liability of the Fund for purposes of calculating the Preferred Shares Basic Maintenance Amount. Collateral received by the Trust in a securities lending transaction and maintained by the Trust in the form received shall not be included as a Fitch Eligible Asset for purposes of calculating the Preferred Shares Basic Maintenance Amount.

(xii) Swaps (including Total Return Swaps, Interest Rate Swaps and Credit Default Swaps): Total Return and Interest Rate Swaps are subject to the following provisions:

If the Trust has an outstanding gain from a swap transaction on a Valuation Date, the gain will be included as a Fitch Eligible Asset subject to the Fitch Discount Factor on the counterparty to the swap transaction.

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At the time a swap is executed, the Trust will only enter into swap transactions where the counterparty has at least a Fitch rating of A- or Moody's rating of A3.

(A) Only the cumulative unsettled profit and loss from a Total Return Swap transaction will be calculated when determining the Preferred Shares Basic Maintenance Amount. If the Trust has an outstanding liability from a swap transaction on a Valuation Date, the Trust count such liability as an outstanding liability from the total Fitch Eligible Assets in calculating the Preferred Shares Basic Maintenance Amount.

(B) In addition, for swaps other than Total Return Swaps, the Market Value of the position (positive or negative) will be included as a Fitch Eligible Asset. The aggregate notional value of all swaps will not exceed the Liquidation Preference of the Outstanding Preferred Shares.

(C) (1) The underlying securities subject to a Credit Default Swap sold by the Trust will be subject to the applicable Fitch Discount Factor for each security subject to the swap;

(2) If the Trust purchases a Credit Default Swap and holds the underlying security, the Market Value of the Credit Default Swap and the underlying security will be included as a Fitch Eligible Asset subject to the Fitch Discount Factor assessed based on the counterparty risk; and

(3) The Trust will not include a Credit Default Swap as a Fitch Eligible Asset purchased by the Trust without the Trust holding the underlying security or when the Trust buys a Credit Default Swap for a basket of securities without holding all the securities in the basket.

"Fitch Eligible Asset" means:

(i) Senior Loans;

(ii) Cash (including interest and dividends due on assets rated (A) BBB or higher by Fitch or the equivalent by another Rating Agency if the payment date is within five (5) Business Days of the Valuation Date, (B) A or higher by Fitch or the equivalent by another Rating Agency if the payment date is within thirty days of the Valuation Date, and (C) A+ or higher by Fitch or the equivalent by another Rating Agency if the payment date is within the Fitch Exposure Period) and receivables for Fitch Eligible Assets sold if the receivable is due within five (5) Business Days

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of the Valuation Date, and if the trades which generated such receivables are settled within five (5) Business Days;

(iii) Short Term Money Market Instruments so long as (A) such securities are rated at least F1+ by Fitch or the equivalent by another Rating Agency, (B) in the case of demand deposits, time deposits and overnight funds, the supporting entity is rated at least A by Fitch or the equivalent by another Rating Agency, or (C) in all other cases, the supporting entity (1) is rated at least A by Fitch or the equivalent by another Rating Agency and the security matures within one month, (2) is rated at least A by Fitch or

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the equivalent by another Rating Agency and the security matures within three months or (3) is rated at least AA by Fitch or the equivalent by another Rating Agency and the security matures within six months;

(iv) U.S. Government Securities;

(v) debt securities if such securities have been registered under the Securities Act or are restricted as to resale under federal securities laws but are eligible for resale pursuant to Rule 144A under the Securities Act as determined by the Trust's investment manager or portfolio manager acting pursuant to procedures approved by the Board of Trustees of the Trust; and such securities are issued by (1) a U.S. corporation, limited liability company or limited partnership, (2) a corporation, limited liability company or limited partnership domiciled in Argentina, Australia, Brazil, Chile, France, Germany, Italy, Japan, Korea, Mexico, Spain or the United Kingdom or other country if Fitch does not inform the Trust that including debt securities from such foreign country will adversely impact Fitch's rating of the APS (the "Approved Foreign Nations"), (3) the government of any Approved Foreign Nation or any of its agencies, instrumentalities or political subdivisions (the debt securities of Approved Foreign Nation issuers being referred to collectively as "Foreign Bonds"), (4) a corporation, limited liability company or limited partnership domiciled in Canada or (5) the Canadian government or any of its agencies, instrumentalities or political subdivisions (the debt securities of Canadian issuers being referred to collectively as "Canadian Bonds"). Foreign Bonds held by the Trust will qualify as Fitch Eligible Assets only up to a maximum of 20% of the aggregate Market Value of all assets constituting Fitch Eligible Assets. Similarly, Canadian Bonds held by the Trust will qualify as Fitch Eligible Assets only up to a maximum of 20% of the aggregate Market Value of all assets constituting Fitch Eligible Assets. Notwithstanding the limitations in the two preceding sentences, Foreign Bonds and Canadian Bonds held by the Trust will qualify as Fitch Eligible Assets only up to a maximum of 30% of the aggregate Market Value of all assets constituting Fitch Eligible Assets. All debt securities satisfying the foregoing requirements and restrictions of this paragraph (iv) are herein referred to as "Debt Securities;"

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(vi) Common stocks (i) (A) which are traded on the New York Stock Exchange, the American Stock Exchange or in the over-the-counter market, (B) which, if cash dividend paying, pay cash dividends in U.S. dollars, and (C) which may be sold without restriction by the Fund; provided, however, that (1) common stock which, while a Fitch Eligible Asset owned by the Fund, ceases paying any regular cash dividend will no longer be considered a Fitch Eligible Asset until 60 calendar days after the date of the announcement of such cessation, unless the issuer of the common stock has senior debt securities rated at least A- by Fitch and (2) the aggregate Market Value of the Fund's holdings of the common stock of any issuer in excess of 5% per U.S. issuer of the number of outstanding shares times the Market Value of such common stock shall not be a Fitch's Eligible Asset; (ii) securities denominated in any currency other than the U.S. dollar and securities of issuers formed under the laws of jurisdictions other than the United States, its states and the District of Columbia for which there are dollar-denominated American Depository Receipts ("ADRs") which are traded in the United States on exchanges or over-the-counter and are issued by banks formed under the laws of the United States, its states or the District of Columbia; provided, however, that the aggregate Market Value of the Fund's holdings of securities denominated in currencies other than the U.S. dollar and ADRs in excess of 3% of the aggregate Market Value of the Outstanding shares of common stock of such issuer or in excess of 10% of the Market Value of the Fund's Fitch Eligible Assets with respect to issuers formed under the laws of any single such non-U.S. jurisdiction other than Argentina, Australia, Brazil, Chile, France, Germany, Italy, Japan, Korea, Mexico, Spain or the United Kingdom (the "Approved Foreign Nations") shall not be a Fitch Eligible Asset;

(vii) Preferred stocks if (i) dividends on such preferred stock are cumulative, (ii) such securities provide for the periodic payment of dividends thereon in cash in U.S. dollars or euros and do not provide for conversion or exchange into, or have warrants attached entitling the holder to receive equity capital at any time over the respective lives of such securities, (iii) the issuer of such a preferred stock has common stock listed on either the New York Stock Exchange or the American Stock Exchange, (iv) the issuer of such a preferred stock has a senior debt rating or preferred stock rating from Fitch of BBB- or higher or

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the equivalent rating by another Rating Agency. In addition, the preferred stocks issue must be at least \$50 million;

(viii) asset-backed and MBS;

(ix) Rule 144A Securities;

(x) Interest Rate Swaps entered into according to International Swap Dealers Association ("ISDA") standards if (1) the counterparty to the swap transaction has a short-term rating of not less than F1 by Fitch or the equivalent by another Rating Agency, or, if the swap counterparty does not have a short-term rating, the counterparty's senior unsecured long-term

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debt rating is AA or higher by Fitch or the equivalent by another Rating Agency and (2) the original aggregate notional amount of the Interest Rate Swap transaction or transactions is not greater than the liquidation preference of the Preferred Shares originally issued;

(xi) swaps, including total return and Credit Default Swaps entered into according to ISDA; and

(xii) Fitch Hedging Transactions.

Financial contracts, as such term is defined in Section 3(c)(2)(B)(ii) of the 1940 Act, not otherwise provided for in this definition may be included in Fitch Eligible Assets, but, with respect to any financial contract, only upon receipt by the Trust of a writing from Fitch specifying any conditions on including such financial contract in Fitch Eligible Assets and assuring the Trust that including such financial contract in the manner so specified would not affect the credit rating assigned by Fitch to the Preferred Shares.

Where the Trust sells an asset and agrees to repurchase such asset in the future, the Discounted Value of such asset will constitute a Fitch Eligible Asset and the amount the Trust is required to pay upon repurchase of such asset will count as a liability for the purposes of the APS Basic Maintenance Amount.

Where the Trust purchases an asset and agrees to sell it to a third party in the future, cash receivable by the Trust thereby will constitute a Fitch Eligible Asset if the long-term debt of such other party is rated at least A- by Fitch or the equivalent by another Rating Agency and such agreement has a term of 30 days or less; otherwise the Discounted Value of such purchased asset will constitute a Fitch Eligible Asset.

Notwithstanding the foregoing, an asset will not be considered a Fitch Eligible Asset to the extent that it has been irrevocably deposited for the payment of (i) (A) through (i) (E) under the definition of Preferred Shares Basic Maintenance Amount or to the extent it is subject to any liens, except for (A) liens which are being contested in good faith by appropriate proceedings and which Fitch has indicated to the Trust will not affect the status of such asset as a Fitch Eligible Asset, (B) liens for taxes that are not then due and payable or that can be paid thereafter without penalty, (C) liens to secure payment for services rendered or cash advanced to the Trust by its investment manager or portfolio manager, the Trust's custodian, transfer agent or registrar or the Auction Agent and (D) liens arising by virtue of any repurchase agreement.

Fitch Diversification Limitations:

Portfolio holdings as described below must be within the following diversification and issue size requirements in order to be included in Fitch's

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Eligible Assets:

SECURITY RATED AT LEAST -----	MAXIMUM SINGLE ISSUER(1) -----	MAXIMUM SINGLE INDUSTRY(1), (2) -----	MINIMUM ISSUE SIZE ----- (\$ IN MILLION) (3)
AAA.....	100%	100%	\$100
AA-.....	20	75	100
A-.....	10	50	100
BBB-.....	6	25	100
BB-.....	4	16	50
B-.....	3	12	50
CCC.....	2	8	50

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(1) Percentages represent a portion of the aggregate Market Value of corporate debt securities.

(2) Industries are determined according to Fitch's Industry Classifications, as defined herein.

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(3) Preferred stock has a minimum issue size of \$50 million.

If a security is not rated by Fitch but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A and the Moody's rating is Baa, a Fitch rating of BBB will be used). If a security is not rated by Fitch but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Diversification Limitations (e.g., where the only rating on a security is an S&P rating of AAA, a Fitch rating of AAA will be used, and where the only rating on a security is a Moody's rating of Ba, a Fitch rating of BB will be used). If a security is not rated by any Rating Agency, the Trust will use the percentage set forth under "not rated" in this table.

"Fitch Exposure Period" means the period commencing on (and including) a given Valuation Date and ending 41 days thereafter.

"Fitch General Portfolio Requirements" means that the Trust's portfolio must meet the following diversification requirements: (a) no more than 25% by

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par value of the Trust's total assets can be invested in the securities of borrowers and other issuers having their principal business activities in the same Fitch Industry Classification; provided, that this limitation shall not apply with respect to U.S. Government Securities and provided further that for purposes of this subsection (a), the term "issuer" shall not include a lender selling a participation to the Trust or any other person interpositioned between such lender and the Trust with respect to a participation and (b) no more than 10% by par value of the Trust's total assets can be invested in securities of a single issuer, and provided further that for purposes of this subsection (b), the term "issuer" includes both the borrower under a loan agreement and the lender selling a participation to the Trust together with any other persons interpositioned between such lender and the Trust with respect to such participation.

"Fitch Hedging Transactions" means purchases or sales of exchange-traded financial futures contracts based on any index approved by Fitch, LIBOR or Treasury Bonds, and purchases, writings or sales of exchange-traded put options on such futures contracts, and purchases, writings or sales of exchange-traded call options on such financial futures contracts, and put and call options on such financial futures contracts ("Fitch Hedging Transactions"), subject to the following limitations:

(i) The Trust may not engage in any Fitch Hedging Transaction based on any index approved by Fitch (other than transactions that terminate a futures contract or option held by the Trust by the Trust's taking the opposite position thereto ("closing transactions")) that would cause the Trust at the time of such transaction to own or have sold outstanding financial futures contracts based on such index exceeding in number 10% of the average number of daily traded financial futures contracts based on such index in the 30 days preceding the time of effecting such transaction as reported by The Wall Street Journal.

(ii) The Trust will not engage in any Fitch Hedging Transaction based on Treasury Bonds or LIBOR (other than closing transactions) that would cause the Trust at the time of such transaction to own or have sold:

(A) Outstanding financial futures contracts based on Treasury Bonds or LIBOR with such contracts having an aggregate Market Value exceeding 60% of the aggregate Market Value of Fitch Eligible Assets owned by the Trust and at least rated AA by Fitch (or, if not rated by Fitch Ratings, rated at least Aa by Moody's; or, if not rated by Moody's, rated AAA by S&P); or

(B) Outstanding financial futures contracts based on Treasury Bonds or LIBOR with such contracts having an aggregate Market Value exceeding 40% of the aggregate Market Value of all Fitch Eligible Assets owned by the Trust (other than Fitch Eligible Assets already subject to a Fitch Hedging Transaction) and rated at least A or BBB by Fitch (or, if not rated by Fitch Ratings, rated at least Baa by Moody's; or, if not rated by Moody's, rated at least A or AA by S&P) (for purposes of the foregoing clauses (i) and (ii), the Trust shall be deemed to own futures contracts that underlie any outstanding options written by the Trust);

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(iii) The Trust may engage in closing transactions to close out any outstanding financial futures contract based on any index approved by Fitch if the amount of open interest in such index as reported by The Wall Street Journal is less than an amount to be mutually determined by Fitch and the Trust.

(iv) The Trust may not enter into an option or futures transaction unless, after giving effect thereto, the Trust would continue to have Fitch Eligible Assets with an aggregate Discounted Value equal to or greater than the Preferred Shares Basic Maintenance Amount.

"Fitch Industry Classification" means, for the purposes of determining Fitch Eligible Assets, each of the following industry classifications:

FITCH INDUSTRY CLASSIFICATIONS  
(MAJOR GROUPS)

-----	SIC CODE -----
Aerospace and Defense.....	37, 45
Automobiles.....	37, 55
Banking, Finance and Real Estate.....	60, 65, 67
Broadcasting and Media.....	27, 48
Building and Materials.....	15-17, 32, 52
Cable.....	48
Chemicals.....	28, 30
Computers and Electronics.....	35, 36
Consumer Products.....	23, 51
Energy.....	13, 29, 49
Environmental Services.....	87
Farming and Agriculture.....	1-3, 7-9
Food, Beverage and Tobacco.....	20, 21, 54
Gaming, Lodging and Restaurants.....	70, 58
Health Care and Pharmaceuticals.....	38, 28, 80
Industrial/Manufacturing.....	35
Insurance.....	63, 64
Leisure and Entertainment.....	78, 79
Metals and Mining.....	10, 12, 14, 33, 34
Miscellaneous.....	50, 72-76, 99
Paper and Forest Products.....	8, 24, 26
Retail.....	53, 56, 59
Sovereign.....	NA
Supermarkets and Drug Stores.....	54
Telecommunications.....	48
Textiles and Furniture.....	22, 25, 31, 57
Transportation.....	40, 42-47
Utilities.....	49
Structured Finance Obligations.....	NA
Packaging and Containers.....	26, 32, 34

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Business Services.....

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The Trust shall use its discretion in determining which industry classification is applicable to a particular investment.

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"Fitch Loan Category" means the following four categories (and, for purposes of this categorization, the Market Value of a Fitch Eligible Asset trading at par is equal to \$1.00):

(i) "Fitch Loan Category A" means Performing Loans which have a Market Value or an Approved Price greater than or equal to \$0.90.

(ii) "Fitch Loan Category B" means: (A) Performing Loans which have a Market Value or an Approved Price of greater than or equal to \$0.80 but less than \$0.90; and (B) non-Performing Loans which have a Market Value or an Approved Price greater than or equal to \$0.85.

(iii) "Fitch Loan Category C" means: (A) Performing Loans which have a Market Value or an Approved Price of greater than or equal to \$0.70 but less than \$0.80; (B) non-Performing Loans which have a Market Value or an Approved Price of greater than or equal to \$0.75 but less than \$0.85; and (C) Performing Loans without an Approved Price rated BB- or higher by Fitch. If a security is not rated by Fitch but is rated by two other Rating Agencies, then the lower of the ratings on the security from the two other Rating Agencies will be used to determine the Fitch Discount Factor (e.g., where the S&P rating is A- and the Moody's rating is Baal, a Fitch rating of BBB+ will be used). If a security is not rated by Fitch but is rated by only one other Rating Agency, then the rating on the security from the other Rating Agency will be used to determine the Fitch Discount Factor (e.g., where the only rating on a security is an S&P rating of AAA-, a Fitch rating of AAA- will be used, and where the only rating on a security is a Moody's rating of Ba3, a Fitch rating of BB- will be used).

(iv) "Fitch Loan Category D" means Loans not described in any of the foregoing categories.

Notwithstanding any other provision contained above, for purposes of determining whether a Fitch Eligible Asset falls within a specific Fitch Loan Category, to the extent that any Fitch Eligible Asset would fall within more than one of the Fitch Loan Categories, such Fitch Eligible Asset shall be deemed to fall into the Fitch Loan Category with the lowest applicable Fitch Discount Factor.

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"Hold Order" has the meaning set forth in Section 2(a)(ii) of Part II of this Certificate.

"Holder" means, with respect to Preferred Shares, the registered holder of shares of each Series as the same appears on the share ledger or share records of the Trust.

"Interest Equivalent" means a yield on a 360-day basis of a discount basis security which is equal to the yield on an equivalent interest-bearing security.

"LIBOR" means the Londer Interbank Offered Rate.

"Loan" means any assignment of or participation in any bank loan denominated in U.S. dollars including term loans, the funded and unfunded portions of revolving credit lines (provided that the Trust shall place in reserve an amount equal to any unfunded portion of any revolving credit line) and debtor-in possession financings; provided that such loan (a) is not extended for the purpose of purchasing or carrying any margin stock and (b) is similar to those typically made, syndicated, purchased or participated by a commercial bank in the ordinary course of business.

"Mandatory Redemption Date" has the meaning set forth in Section 3(a)(iv) of Part I of this Certificate.

"Mandatory Redemption Price" has the meaning set forth in Section 3(a)(iv) of Part I of this Certificate.

"Market Value" means the Market Value Price or, if a Market Value Price is not readily available, the Approved Price of each Eligible Asset held by the Trust.

"Market Value Price" means the price of an Eligible Asset which is the price obtained from an Approved Pricing Service or, if such price is not available, the lower of the bid prices quoted by two Dealers.

"Maximum Rate" means, on any date on which the Applicable Rate is determined, the applicable percentage of the Reference Rate on the date of such Auction determined as set forth below based on the

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lower of the credit ratings assigned to the Preferred Shares by Moody's and Fitch subject to upward but not downward adjustment in the discretion of the Board of Trustees after consultation with the Broker-Dealers; provided that immediately following any such increase the Trust would be in compliance with the Preferred Shares Basic Maintenance Amount. In no event will the Maximum Rate be greater than 18%.

MOODY'S CREDIT RATING	FITCH CREDIT RATING	APPLICABLE PERCENTAGE OF REFERENCE RATE	APPLICABLE OVER REFERENCE RATE
Aaa.....	AAA	150%	150%
Aa3 to Aa1.....	AA- to AA+	250%	250%
A3 to A1.....	A- to A+	350%	350%
Baa1 and lower.....	BBB+ and lower	550%	550%

"MBS" means mortgage backed securities that are issued, backed or otherwise guaranteed by the U.S. Government or its agencies or instrumentalities or that are issued by private issuers.

"Moody's" means Moody's Investors Service, Inc. and its successors at law.

"Moody's Discount Factor" means for purposes of determining the Discounted Value of any Moody's Eligible Asset, the percentage determined as follows. The Moody's Discount Factor for any Moody's Eligible Asset other than the securities set forth below will be the percentage provided in writing by Moody's.

(i) CORPORATE DEBT SECURITIES: The percentage determined by reference to the rating on such asset with reference to the remaining term to maturity of such asset, in accordance with the table set forth below (non-convertibles).

TERM TO MATURITY OF CORPORATE DEBT SECURITY (2)	MOODY'S RATING CATEGORY						
	AAA	AA	A	BAA	BA	B	UNRATED (1)
1 year or less.....	109%	112%	115%	118%	137%	150%	250%
2 years or less (but longer than 1 year).....	115	118	122	125	146	160	250
3 years or less (but longer than 2 years).....	120	123	127	131	153	168	250
4 years or less (but longer than 3 years).....	126	129	133	138	161	176	250
5 years or less (but longer than 4 years).....	132	135	139	144	168	185	250
7 years or less (but longer than 5 years).....	139	143	147	152	179	197	250
10 years or less (but longer than 7 years)....	145	150	155	160	189	208	250

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15 years or less (but longer than 10 years)...	150	155	160	165	196	216	250
20 years or less (but longer than 15 years)...	150	155	160	165	196	228	250
30 years or less (but longer than 20 years)...	150	155	160	165	196	229	250
Greater than 30 years.....	165	173	181	189	205	240	250

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- (1) Unless conclusions regarding liquidity risk as well as estimates of both the probability and severity of default for the Corporation's assets can be derived from other sources, securities rated below B by Moody's and unrated securities, which are securities rated by neither Moody's, S&P nor Fitch, are limited to 10% of Moody's Eligible Assets. If a corporate debt security is unrated by Moody's, S&P or Fitch, the Fund will use the percentage set forth under "Unrated" in this table. Ratings assigned by S&P or Fitch are generally accepted by Moody's at face value. However, adjustments to face value may be made to particular categories of credits for which the S&P and/or Fitch rating does not seem to approximate a Moody's rating equivalent. Split rated securities assigned by S&P and Fitch will be accepted at the lower of the two ratings.
- (2) The Moody's Discount Factors for debt securities shall also be applied to any interest rate swap or cap, in which case the rating of the counterparty shall determine the appropriate rating category.

For corporate debt securities that do not pay interest in U.S. dollars, the fund sponsor will contact Moody's to obtain the applicable currency conversion rates.

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PREFERRED STOCK: The Moody's Discount Factor for taxable preferred stock shall be:

Aaa.....	150%
Aa.....	155%
A.....	160%
Baa.....	165%
Ba.....	196%
B.....	216%
<b>1.76</b>	

December 22, 2010

350,000

2.69

2.69

1.74

**May 3, 2011**

1,967,368

5.54

5.54

3.57

**August 2, 2011**

67,100

6.37

6.37

4.09

**November 2, 2011**

315,000

6.78

6.78

4.28

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The per share estimated fair value of common stock in the table above represents the determination by our board of directors of the fair value of our common stock as of the date of grant, taking into consideration various objective and subjective factors, including the conclusions, if applicable, of contemporaneous valuations of our common stock as discussed below. We computed the per share weighted average estimated fair value for stock option grants based on the Black-Scholes option valuation model.

Historically, we have granted stock options at exercise prices equal to the estimated fair value of our common stock. Due to the absence of an active market for our common stock, the fair value for purposes of determining the exercise price for stock option grants was determined by our board of directors, with the assistance and upon the recommendation of management, in good faith based on a number of objective and subjective factors including:

the prices of our convertible preferred stock sold to or exchanged between outside investors in arm's length transactions, and the rights, preferences and privileges of the convertible preferred stock as compared to those of our common stock, including the liquidation preferences of the convertible preferred stock;

our results of operations, financial position and the status of research and development efforts, including clinical trial data for the various compounds under development;

the composition of, and changes to, our management team and board of directors;

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the lack of liquidity of our common stock as a private company;

the material risks related to our business;

achievement of enterprise milestones, including results of clinical trials and entering into collaboration and license agreements;

the market performance of publicly traded companies in the life sciences and biotechnology sectors, and recently completed mergers and acquisitions of companies comparable to us;

external market conditions affecting the life sciences and biotechnology industry sectors;

the likelihood of achieving a liquidity event for the holders of our common stock and stock options, such as an initial public offering, given prevailing market conditions; and

contemporaneous valuations prepared in accordance with methodologies outlined in the American Institute of Certified Public Accountants Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, or the Practice Aid.

Based on these factors, our board of directors granted options at exercise prices that increased from \$2.12 per share in 2010 up to \$6.78 per share in 2011.

In determining the exercise prices of the options set forth in the table above granted in 2010 and 2011, our board of directors considered the most recent contemporaneous valuations of our common stock, which were prepared by an external consultant as of October 6, 2009, August 24, 2010, March 31, 2011, July 31, 2011 and October 17, 2011, and based its determination in part on the analyses summarized below.

For the options listed above granted in 2010 and 2011, we used the market approach, specifically the guideline public company and the guideline transaction methods, to estimate the enterprise value of our company by comparing it to similar publicly traded companies and acquisition transactions. In addition, the valuations considered the prices paid for our preferred stock in recent arm's length market financing transactions, most notably, transactions in August 2010 in which one of our preferred stockholders sold shares to several unrelated third parties and our series G convertible preferred stock financing completed in April 2011. Given the complex capital structure of our company, it was also necessary to allocate the aggregate equity value to the various classes of our outstanding capital stock, including several series of convertible preferred stock and our common stock.

We used the probability-weighted expected return method to allocate the enterprise values to the common stock. Under this method, the value of the common stock is estimated based upon an analysis of future values for our company assuming various investment outcomes, the timing of which is based, in part, on the plans of our board of directors and management. Under this approach, share value is derived from the probability-weighted present value of expected future investment returns, considering each of the possible outcomes available to us, as well as the economic and control rights of each share class. The fair value of our common stock was estimated using a probability-weighted analysis of the present value of the returns afforded to common stockholders under several future stockholder exit or liquidity event scenarios, either through (1) an initial public offering, or IPO; (2) a trade sale of our company at a premium to cumulative amounts invested by preferred stock investors; or (3) a trade sale of our company at a value below the cumulative liquidation preference of the preferred stockholders.

The individual stockholder exit or liquidity scenarios considered in each analysis depended on the specific facts and circumstances, both internal and external, present as of each valuation date. For the October 6, 2009 valuation, we considered the following significant events:

In September 2009, we entered into a license and collaboration agreement with Sanofi for the co-development and commercialization of MM-121, which included an upfront \$60.0 million license fee, future clinical development and sales milestone payments and future royalty



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payments, depending on the success of MM-121. The agreement also provided that Sanofi would reimburse us for all direct development and manufacturing costs incurred in connection with MM-121.

In October 2009, we completed the acquisition of Hermes, through which we expanded our discovery capabilities into the area of targeted liposomes and added the MM-398 development program.

As a result, in October 2009, we utilized the probability-weighted expected return method, and the exit events considered included one short-term IPO scenario, one long-term IPO scenario, two separate trade sale scenarios at premiums to the cumulative liquidation preference of the preferred stockholders and a fifth scenario presuming a sale below the aggregate convertible preferred stock liquidation preference.

Subsequently, in January 2011, we received positive Phase 2 clinical results for MM-398 in both pancreatic and gastric cancer indications. As a result of the positive data from these trials, the continued progress of our MM-121 and MM-111 clinical programs, the filing of an IND for MM-302 and the further expansion of our preclinical development pipeline, beginning with the March 31, 2011 valuation and continuing through the October 17, 2011 valuation, a third low-case IPO scenario was added and the sale below the aggregate convertible preferred stock liquidation preference was removed. This third low-case IPO scenario was added to better reflect the expectations of our board of directors and management with respect to the potential liquidity outcomes for our company as of the valuation date considering, in part, the number of compounds in our clinical development pipeline and the anticipated level of future funding necessary to initiate multiple Phase 2/3 clinical trials for two or more of these development programs simultaneously.

The future values of our common stock in the IPO scenarios and the trade sale scenarios were estimated by application of the market approach based on certain key assumptions, including the following:

expected pre-money IPO valuations from recently completed initial public offerings;

estimated third party trade sale values based on recent transactions involving biotechnology or biopharmaceutical companies; and

expected dates for a future IPO or trade sale of our company.

For the sale above the preferred stock liquidation preference scenario, the future common stock value was estimated based on certain assumptions, including the estimated aggregate enterprise value that could be attained through such a sale and the estimated expected date of the future sale. The present values of our common stock under each scenario were then calculated by applying a risk-adjusted discount rate and then probability-weighting those present values based on our estimate of the relative probability of each scenario.

Finally, the estimated fair value of our common stock was reduced by a discount for lack of marketability. The discount for lack of marketability was analyzed based on the restrictive factors inherent in privately held common stock. Among other considerations, the determination of an appropriate discount for lack of marketability, was based in part on a put-option model that considers variables such as time to liquidity, volatility and the risk-free rate. Based on these analyses and consideration of liquidity restrictions, discounts for lack of marketability ranging from 7.5% to 5.0% were applied, depending on the presumed timing of the exit event.

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*Stock option grants from February 1, 2010 to May 12, 2010*

Our board of directors granted stock options on February 1, 2010, February 9, 2010 and May 12, 2010, with each having an exercise price of \$2.12 per share. In addition to the objective and subjective factors discussed above, our board of directors also considered input from management and the valuation as of October 6, 2009. Management determined that no significant events or other circumstances had occurred between October 6, 2009 and May 12, 2010 that would indicate there was a change in the fair value of our common stock during that period. The specific facts and circumstances considered by our board of directors for the October 6, 2009 valuation included the following:

execution of a license and collaboration agreement with Sanofi for the development and commercialization of MM-121 in September 2009, as described above;

completion of the acquisition of Hermes in October 2009, expanding our discovery capabilities into the area of targeted liposomes, including the MM-398 development program;

filing of an IND for MM-111;

out-licensing of MM-093 to GTC; and

continued dislocation in the public and private capital markets resulting from weakness in macroeconomic conditions and the global credit and liquidity crisis.

In the October 6, 2009 valuation, the short-term IPO scenario assumed a liquidity event in July 2010 and the long-term IPO scenario assumed an exit event in October 2011. In applying the market approach under both IPO scenarios, it was assumed that all development programs, including MM-121 and MM-111, would continue to advance in the clinic through the time of an exit event. The guideline public company method as described in the Practice Aid was used to apply the market approach to both IPO scenarios. Market data on pre-money IPO valuations for biotechnology companies that went public in the period from 2005 to 2008 was analyzed under this method. From this set of data, a narrower sub-set of comparable companies was selected which had product candidates in various stages of drug development ranging from discovery stage to Phase 3 clinical trials. The selected enterprise values for the short-term IPO scenario and the long-term IPO scenario were at or above the high-end of the observed range of the IPO market data based on consideration of our Network Biology approach, the collaboration agreement with Sanofi, the recently completed Hermes acquisition and progress made in our ongoing development programs.

In applying the market approach to estimate our aggregate future enterprise values under the base-case and high-case trade sale scenarios, the high-case scenario assumed all development programs, including MM-121 and MM-111, would advance in the clinic until the time of a trade sale, while the base-case scenario assumed one or more program would experience a clinical delay or setback prior to an exit event. In both trade sale scenarios, the liquidity event was assumed to occur in October 2012. In applying the market approach to the trade sale scenarios, the guideline transaction method was utilized. Under this method, sale transactions of similar private biotechnology companies were analyzed. The values utilized were supported by published transaction values between 2006 and 2008 involving comparable companies with product candidates in various stages of drug development, ranging from discovery stage to Phase 3 clinical trials. In estimating our enterprise value, consideration was given to those transactions for companies that were in a comparable stage of development as we were expected to be in as of October 2012. The selected enterprise value for the base-case scenario was based on consideration of the median of the comparable transaction values, and the selected enterprise value used in the high-case scenario was based on consideration of comparable transaction values between third quartile and the maximum of the observed range.

In the sale at a price below liquidation preference scenario, a sale of our existing research and intellectual property was assumed as of October 2012, at a value that would not allow preferred

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stockholders to realize their full liquidation preference. The fair value of our common stock under this exit scenario was determined by reducing the total estimated enterprise value by the liquidation preferences of convertible preferred shares, all of which would receive more value based on their liquidation preferences plus accrued dividends, as opposed to converting to common stock.

Under all the exit scenarios considered in the probability-weighted expected return method, the fair value of our common stock was calculated using the estimated future enterprise valuations, a risk-adjusted discount rate of 30.0% based on the inherent risk of a hypothetical investment in our common stock, and a discount for lack of marketability which ranged between 5.0% in the short-term IPO scenario to 7.5% in all other assumed liquidity events. The risk-adjusted discount rate was based on consideration of the weighted average cost of capital for comparable biotechnology companies adjusted for company specific risk factors, the venture capital rates of return detailed in the Practice Aid, and an analysis of other quantitative and qualitative factors considered pertinent to estimating the discount rate.

In the October 6, 2009 valuation, probability weightings of 20.0% were used for the short-term and long-term IPO scenarios, 30.0% and 10.0% were used for the base-case and high-case trade sale scenarios, respectively, and 20.0% was used for the sale at a price below liquidation preference scenario. The probability weightings assigned to the respective exit scenarios were primarily based on consideration of our various drug development programs, industry clinical success rates, our expected near-term and long-term funding requirements, and an assessment of the current financing and biotechnology industry environments at the time of the valuation. The resulting value, which represented the estimated fair value of our common stock as of October 6, 2009, was \$2.12 per share.

*Stock option grants from August 24, 2010 to December 22, 2010*

Our board of directors granted stock options on August 24, 2010, August 25, 2010, October 15, 2010, December 9, 2010, December 15, 2010 and December 22, 2010, with each having an exercise price of \$2.69 per share. In addition to the objective and subjective factors discussed above, our board of directors also considered input from management and the valuation as of August 24, 2010. The increase in share value from the October 6, 2009 valuation was primarily attributable to increases in the selected enterprise values in the long-term IPO and the base-case trade sale scenarios and a decrease in the probability weighting assigned to the sale at a price below liquidation preference scenario. The specific facts and circumstances considered by our board of directors in assessing these key valuation assumptions included the following:

transactions in August 2010 in which one of our preferred stock investors sold shares of series B, series C and series D convertible preferred stock to several unrelated third parties in arm's length transactions;

initiation in July 2010 of a randomized, double blind Phase 2 clinical trial of MM-121 in combination with exemestane (Aromasin) in breast cancer patients; and

difficult conditions in the IPO and merger and acquisition markets, which resulted in an extension of the assumed timing for a liquidity event in all of the scenarios considered in the probability-weighted expected return method.

In applying the market approach to estimate our future enterprise values under the IPO exit scenarios, as described previously, it was assumed that a liquidity event would occur in November 2011 in the short-term scenario and in August 2012 in the long-term scenario. The valuation methodologies and underlying assumptions utilized to apply the market approach under the IPO liquidity scenarios were consistent with those employed in the October 6, 2009 valuation. Given our development pipeline, which included three clinical programs (MM-398, MM-121 and MM-111) and four additional compounds in various stages of preclinical development (MM-302, MM-151, MM-141 and MM-131) as

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of the valuation date, the selected enterprise value in the short-term scenario was based on the pre-money IPO market data for transactions between the third quartile and the maximum of the observed range. The selected aggregate enterprise value in the long-term scenario was based on consideration of the high-end of the observed range of transaction values and assumed our three most advanced development projects (MM-398, MM-121 and MM-111) would continue their positive clinical progression.

In applying the market approach to estimate our aggregate future enterprise values under the two trade sale scenarios, as described previously, it was assumed that a liquidity event would occur in August 2013 for the base-case scenario and in February 2013 for the high-case scenario. The valuation methodologies and underlying assumptions utilized to apply the market approach under the trade-sale scenarios were consistent with those employed in the October 6, 2009 valuation. The selected enterprise value utilized in the base-case scenario considered the median of the observed range of comparable transaction values. The selected enterprise value for the high-case scenario was based on the comparable transaction values between the third quartile and the high-end of the observed range. We assumed we would make significant progress and achieve certain key milestones with respect to our development pipeline by the time a trade sale was consummated, including assumptions that our three most advanced development projects (MM-398, MM-121 and MM-111) would continue their positive clinical progression, one or more additional compounds would enter Phase 1/2 trials, including MM-302, and several other compounds would near Phase 1 trials (MM-151, MM-141 and MM-131).

In the sale at a price below liquidation preference scenario, a sale of our existing research and intellectual property was assumed as of August 2013, at a value that would not allow the preferred stockholders to realize their full liquidation preference. The valuation methodologies and underlying assumptions utilized in this scenario were consistent with those employed as of October 6, 2010.

Under all the exit scenarios considered in the probability-weighted expected return method, the fair value of our common stock was calculated using the estimated future enterprise valuations, a risk-adjusted discount rate of 30.0% based on the inherent risk of a hypothetical investment in our common stock, and a discount for lack of marketability which ranged between 5.0% in the short-term IPO scenario to 7.5% in all other assumed liquidity events. The risk-adjusted discount rate was based on consideration of the weighted average cost of capital for comparable biotechnology companies adjusted for company specific risk factors, the venture capital rates of return detailed in the Practice Aid, and an analysis of other quantitative and qualitative factors considered pertinent to estimating the discount rate.

In the August 24, 2010 valuation, probability weightings of 20.0% were used for the short-term and long-term IPO scenarios, respectively, 10.0% and 35.0% were used for the high-case and base-case trade sale scenarios, respectively, and 15.0% was used for the sale below liquidation preference scenario. The probability weightings assigned to the respective exit scenarios were primarily based on consideration of our various drug development programs, industry clinical success rates, our expected near-term and long-term funding requirements, and an assessment of the current financing and biotechnology industry environments at the time of the valuation. The resulting value, which represented the estimated fair value of our common stock as of August 24, 2010, was \$2.69 per share. Management determined that no significant events or other circumstances had occurred between August 24, 2010 and December 22, 2010 that would indicate there was a change in the fair value of our common stock during that period.

*Stock option grants on May 3, 2011*

Our board of directors granted stock options on May 3, 2011 with an exercise price of \$5.54 per share. In addition to the objective and subjective factors discussed above, our board of directors also considered input from management and the valuation as of March 31, 2011. The increase in share

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value from the August 24, 2010 valuation was primarily attributable to increases in the selected enterprise values in the long-term IPO, short-term IPO and high-case trade sale scenarios, a decrease in estimated time until a liquidity event in each of the exit scenarios and the addition of a third low-case IPO scenario and the elimination of the sale at a price below liquidation preference scenario. The specific facts and circumstances considered by our board of directors in assessing these key valuation assumptions included the following:

positive results in January 2011 indicating that MM-398 met its primary endpoint in a Phase 2 clinical trial for patients with metastatic pancreatic cancer who had failed prior treatment with gemcitabine;

positive Phase 2 clinical trial results in January 2011 for MM-398 as a second line therapy for patients with gastric or gastroesophageal junction adenocarcinoma;

completion of a series G convertible preferred stock financing on April 6, 2011 in which we sold 11.0 million shares at \$7.00 per share for aggregate proceeds of approximately \$77.0 million;

execution of a term sheet with PharmaEngine in February 2011 and determination by management as of the valuation date of a high likelihood that a final agreement would be executed under which we would reacquire the major Asia and Europe country rights to commercialize and market MM-398;

filing of an IND in February 2011 for MM-302; and

positive equity market conditions and performance for publicly traded biotechnology and biopharmaceutical companies.

The market approach was used to estimate our aggregate future enterprise values under three separate IPO scenarios, as described previously. The short-term scenario assumed a liquidity event in December 2011, the long-term scenario assumed a liquidity event in June 2012, and the low-case IPO scenario assumed a liquidity event in September 2012. The valuation methodologies and underlying assumptions utilized to apply the market approach under the short-term and long-term IPO liquidity scenarios were consistent with those employed in the August 24, 2010 valuation. The selected future enterprise value in the short-term IPO scenario was at the high end of the observed range of IPO market data based on consideration of the recent series G convertible preferred stock financing at \$7.00 per share and our development pipeline as of the valuation date, which included:

MM-398, positive Phase 2 data announced in January 2011;

MM-121, in Phase 2 development;

MM-111, in Phase 1 development;

MM-302, IND filed in February 2011;

MM-151, in advanced preclinical development; and

three additional compounds in the discovery phase, MM-310, MM-141 and MM-131.

The future enterprise value selected in the long-term IPO scenario was above the high-end of the range of IPO market data and was based on the considerations listed above, and the assumption that clinical progress would be made in multiple development programs between the assumed short-term IPO and long-term IPO liquidity dates. The selected future enterprise value in the low-case IPO scenario was based on

consideration of the IPO market data between the third quartile and the high-end of the range and assumed a clinical set-back or delay in one or more of our three clinical development programs.

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In applying the market approach to estimate our aggregate future enterprise values under the two trade sale scenarios, as described previously, it was assumed that a liquidity event would occur in June 2013 for the base-case scenario, and in December 2012 for the high-case scenario. The valuation methodologies and underlying assumptions utilized to apply the market approach under the trade-sale scenarios were consistent with those employed in the August 24, 2010 valuation. The selected enterprise value for the base-case was based on consideration of the median of the observed range of comparable transaction values. The selected enterprise value for the high-case sale scenario was based on consideration of the high-end of the observed range of comparable transaction values.

Based on consideration of our development pipeline and the Network Biology approach, the March 31, 2011 valuation did not include a sale at a price below the liquidation preference scenario.

Under all the scenarios considered in the probability-weighted expected return method, the fair value of our common stock was calculated using the expected future enterprise valuations, a risk-adjusted discount rate of 25.0% based on the inherent risk of a hypothetical investment in our common stock, and a discount for lack of marketability of 5.0% in all of the assumed liquidity scenarios. The risk-adjusted discount rate was based on consideration of the weighted average cost of capital for comparable biotechnology companies adjusted for company specific risk factors, the venture capital rates of return detailed in the Practice Aid, and an analysis of other quantitative and qualitative factors considered pertinent to estimating the discount rate.

In the March 31, 2011 valuation, probability weightings of 30.0%, 20.0% and 10.0% were used for the short-term, long-term and low-case IPO scenarios, respectively, and 15.0% and 25.0% were used for the high-case and base-case trade sale scenarios, respectively. The probability weightings assigned to the respective exit scenarios were primarily based on consideration of our various drug development programs, industry clinical success rates, our expected near-term and long-term funding requirements, and an assessment of the current financing and biotechnology industry environments at the time of the valuation. The resulting value, which represented the estimated fair value of our common stock as of March 31, 2011, was \$5.54 per share. Management determined that no significant events or other circumstances that had not been taken into consideration in the March 31, 2011 valuation had occurred between March 31, 2011 and May 3, 2011 that would indicate there was a change in the fair value of our common stock during that period.

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*Stock option grants on August 2, 2011*

Our board of directors granted stock options on August 2, 2011 with an exercise price of \$6.37 per share. In addition to the objective and subjective factors discussed above, our board of directors also considered input from management and the valuation as of July 31, 2011. The increase in share value from the March 31, 2011 valuation was primarily attributable to a decrease in the estimated time until a liquidity event in each of the exit scenarios and the increase in probability of an IPO compared to a trade sale when estimating the probability of each potential future liquidity event. The specific facts and circumstances considered by our board of directors in assessing these key valuation assumptions included the following:

filing a registration statement for an IPO with the Securities and Exchange Commission, or SEC, on July 8, 2011;

dosing the first patient in July 2011 in our MM-302 Phase 1 clinical trial;

filing of an IND in July 2011 for MM-151; and

receipt of orphan drug status in July 2011 for MM-398 for the treatment of pancreatic cancer.

The market approach was used to estimate our aggregate future enterprise values under three separate IPO scenarios, as described previously. The short-term scenario assumed a liquidity event in November 2011, the long-term scenario assumed a liquidity event in June 2012, and the low-case IPO scenario assumed a liquidity event in September 2012. The valuation methodologies and underlying assumptions utilized to apply the market approach under all scenarios were consistent with those employed in the March 31, 2011 valuation.

Under all the scenarios considered in the probability-weighted expected return method, the fair value of our common stock was calculated using the expected future enterprise valuations, a risk-adjusted discount rate of 25.0% based on the inherent risk of a hypothetical investment in our common stock, and a discount for lack of marketability of 5.0% in all of the assumed liquidity scenarios. The risk-adjusted discount rate was based on consideration of the weighted average cost of capital for comparable biotechnology companies adjusted for company specific risk factors, the venture capital rates of return detailed in the Practice Aid, and an analysis of other quantitative and qualitative factors considered pertinent to estimating the discount rate.

In the July 31, 2011 valuation, probability weightings of 40.0%, 20.0% and 20.0% were used for the short-term, long-term and low-case IPO scenarios, respectively, and 10.0% and 10.0% were used for the high-case and base-case trade sale scenarios, respectively. The probability weightings assigned to the respective exit scenarios were primarily based on consideration of our various drug development programs, industry clinical success rates, our expected near-term and long-term funding requirements, and an assessment of the current financing and biotechnology industry environments at the time of the valuation. The resulting value, which represented the estimated fair value of our common stock as of July 31, 2011, was \$6.37 per share. Management determined that no significant events or other circumstances that had not been taken into consideration in the July 31, 2011 valuation had occurred between July 31, 2011 and August 2, 2011 that would indicate there was a change in the fair value of our common stock during that period.

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*Stock option grants on November 2, 2011*

Our board of directors granted stock options on November 2, 2011 with an exercise price of \$6.78 per share. In addition to the objective and subjective factors discussed above, our board of directors also considered input from management and the valuation as of October 17, 2011. The increase in share value from the July 31, 2011 valuation was directly attributable to a decrease in the estimated time until a liquidity event in each of the exit scenarios. The decrease in the estimated time until a liquidity event corresponded to the time elapsed from July 31, 2011 to November 2, 2011. No other material assumptions changed from the July 31, 2011 valuation to the October 17, 2011 valuation. Management determined that no significant events or other circumstances that had not been taken into consideration in the October 17, 2011 valuation had occurred between October 17, 2011 and November 2, 2011 that would indicate there was a change in the fair value of our common stock during that period.

There are significant judgments and estimates inherent in the determination of these valuations. These judgments and estimates include assumptions regarding our future performance; the time to completing an IPO, a trade sale, or other liquidity event; and the timing of and probability of continuing to successfully progress our various drug development candidates toward commercialization, as well as determinations of the appropriate valuation methods. If different assumptions had been applied in the valuations, our stock-based compensation expense, net loss and net loss per share could have been significantly different. While the assumptions used to calculate and account for stock-based compensation awards represents management's best estimates, these estimates involve inherent uncertainties and the application of management's judgment. As a result, if revisions are made to the underlying assumptions and estimates, our stock-based compensation expense could vary significantly from period to period.

On March 23, 2012, we and our underwriters determined the estimated price for our IPO of \$7.00 per share. In comparison, our estimate of the fair value of our common stock was \$6.78 per share as of November 2, 2011. In determining the estimated fair value of \$6.78 per share on November 2, 2011, our board of directors considered a contemporaneous valuation of our common stock as of October 17, 2011 prepared by an external consultant. We note that, as is typical in IPOs, the estimated price for our IPO was not derived using a formal determination of fair value, but was determined based upon discussions between us and the underwriters. Among the factors that were considered in setting this price were existing conditions in the public capital markets and the prospects for our company and the industry in which we operate. Specifically, we believe that the difference between the fair value of our common stock as of November 2, 2011 and the estimated price for our IPO was primarily the result of the following factors:

Historically, and we believe it is reasonable to expect that, the completion of an IPO increases the value of an issuer's common stock as a result of the increase in the liquidity and ability to trade such securities in the public market. In addition, our convertible preferred stock currently has substantial economic rights and preferences over our common stock. The estimated price for our IPO necessarily assumed that the IPO has occurred, a public market for our common stock has been created and that our preferred stock has converted into common stock in connection with the IPO.

Since November 2, 2011, we achieved important milestones in the clinical development of our most advanced product candidates and generally continued to advance the development of these product candidates, as described in more detail below, which has had a positive impact on the fair value of our common stock:

in November 2011, we dosed the first patient in a Phase 2 clinical trial of MM-121 in non-small cell lung cancer;

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in December 2011, the FDA notified us that a clinical hold had been released for our IND for MM-151, and in January 2012, we dosed the first patient in a Phase 1 clinical trial of MM-151 in solid tumors;

in January 2012, we dosed the first patient in a pivotal Phase 3 clinical trial of MM-398 for the treatment of patients with metastatic pancreatic cancer who have previously failed treatment with gemcitabine;

in February 2012, we dosed the first patient in a Phase 2 trial of MM-121 in ovarian cancer; and

we generally continued clinical advancement of MM-111, MM-302 and MM-151 in accordance with our overall development plans.

***Acquisition***

In connection with our acquisition of Hermes, we recorded the assets acquired, liabilities assumed, contractual contingencies and contingent consideration at their fair value on the acquisition date. The purchase price allocation process requires management to make significant estimates and assumptions at the acquisition date, especially with respect to intangible assets and estimated contingent consideration payments.

Although we believe the assumptions and estimates we have made with respect to the Hermes acquisition were reasonable and appropriate, they were based in part on management's judgment and information obtained from the management of the acquired company and are inherently uncertain. Examples of critical estimates in valuing the estimated contingent consideration and certain of the intangible assets we have acquired include the following:

estimated fair value of the acquisition-related contingent consideration, which was performed using a probability-weighted analysis of future liquidity events;

future expected cash flows of research and development activities and future expected cash flows from product sales and license agreements; and

discount rates.

Unanticipated events and circumstances may occur which may affect the accuracy or validity of such assumptions, estimates or actual results. Additionally, any change in the fair value of the acquisition-related contingent consideration subsequent to the acquisition date, including changes from events after the acquisition date, such as changes in our estimate of the probability of certain future liquidity events, will be recognized in earnings in the period of the estimated fair value change. A change in fair value of the acquisition-related contingent consideration could have a material affect on the statement of operations and financial position in the period of the change in estimate.

Table of Contents**Results of operations***Comparison of the years ended December 31, 2010 and 2011*

(in thousands)	Year ended December 31,	
	2010	2011
Research and development revenues	\$ 20,305	\$ 34,215
Research and development expenses	58,278	100,630
General and administrative expenses	11,381	14,454
Contingent consideration	(178)	
Loss from operations	(49,176)	(80,869)
Interest income	74	56
Interest expense	(3,726)	(13)
Other income	2,669	1,150
Net loss before income taxes and non-controlling interest	(50,159)	(79,676)
Benefit from income taxes		
Net loss	\$ (50,159)	\$ (79,676)

*Research and development revenues*

Revenues for 2011 were \$34.2 million, compared to \$20.3 million for 2010, an increase of \$13.9 million, or 68%. This increase resulted from increases in milestone, manufacturing and research and development revenues recognized under the collaboration agreement with Sanofi.

*Research and development expense*

Research and development expenses for 2011 were \$100.6 million, compared to \$58.3 million for 2010, an increase of \$42.3 million, or 73%. This increase was primarily attributable to:

\$18.9 million of increased MM-398 spending due to a \$10.0 million upfront license payment made to PharmaEngine in May 2011 and costs associated with preparing to initiate a Phase 3 clinical trial;

\$14.3 million of increased MM-121 spending due to initiation of two new clinical trials and increased spending on ongoing clinical trials;

\$7.6 million of increased MM-151 spending due to increased toxicology and other preclinical costs incurred in preparation of initiating a Phase 1 clinical trial, including a \$1.2 million license fee under our agreement with Adimab;

\$6.5 million of increased spending on preclinical product candidates and other general unallocated research and development due to an increase in the number of preclinical programs; and

\$0.8 million of increased stock compensation expense due to increased headcount.

These increases were partially offset by a decrease of \$5.8 million in MM-111 spending due to the timing of clinical and manufacturing costs.

*General and administrative expense*

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General and administrative expenses for 2011 were \$14.5 million, compared to \$11.4 million for 2010, an increase of \$3.1 million, or 27%. This increase was primarily attributable to the timing of

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stock option grants to our directors, the impact of outstanding non-employee stock options, which are marked to market, and increased labor and labor-related costs due to an increase in headcount.

#### *Contingent consideration*

Contingent consideration for 2011 was \$0, compared to a benefit of \$0.2 million for 2010. The benefit in 2010 was the result of a change in the estimated fair value of our common stock used to value the contingent consideration liability from the Hermes acquisition.

#### *Interest income*

Interest income for both 2011 and 2010 was \$0.1 million. Interest income was related to interest earned on our money market investments.

#### *Interest expense*

Interest expense for 2011 was minimal, compared to \$3.7 million for 2010. This decrease was primarily due to lower non-cash interest expense recognized on the series F amount, which was settled in October 2010 and was not present during 2011.

#### *Other income*

Other income for 2011 was \$1.2 million, compared to \$2.7 million for 2010, a decrease of \$1.5 million, or 56%. This decrease was primarily due to the receipt of a \$2.4 million grant awarded under the federal Qualifying Therapeutic Discovery Project program, which was recognized in 2010 and did not occur in 2011, coupled with \$0.8 million of additional expense from the change in fair value of preferred stock warrants, partially offset by a \$1.8 million cash settlement from a former service provider recognized in 2011.

#### *Comparison of the years ended December 31, 2009 and 2010*

(in thousands)	Year ended December 31,	
	2009	2010
Research and development revenues	\$ 2,148	\$ 20,305
Research and development expenses	37,658	58,278
General and administrative expenses	12,178	11,381
Contingent consideration		(178)
Loss from operations	(47,688)	(49,176)
Interest income	81	74
Interest expense	(4,909)	(3,726)
Other income	41	2,669
Net loss before income taxes and non-controlling interest	(52,475)	(50,159)
Benefit from income taxes	3,402	
Net loss	\$ (49,073)	\$ (50,159)

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*Research and development revenues*

Revenues for 2010 were \$20.3 million, compared to \$2.1 million for 2009, an increase of \$18.2 million. This increase resulted from a full year of revenues recognized under the collaboration agreement with Sanofi.

*Research and development expense*

Research and development expenses for 2010 were \$58.3 million, compared to \$37.7 million for 2009, an increase of \$20.6 million, or 55%. This increase was primarily attributable to:

\$8.5 million of increased MM-111 spending due to initiation of one new clinical trial and increased manufacturing activity;

\$3.4 million of increased spending on preclinical product candidates and other general unallocated research and development due to an increase in the number of preclinical programs;

\$5.7 million of increased MM-121 spending due to initiation of three new clinical trials and increased spending on ongoing clinical trials;

\$4.0 million of increased MM-302 spending due to increased preclinical activities; and

\$0.8 million of increased stock compensation expense due to increased headcount.

These increases were partially offset by the following decreases:

\$0.4 million of MM-093 spending due to out-licensing the program to GTC during 2009; and

\$1.5 million of MM-151 spending due to the timing of toxicology studies and other preclinical activities.

*General and administrative expense*

General and administrative expenses for 2010 were \$11.4 million, compared to \$12.2 million for 2009, a decrease of \$0.8 million, or 7%. This decrease was primarily attributable to a \$2.0 million consulting and banking fee related to the MM-121 license and collaboration agreement with Sanofi in 2009, which was not present in 2010, partially offset by higher legal costs and higher labor and labor-related costs.

*Contingent consideration*

Contingent consideration for 2010 was a benefit of \$0.2 million, compared to \$0 in 2009. This benefit was a result of a change in the estimated probability of occurrence of a financing event in the contingent consideration arrangement from the Hermes acquisition.

*Interest income*

Interest income for each of 2010 and 2009 was \$0.1 million. Interest income was related to interest earned on our money market investments.

*Interest expense*

Interest expense for 2010 was \$3.7 million, compared to \$4.9 million for 2009, a decrease of \$1.2 million, or 24%. This decrease was primarily due to lower non-cash interest expense recognized on the series F amount, which was settled in October 2010.



Table of Contents*Other income*

Other income for 2010 was \$2.7 million, compared to \$41,000 for 2009, an increase of \$2.7 million. This increase was primarily due to the receipt of a \$2.4 million grant awarded under the federal Qualifying Therapeutic Discovery Project program, which was recognized as other income in 2010.

*Benefit from income taxes*

In 2009, we recognized a benefit from income taxes of \$3.4 million upon the release of a tax valuation allowance as a result of the acquisition of Hermes.

**Liquidity and capital resources***Sources of liquidity*

We have financed our operations to date primarily through private placements of our convertible preferred stock, collaborations and, to a lesser extent, through government grants, the monetization of tax credits and equipment lease financings. Through December 31, 2011, we have received \$268.2 million from the sale of convertible preferred stock and warrants and \$133.4 million of upfront license fees, milestone payments, reimbursement of research and development costs and manufacturing services and other payments from our collaborations.

As of December 31, 2011, we had consolidated cash and cash equivalents of approximately \$50.5 million, of which \$2.1 million related to the cash and cash equivalents held by our majority owned subsidiary, Silver Creek, which is consolidated for financial reporting purposes and is designated for the operations of Silver Creek.

On March 28, 2012, we signed an underwriting agreement and agreed to pricing terms on an initial public offering of 14,300,000 shares of common stock at a price of \$7.00 per share, which is expected to generate net proceeds of approximately \$93.5 million. We expect this transaction to close on April 3, 2012.

We have received payment of a \$5.0 million milestone under our license and collaboration agreement with Sanofi in the first quarter of 2012.

We made a \$1.5 million payment under our collaboration agreement with Adimab during the first quarter of 2012. We made a \$5.0 million milestone payment under our license agreement with PharmaEngine during the first quarter of 2012.

We primarily invest cash and cash equivalents in money market funds backed by the U.S. treasury and U.S. federal agencies.

*Cash flows*

The following table provides information regarding our cash flows for the years ended December 31, 2009, 2010 and 2011.

(in thousands)	Year ended December 31,		
	2009	2010	2011
Cash provided by (used in) operating activities	\$ 19,055	\$ (26,369)	\$ (52,817)
Cash used in investing activities	(4,851)	(4,900)	(3,747)
Cash (used in) provided by financing activities	(791)	3,595	76,305
Net increase (decrease) in cash and cash equivalents	\$ 13,413	\$ (27,674)	\$ 19,741

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*Operating activities*

Cash provided by operating activities of \$19.1 million during the year ended December 31, 2009 was primarily a result of our \$49.1 million net loss, partially offset by non-cash items of \$7.2 million, changes in operating assets and liabilities of \$0.9 million and receipt of \$60 million upfront payment under the collaboration agreement with Sanofi. Cash used in operating activities of \$26.4 million during the year ended December 31, 2010 was primarily a result of our \$50.2 million net loss, partially offset by non-cash items of \$11.7 million, changes in operating assets and liabilities of \$2.1 million and receipt of \$10.0 million milestone payment under the collaboration agreement with Sanofi. Cash used in operating activities of \$52.8 million during the year ended December 31, 2011 was primarily a result of our net loss of \$79.7 million partially offset by non-cash items of \$12.4 million, changes in operating assets and liabilities of \$4.4 million and receipt of a \$10.0 million milestone payment under the collaborative agreement with Sanofi.

*Investing activities*

Investing activities used cash of \$4.9 million for both the years ended December 31, 2009 and 2010 and used cash of \$3.7 million for the year ended December 31, 2011. Cash used in investing activities during 2009, 2010 and 2011 was primarily due to the purchase of plant, property and equipment.

*Financing activities*

Financing activities used cash of \$0.8 million for the year ended December 31, 2009, and provided cash of \$3.6 million and \$78.3 million for the years ended December 31, 2010 and 2011, respectively. Cash used in financing activities of \$0.8 million during 2009 was primarily a result of payment of capital leases of \$1.0 million. Cash provided by financing activities of \$3.6 million during 2010 was primarily a result of proceeds received by Silver Creek for the issuance of convertible preferred stock of \$4.2 million, partially offset by the payment of capital leases of \$0.9 million. Cash provided by financing activities of \$76.3 million for the year ended December 31, 2011 was primarily a result of \$76.9 million of proceeds received from the series G convertible preferred stock financing, net of offering costs, \$1.7 million of proceeds from the issuance of common stock from the exercise of warrants and stock options, partially offset by deferred financing costs of \$1.9 million and the payment of capital leases of \$0.4 million.

*Funding requirements*

As of December 31, 2011, we had cash and cash equivalents of \$50.5 million. Our capital resources as of December 31, 2011 are not sufficient to fund our planned operations for a twelve month period, and therefore, raise substantial doubt about our ability to continue as a going concern. We will, during 2012, require significant additional funding to continue our operations. On March 28, 2012, we signed an underwriting agreement and agreed to pricing terms on an initial public offering of 14,300,000 shares of common stock at a price of \$7.00 per share, which is expected to raise net proceeds of approximately \$93.5 million. We expect the offering to close on April 3, 2012 and the related net proceeds is expected to address the substantial doubt about our ability to continue as a going concern through 2012.

We have not completed development of any therapeutic products or companion diagnostics. We expect to continue to incur significant expenses and increasing operating losses for at least the next several years. We anticipate that our expenses will increase substantially as we:

initiate or continue our clinical trials of our five most advanced product candidates;

continue the research and development of our other product candidates;

seek to discover additional product candidates;

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seek regulatory approvals for our product candidates that successfully complete clinical trials;

establish a sales, marketing and distribution infrastructure and scale up manufacturing capabilities to commercialize products for which we may obtain regulatory approval; and

add operational, financial and management information systems and personnel, including personnel to support our product development and planned commercialization efforts.

We expect that the net proceeds from our initial public offering, together with our existing cash and cash equivalents, anticipated interest income and anticipated milestone payments and research and development and manufacturing funding under our collaboration with Sanofi related to MM-121, will enable us to fund our operating expenses and capital expenditure requirements into the second half of 2013. We have based this estimate on assumptions that may prove to be wrong, and we could use our available capital resources sooner than we currently expect. Because of the numerous risks and uncertainties associated with the development and commercialization of our product candidates, and the extent to which we enter into collaborations with third parties to participate in their development and commercialization, we are unable to estimate the amounts of increased capital outlays and operating expenditures associated with our current and anticipated clinical trials. Our future capital requirements will depend on many factors, including:

the progress and results of the clinical trials of our five most advanced product candidates;

the success of our collaborations with Sanofi related to MM-121 and PharmaEngine related to MM-398;

the scope, progress, results and costs of preclinical development, laboratory testing and clinical trials for our other product candidates;

the costs, timing and outcome of regulatory review of our product candidates;

the costs of commercialization activities, including product sales, marketing, manufacturing and distribution;

the costs of preparing, filing and prosecuting patent applications and maintaining, enforcing and defending intellectual property-related claims;

the extent to which we acquire or invest in businesses, products and technologies; and

our ability to establish and maintain additional collaborations on favorable terms, particularly marketing and distribution arrangements for oncology product candidates outside the United States and Europe.

Until such time, if ever, as we can generate substantial product revenues, we expect to finance our cash needs through a combination of equity offerings, debt financings, collaborations, strategic alliances, licensing arrangements and other marketing and distribution arrangements. We do not have any committed external sources of funds, other than our collaboration with Sanofi, which is terminable by Sanofi for convenience upon 180 days' prior written notice. To the extent that we raise additional capital through the sale of equity or convertible debt securities, the ownership interest of our stockholders will be diluted, and the terms of these securities may include liquidation or other preferences that adversely affect your rights as a stockholder. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take specific actions, such as incurring additional debt, making capital expenditures or declaring dividends. If we raise additional funds through marketing and distribution arrangements or other collaborations, strategic alliances or licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies, future revenue streams, research programs or product candidates or to grant licenses on terms that may not be favorable to us. If we are unable to raise additional funds through equity or debt

financings when needed, we may be required to delay, limit, reduce or terminate our product development or

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commercialization efforts or grant rights to develop and market product candidates that we would otherwise prefer to develop and market ourselves.

**Contractual obligations and commitments**

The following table summarizes our contractual obligations as of December 31, 2011:

(in thousands)	Total	Less than 1 year	1 to 3 years	3 to 5 years	More than 5 years
Capital lease obligations(1)	\$ 49	\$ 49	\$	\$	\$
Operating lease obligations(2)	6,693	2,899	3,312	482	
License and collaboration, antibody and technology licensing costs(3)(4)(5)(6)	625	180	230	215	
Total contractual cash obligations	\$ 7,367	\$ 3,128	\$ 3,542	\$ 697	\$

- (1) Capital lease obligations include obligated interest payments.
- (2) Operating lease obligations do not include the costs associated with an amendment to our existing office, laboratory and manufacturing space lease, which was executed during the first quarter of 2012. This amendment increases operating lease obligations by approximately \$2.8 million in the aggregate over the next seven years.
- (3) License and collaboration, antibody and technology licensing costs include a €50,000 milestone payment related to an agreement with Selexis SA to be paid in the second quarter of 2012. License and collaboration, antibody and technology licensing costs also include costs under license agreements with The Regents of the University of California, which include annual license maintenance fee payments of \$20,000 and \$95,000 estimated to be paid from 2012 through 2015 and a minimum annual royalty payment of \$100,000 estimated to be paid in 2015. We have not included annual license maintenance fees or minimum royalty payments after December 31, 2015, as we cannot estimate if they will occur.
- (4) License and collaboration, antibody and technology licensing costs do not include a payment under our collaboration agreement with Adimab LLC for \$1.5 million, which became payable and we paid during the first quarter of 2012.
- (5) License and collaboration, antibody and technology licensing costs do not include antibody discovery efforts performed by a third party of \$400,000, which became payable in the first quarter of 2012. We expect to make this payment in the second quarter of 2012.
- (6) In May 2011, we entered into an agreement with PharmaEngine under which we reacquired previously licensed rights for MM-398 and made an upfront license payment to PharmaEngine of \$10.0 million. We made a \$5.0 million milestone payment to PharmaEngine in connection with dosing the first patient in our Phase 3 clinical trial of MM-398, which occurred and was paid in the first quarter of 2012. This \$5.0 million milestone payment has not been included in the above table, as the payment obligation was triggered in 2012. We may be required to make up to an aggregate of \$75.0 million in additional development and regulatory milestone payments and \$130.0 million in additional sales milestone payments upon the achievement of specified development, regulatory and annual net sales milestones. We cannot estimate if or when these milestone payments will occur. PharmaEngine is also entitled to tiered royalties on net sales of MM-398 in Europe and certain countries in Asia. The royalty rates under the agreement range from high single digits up to the low teens as a percentage of our net sales of MM-398 in these territories. We cannot estimate if or when these royalties will occur.

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We are required to pay the holders of series B convertible preferred stock cash dividends of approximately \$4.3 million upon the closing of our initial public offering.

Expenditures to contract research organizations represent a significant cost in clinical development. However, our contracts with these research organizations are cancellable at our option upon short notice and do not have cancellation penalties. Therefore, payments to contract research organizations have not been included in the above table.

In January 2010, we received \$1.5 million of tax incentives from the Massachusetts Life Sciences Center, or MLSC, an independent agency of the Commonwealth of Massachusetts, which allowed us to monetize approximately \$1.4 million of state research and development tax credits. In exchange for these incentives, we pledged to hire 50 employees and to maintain the additional headcount through at least December 31, 2014. Failure to do so could result in our being required to repay a portion of these incentives. This contingent obligation has not been included in the above table as we cannot estimate if or when it will become payable.

In January 2011, we received \$1.3 million of tax incentives from the MLSC, which allowed us to monetize approximately \$1.2 million of state research and development tax credits. In exchange for these incentives, we pledged to hire 50 employees and to maintain the additional headcount through at least December 31, 2015. Failure to do so could result in our being required to repay these incentives. This contingent obligation has not been included in the above table as we cannot estimate if or when it will become payable.

Other than the specific payments noted in the table and as described above, milestone and royalty payments associated with antibody licensing, manufacturing technology licensing costs and other in-licensed collaboration payments have not been included in the above table as management cannot reasonably estimate if or when they will occur. These arrangements include the following:

Under a collaboration agreement with Dyax Corp., or Dyax, related to antibody identification and evaluation, we are required to make aggregate development and regulatory milestone payments of up to \$16.2 million for therapeutic products and aggregate regulatory milestone payments of up to \$1.0 million for diagnostic products directed to selected targets. We also are required to pay mid single digit royalties on net sales of licensed products.

Under license agreements with The Regents of the University of California, we are required to make aggregate development and regulatory milestone payments of up to \$1.4 million associated with MM-111 and MM-302 and pay royalties in the low single digits on net sales of licensed products.

In addition to the amounts included in the table above payable to Adimab LLC, we are required to make aggregate development and regulatory milestone payments of up to \$52.5 million related to therapeutic antibody licensing costs associated with MM-151 and pay mid single digit royalties on net sales of licensed products.

Under a license agreement with the U.S. Public Health Service, a division of the U.S. Department of Health and Human Services, we are required to make aggregate development and regulatory milestone payments of up to \$6.0 million, per therapeutic licensed product, related to ErbB3 receptor patents associated with MM-121 and MM-111, and pay royalties in the low single digits on net sales of licensed products. The term of the agreement extends until the expiration of the licensed patent rights, which is 2016.

Under an agreement with Selexis SA, we are required to make aggregate milestone payments of up to €1.0 million, per licensed product, related to the manufacturing of all of our clinical programs, with the exception MM-398, and royalties of less than one percent on net sales of licensed products.

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Milestone and royalty payments that we may be required to make to Dyax, the U.S. Public Health Service and Selexis SA related to MM-121 are fully reimbursed by Sanofi under the terms of our license and collaboration agreement. Sanofi is then entitled to deduct 50% of any amount reimbursed against future royalty payments that Sanofi may be required to make to us.

**Off-balance sheet arrangements**

We did not have during the periods presented, and we do not currently have, any off-balance sheet arrangements, as defined under SEC rules.

**Tax loss carryforwards**

As of December 31, 2011, we had federal net operating loss carryforwards of \$108.3 million and state net operating loss carryforwards of \$65.7 million, which began to expire in 2012. As of December 31, 2011, we had federal research and development and investment tax credit carryforwards of \$11.1 million and state research and development and investment tax credit carryforwards of \$3.5 million, which also began to expire in 2012. Management has evaluated the positive and negative evidence bearing upon the realizability of our deferred tax assets and determined that it is more likely than not we will not recognize the benefits of federal and state deferred tax assets. As a result, we have established a valuation allowance of \$103.9 million as of December 31, 2010 and \$132.7 million as December 31, 2011. Our ability to use our net operating loss carryforwards and research and development credit carryforwards to offset future taxable income may be subject to a substantial annual limitation under Section 382 of the Internal Revenue Code due to ownership changes that have occurred previously or that could occur in the future. Ownership changes, as defined in Section 382 of the Internal Revenue Code, limit the amount of net operating loss carryforwards and research and development credit carryforwards we can use each year to offset future taxable income and taxes payable. We have not performed a complete study to determine whether an ownership change has occurred or the limit on the future use of our net operating loss carryforwards or research and development credit carryforwards. Any such limitation would reduce our gross deferred tax asset.

**Modification of warrants to purchase common stock held by a related party**

In August 2010, we modified warrants held by a related party stockholder to purchase 2,596,000 shares of our common stock to extend the expiration dates by four years and increase the exercise prices from \$2.12 and \$2.47 to \$3.00 per share. We valued the modification using a Black-Scholes option valuation model and accounted for the \$1,803,000 of incremental value within the equity section of the accompanying balance sheets as a capital transaction.

**Recent accounting pronouncements**

In September 2011, the FASB amended the authoritative guidance regarding the testing for goodwill impairment. Under the amendments, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value reporting of a reporting unit is less than the carrying amount, then performing the two-step impairment test is unnecessary. The changes are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, however, early adoption is permitted. We adopted this authoritative guidance on January 1, 2012 with no impact.

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**Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to market risk related to changes in interest rates. Our current investment policy is to invest our cash in a variety of financial instruments, principally deposits, securities issued by the U.S. government and its agencies and money market instruments. The goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and investments. We also seek to maximize income from our investments without assuming significant risk.

Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of interest rates, particularly because our investments are in short-term marketable securities. Due to the short-term duration of our investment portfolio and the low risk profile of our investments, an immediate 10.0% change in interest rates would not have a material effect on the fair market value of our portfolio. Accordingly, we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our investment portfolio.

We do not believe that our cash, cash equivalents and available-for-sale investments have significant risk of default or illiquidity. While we believe our cash, cash equivalents and available-for-sale investments do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits.

**Item 8. Financial Statements and Supplementary Data**

Our consolidated financial statements, together with the report of our independent registered public accounting firm, appear on pages F-1 through F-37 of this Annual Report on Form 10-K.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2011. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of December 31, 2011, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

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**Management's Annual Report on Internal Control Over Financial Reporting**

This Annual Report on Form 10-K does not include a report of management's assessment regarding internal control over financial reporting or an attestation report of our independent registered public accounting firm due to a transition period established by rules of the SEC for newly public companies.

**Changes in Internal Control Over Financial Reporting**

No change in our internal control over financial reporting occurred during the three months ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

Table of Contents**PART III****Item 10. Directors, Executive Officers and Corporate Governance****Directors and Executive Officers**

The following table sets forth the name, age and position of each of our executive officers and directors as of February 29, 2012.

<b>Name</b>	<b>Age</b>	<b>Position</b>
Robert J. Mulroy(4)	47	President, Chief Executive Officer and Director
Fazal R. Khan, Ph.D.	62	Senior Vice President of Manufacturing
William M. McClements	48	Senior Vice President of Corporate Operations
Ulrik B. Nielsen, Ph.D.	39	Senior Vice President and Chief Scientific Officer
Clet M. Niyikiza, Ph.D.	53	Executive Vice President of Development
Edward J. Stewart	41	Senior Vice President and President, Merrimack Healthcare Solutions
William A. Sullivan	40	Chief Financial Officer and Treasurer
Gary L. Crocker(2)(4)	60	Chairman of the Board of Directors
James van B. Dresser(1)	70	Director
Gordon J. Fehr(1)(3)	78	Director
Robert C. Gay, Ph.D.(2)	60	Director
Walter M. Lovenberg, Ph.D.(3)	77	Director
Sarah E. Nash(1)	58	Director
Michael E. Porter, Ph.D.(4)	64	Director
Anthony J. Sinskey, Sc.D.(3)	71	Director

- (1) Member of the audit committee.
- (2) Member of the corporate governance and nominating committee.
- (3) Member of the organization and compensation committee.
- (4) Member of the executive committee.

*Robert J. Mulroy* has served as our President and Chief Executive Officer and a member of our board of directors since May 1999. Prior to joining us, Mr. Mulroy worked as a management consultant in the pharmaceutical and healthcare industries. Mr. Mulroy has also worked as a consultant in the field of international development and has served as an advisor to multiple start-up companies in the biotechnology industry. Mr. Mulroy holds a master's degree in public and private management from Yale University and a B.A. from Stanford University. We believe that Mr. Mulroy is qualified to serve on our board of directors because of his extensive executive leadership experience, many years of service as one of our directors and our President and Chief Executive Officer and extensive knowledge of our company and industry.

*Fazal R. Khan, Ph.D.* has served as our Senior Vice President of Manufacturing since April 2006. Prior to joining us, Dr. Khan served as Vice President of Manufacturing for Collective Therapeutics, Inc., Vice President of Manufacturing Operations at Human Genome Sciences and Director of Biopharmaceuticals Development and Manufacturing at Hoffmann-LaRoche, Inc. Dr. Khan holds a Ph.D. and an M.S. in biochemistry and a B.S. in biology from Aligarh University in India.

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*William M. McClements* has served as our Senior Vice President of Corporate Operations since September 2011. Previously, Mr. McClements served as Chief Human Resources Officer of Integreon Managed Solutions, Inc., a global research and business services company, from May 2010 to September 2011. Prior to that, Mr. McClements served as Chief Operating Officer and a partner at Monitor Group, a global strategic advisory firm, where he worked from 1987 to May 2010. From September 2009 to March 2010, Mr. McClements also served as Acting President of Be the Change Inc., a non-profit focused on creating national issue-based campaigns. Mr. McClements holds an M.B.A. from Harvard University and a B.A. from Williams College.

*Ulrik B. Nielsen, Ph.D.* has served as our Senior Vice President and Chief Scientific Officer since March 2009. Dr. Nielsen has also served as President and Chief Executive Officer and as a member of the board of directors of Silver Creek Pharmaceuticals, Inc., since July 2010. Dr. Nielsen was one of our co-founders and has been leading our research and drug discovery since March 2002, first as our Director of Research from March 2002 to December 2004 and then as our Vice President of Research from January 2005 to February 2009. Prior to joining us, Dr. Nielsen was a post-doctoral fellow at The Massachusetts Institute of Technology, or MIT, where he researched the interface among biology, engineering and computational biology. Dr. Nielsen holds a Ph.D. in molecular biology and an M.S. in biochemistry from the University of Copenhagen.

*Clet M. Niyikiza, Ph.D.* has served as our Executive Vice President of Development since February 2010. Dr. Niyikiza served as our Senior Vice President of Product Development from July 2009 to February 2010. Previously, Dr. Niyikiza served as Vice President and Medicine Development Leader at GlaxoSmithKline, overseeing product development and global anti-cancer medicine development strategy, from 2005 to July 2009. Prior to that, Dr. Niyikiza held multiple high level positions at Eli Lilly and Company, where he ultimately led the oncology translational and applied genomics research division. Dr. Niyikiza holds a Ph.D. in mathematical sciences and an M.A. in mathematics from Indiana University.

*Edward J. Stewart* has served as our Senior Vice President and President, Merrimack Healthcare Solutions, since December 2011. Mr. Stewart served as our Director of Business Development from August 2001 to July 2006, as our Senior Director of Business Development from August 2006 to July 2007, as our Vice President of Business Development from July 2007 to March 2009 and as our Senior Vice President of Business Development from March 2009 to December 2011. Mr. Stewart began his career at KPMG Peat Marwick LLP in the life sciences strategy consulting group. Mr. Stewart holds an M.B.A. from the Johnson Graduate School of Management at Cornell University and a B.S. in biology from Bates College.

*William A. Sullivan* has served as our Chief Financial Officer since May 2011 and our Treasurer since February 2010. Mr. Sullivan served as our Controller from November 2007 to February 2010 and our Vice President of Finance from February 2010 to May 2011. Previously, Mr. Sullivan served as Corporate Controller of Vette Corp., a thermal management solutions company, from October 2004 to November 2007. Mr. Sullivan began his career at Arthur Andersen LLP, where he obtained his certified public accountant license. Mr. Sullivan holds an M.B.A. and an M.S. in accounting from Northeastern University's Graduate School of Professional Accounting and a B.A. in economics from Williams College.

*Gary L. Crocker* has served as a member of our board of directors since 2004 and as chairman of our board of directors since 2005. Mr. Crocker is President, Manager and Chairman of Crocker Ventures, LLC, a privately-held life science investment firm funding differentiated technologies in the areas of biotechnology and medical devices. Mr. Crocker has held senior executive positions or served on the board of directors of several privately-held life science companies, including as chairman of the board of ARUP Laboratories, co-founder and director of Theratech, Inc., President and Chief Executive Officer, founder and member of the board of directors of Research Medical, Inc. and as a

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member of the board of directors of Interleuken Genetics, Inc., The Med-Design Corporation and LineaGen Genetics, LLC. Mr. Crocker served as a member of the board of the Federal Reserve Branch of San Francisco from 1999 to 2007. Mr. Crocker also serves as a member of the board of directors of Sorenson Legacy Foundation. Mr. Crocker holds an M.B.A. and a B.S. in economics from Harvard University. We believe that Mr. Crocker is qualified to serve on our board of directors due to his experience in the life sciences industry as an entrepreneur, venture capitalist and executive and his service on the boards of directors of a range of public and private companies and government institutions, as well as his ability to provide us with his expertise in diagnostics and therapeutic development.

*James van B. Dresser* has served as a member of our board of directors since 1999. From 1970 until his retirement in 1997, Mr. Dresser held various consulting and leadership positions at The Boston Consulting Group, including serving as the firm's first Chief Administrative Officer from 1982 to 1997. Mr. Dresser served on the Board of Trustees of Wesleyan University from 1990 until 1993 and again from 1995 until 2009, when he also served as the chairman of the Board of Trustees. Mr. Dresser currently serves as a selectman for the Town of Salisbury, Connecticut. Mr. Dresser holds an M.B.A. from Harvard University, an M.A. from the Fletcher School of Law and Diplomacy at Tufts University and a B.A. from Wesleyan University. We believe that Mr. Dresser is qualified to serve on our board of directors due to his background and experience in business and organizational strategy, both as a consultant for and the chief administrative officer of a global management consulting firm and his prior board service.

*Gordon J. Fehr* has served as a member of our board of directors since 1999. Mr. Fehr recently retired from the board of directors of the Research Institute of McGill University Health Centers, where he served from 1996 to October 2011. In 1963, Mr. Fehr joined Pfizer Canada, Inc., or Pfizer Canada, as the Assistant to the President of Pfizer Canada and later became Pfizer Canada's Controller and the General Manager of the Chemical Division. In 1972, Mr. Fehr was named Chairman and President of Pfizer Canada, a position he held until his retirement in 1994. Mr. Fehr served as a member of the board of directors of Labopharm, Inc. from 1998 to 2007. Mr. Fehr also served as President and Chairman of the Montreal Board of Trade from 1983 to 1984 and as a member of the board of directors of the Montreal Airport Authority from 1992 to 2002. In addition, Mr. Fehr has served on advisory boards for the National Research Council's Biotechnology Research Institute and the Montreal Center of Innovative Technology, where he was Chairman of the biotechnology committee. Mr. Fehr holds a B.Eng. in chemical engineering from McGill University. We believe that Mr. Fehr is qualified to serve on our board of directors due to his expertise in the commercialization of pharmaceuticals, his leadership and management experience from his service as an executive for a public pharmaceutical company and his knowledge of our business and industry.

*Robert C. Gay, Ph.D.* has served as a member of our board of directors since 2007. Dr. Gay currently is a Managing Director and the Chief Executive Officer of Huntsman Gay Global Capital, a private equity firm, which he co-founded in 2008. From 2004 to 2007, Dr. Gay served as a Mission President for the Church of Jesus Christ of Latter-day Saints in Ghana. From 1989 to 2004, Dr. Gay was a Managing Director of Bain Capital. Prior to that, Dr. Gay served as an Executive Vice President of General Electric Credit Corporation Capital Markets Group. Dr. Gay serves on the board of directors of The Gymboree Corporation and Sunquest Information Systems, Inc. and serves as vice chairman of the board of directors of ICON Health & Fitness, Inc. Dr. Gay holds a Ph.D. in business economics from Harvard Business School and an A.B. from the University of Utah. We believe that Dr. Gay is qualified to serve on our board of directors due to his educational qualifications and his broad industry experience in business management, financing and development, as well as the unique perspective he brings from the range of executive positions and directorships that he has held and currently holds.

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*Walter M. Lovenberg, Ph.D.* has served as a member of our board of directors since 2000. Dr. Lovenberg is the President of Lovenberg Associates, Inc., a privately-held corporation, a position he has held since 1993 and is also the current acting Chief Executive Officer and a director of Quantum Bio, Inc. Dr. Lovenberg served on the board of directors of OSI Pharmaceuticals, Inc. from 1994 until 2008 and as the chairman of the board of directors of Inflazyme Pharmaceuticals from 1996 until 2006. Dr. Lovenberg served as Executive Vice President and a member of the board of directors of Marion Merrell Dow, Inc. from 1989 until 1993. Dr. Lovenberg served as Chief of the section of Biochemical Pharmacology at the National Institutes of Health from 1968 to 1985. Dr. Lovenberg holds a Ph.D. from the George Washington University School of Medicine and Health Sciences and an M.S. in agricultural biochemistry and a B.S. in agriculture from Rutgers University. We believe that Dr. Lovenberg is qualified to serve on our board of directors due to his expertise and experience in drug discovery, development and management, his experience leading global research and development efforts, and his service on the board of directors at several pharmaceutical companies.

*Sarah E. Nash* has served as a member of our board of directors since 2006. Ms. Nash also currently serves on the boards of directors of Knoll Inc. and Blackbaud Inc. From 2000 until her retirement in 2005, Ms. Nash served as vice chairman of JPMorgan Chase & Co.'s Investment Bank where she was responsible for the firm's client relationships. Prior to that, Ms. Nash was the Regional Executive and Co-Head of Investment Banking for North America at JPMorgan Chase & Co. Previously, Ms. Nash served on the board of directors of Pathmark Stores, Inc. from 2005 to 2009 and AbitibiBowater from 2010 to 2011. Ms. Nash also serves as a Trustee for the New York-Presbyterian Hospital, a Trustee of Washington and Lee University and on the boards of The New York Historical Society, The New York Restoration Project and the Business Leadership Council of The City University of New York. Ms. Nash holds a B.A. from Vassar College. We believe that Ms. Nash is qualified to serve on our board of directors due to her financial expertise, her experience serving on the boards of other public and private companies and her management background as an executive in the financial services industry.

*Michael E. Porter, Ph.D.* has served as a member of our board of directors since December 2010 and has been a strategy advisor to us since 1999. Dr. Porter is the Bishop William Lawrence University Professor at Harvard Business School and has been on the faculty at Harvard Business School since 1973. Dr. Porter also serves on the boards of directors of Parametric Technology Corporation and Thermo Fisher Scientific Inc. Dr. Porter has written extensively on healthcare delivery and has worked with leading healthcare providers in multiple countries and with government leaders on healthcare policy issues. Dr. Porter holds a Ph.D. in business economics from Harvard University, an M.B.A. from Harvard Business School and a B.S.E. in aerospace and mechanical engineering from Princeton University. We believe that Dr. Porter is qualified to serve on our board of directors due to his expertise in corporate strategy, healthcare delivery and the development of companies in the life sciences industry, as well as his experience as an advisor and consultant to many leading companies globally, including a range of healthcare and pharmaceutical companies.

*Anthony J. Sinskey, Sc.D.* has served as a member of our board of directors since 1999 and is one of our co-founders. Dr. Sinskey is a Professor of Microbiology and Engineering Systems at MIT and a Professor of Health Sciences and Technology at the Harvard-MIT Division of Health Sciences and Technology, and he has been a member of the faculty at MIT since 1968. Dr. Sinskey also holds positions as Co-Director of the Malaysia-MIT Biotechnology Partnership Program and as Faculty Director of the Center for Biomedical Innovation. Dr. Sinskey is a co-founder and a member of the boards of directors of Metabolix, Inc. and Tepha, Inc. and a consultant to several chemical and biotechnology companies. Dr. Sinskey received an Sc.D. from MIT and a B.S. from the University of Illinois, and he was a post-doctoral fellow at the Harvard School of Public Health. We believe that Dr. Sinskey is qualified to serve on our board of directors due to his experience in the startup and

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development of other pharmaceutical companies, his scientific expertise in the field of biology and his leadership experience gained from serving as a director of several pharmaceutical companies.

**Family Relationships**

There are no family relationships among any of our directors or executive officers.

**Section 16(a) Beneficial Ownership Reporting Compliance**

We did not have a class of securities registered pursuant to Section 12 of the Exchange Act in 2011.

**Code of Business Conduct and Ethics**

We have adopted a written code of business conduct and ethics that applies to our directors, officers and employees, including our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. A current copy of the code is posted on the "Corporate Governance" section of our website, which is located at [www.merrimackpharma.com](http://www.merrimackpharma.com). In addition, we intend to post on our website all disclosures that are required by law, the rules of the SEC or NASDAQ stock market listing standards concerning any amendments to, or waivers from, any provision of the code.

**Board Committees**

Our board of directors has established an audit committee, a corporate governance and nominating committee, an organization and compensation committee and an executive committee, each of which operates under a charter that has been approved by our board.

Our board of directors has determined that all of the members of the audit committee, the corporate governance and nominating committee and the organization and compensation committee are independent as defined under The NASDAQ Marketplace Rules, including, in the case of all the members of our audit committee, the independence requirements contemplated by Rule 10A-3 under the Exchange Act.

***Audit committee***

The members of our audit committee are Mr. Dresser, Mr. Fehr and Ms. Nash. Ms. Nash chairs the audit committee. Our audit committee's responsibilities include:

appointing, approving the compensation of, and assessing the independence of our registered public accounting firm;

overseeing the work of our independent registered public accounting firm, including through the receipt and consideration of reports from such firm;

reviewing and discussing with management and the independent registered public accounting firm our annual and quarterly financial statements and related disclosures;

monitoring our internal control over financial reporting, disclosure controls and procedures and code of business conduct and ethics;

overseeing our internal audit function;

overseeing our risk assessment and risk management policies;



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establishing policies regarding hiring employees from the independent registered public accounting firm and procedures for the receipt and retention of accounting-related complaints and concerns;

meeting independently with our internal auditing staff, registered public accounting firm and management;

reviewing and approving or ratifying any related person transactions; and

preparing the audit committee report required by SEC rules.

All audit and non-audit services, other than *de minimis* non-audit services, to be provided to us by our independent registered public accounting firm must be approved in advance by our audit committee.

Our board of directors has determined that Mr. Fehr is an "audit committee financial expert" as defined in applicable SEC rules. We believe that the composition of our audit committee meets the requirements for independence under the current NASDAQ Marketplace and SEC rules and regulations.

***Corporate governance and nominating committee***

The members of our corporate governance and nominating committee are Mr. Crocker and Dr. Gay. Dr. Gay chairs the corporate governance and nominating committee. Our corporate governance and nominating committee's responsibilities include:

identifying individuals qualified to become members of our board;

recommending to our board the persons to be nominated for election as directors and to each of our board's committees;

reviewing and making recommendations to our board with respect to our board leadership structure;

developing and recommending to our board corporate governance principles; and

overseeing an annual evaluation of our board.

***Organization and compensation committee***

The members of our organization and compensation committee are Mr. Fehr, Dr. Lovenberg and Dr. Sinskey. Mr. Fehr chairs the organization and compensation committee. Our organization and compensation committee's responsibilities include:

annually reviewing and approving corporate goals and objectives relevant to the compensation of our Chief Executive Officer and our other executive officers;

determining our Chief Executive Officer's compensation;

reviewing and approving, or making recommendations to our board with respect to, the compensation of our other executive officers;

overseeing an evaluation of our executive officers;

overseeing and administering our cash and equity incentive plans;

reviewing and making recommendations to our board with respect to director compensation;

reviewing and making recommendations to our board with respect to management succession planning;

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reviewing and discussing annually with management our "Compensation discussion and analysis" disclosure required by SEC rules; and

preparing the organization and compensation committee report required by SEC rules.

*Executive committee*

The members of our executive committee are Mr. Crocker, Mr. Mulroy and Dr. Porter. Mr. Crocker chairs the executive committee. Our executive committee has, and may exercise, when necessary, all of the authority and powers of our full board of directors during the intervals between meetings of our board, except as limited by Delaware law.

**Item 11. Executive Compensation**

**Compensation discussion and analysis**

*Overview*

This section discusses the principles underlying our policies and decisions with respect to the compensation of our executive officers and the most important factors relevant to an analysis of these policies and decisions. This section also describes the material elements of compensation awarded to, earned by or paid to each of our named executive officers for 2011. Our "named executive officers" for 2011 are Robert J. Mulroy, our President and Chief Executive Officer, William A. Sullivan, our Chief Financial Officer and Treasurer, and our three other most highly compensated executive officers, Fazal R. Khan, our Senior Vice President of Manufacturing, Ulrik B. Nielsen, our Senior Vice President and Chief Scientific Officer, and Clet M. Niyikiza, our Executive Vice President of Development. In addition, this section provides qualitative information regarding the manner and context in which compensation is awarded to and earned by our executive officers and is intended to place in perspective the data presented in the tables and narrative that follow.

Our organization and compensation committee oversees our policies governing the compensation for our executive officers. In this role, the organization and compensation committee reviews and approves all compensation decisions relating to our named executive officers. Our organization and compensation committee consists of three members of our board of directors, all of whom have extensive experience in our industry and each of whom is an independent director. Our organization and compensation committee uses its judgment and experience and has historically considered the recommendations of our President and Chief Executive Officer when determining the amount and appropriate mix of compensation for each of our executive officers. Specifically, our President and Chief Executive Officer provides input and recommendations, via an annual review of executive performance and otherwise, regarding salary adjustments, the corporate and individual goals used to determine annual performance-based cash bonuses and appropriate equity incentive compensation levels. Historically, our President and Chief Executive Officer has provided input to the organization and compensation committee on his own compensation, but has not had any control over setting the amount or mix of his compensation and is not present when the organization and compensation committee discusses his compensation.

The organization and compensation committee periodically evaluates the need for revisions to our executive compensation program to ensure our program is competitive with the companies with which we compete for executive talent.

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***Objectives and philosophy of our executive compensation program***

The primary objectives of the organization and compensation committee with respect to executive compensation are to:

attract, retain and motivate experienced and talented executives;

ensure executive compensation is aligned with our corporate strategies, research and development programs and business goals;

recognize the individual contributions of executives but foster a shared commitment among executives by aligning their individual goals with our corporate goals;

promote the achievement of key strategic, development and operational performance measures by linking compensation to the achievement of measurable corporate and individual performance goals; and

align the interests of our executives with our stockholders by rewarding performance that leads to the creation of stockholder value.

To achieve these objectives, the organization and compensation committee evaluates our executive compensation program with the goal of setting compensation at levels that are justifiable based on each executive's level of experience, performance and responsibility and that the committee believes are competitive with those of other companies in our industry and our region that compete with us for executive talent. In addition, our executive compensation program ties a portion of each executive's overall compensation to the achievement of key corporate and individual goals. We provide a portion of our executive compensation in the form of stock options that vest over time, which we believe helps to retain our executives and aligns their interests with those of our stockholders by allowing them to participate in the longer term success of our company as reflected in the appreciation of our stock price.

*Use of compensation consultants and market benchmarking*

Our organization and compensation committee considers publicly available compensation data for national and regional companies in the biotechnology industry to help guide its executive compensation decisions at the time of hiring and for subsequent adjustments in compensation. Historically, our organization and compensation committee has also retained the services of Mercer, LLC, or Mercer, an independent compensation consultant, to provide it with additional comparative data on executive compensation practices in our industry and to advise it on our executive compensation program generally. Although the organization and compensation committee considers Mercer's advice and recommendations about our executive compensation program, the organization and compensation committee ultimately makes its own decisions about these matters.

Mercer has in the past, most recently in 2010, provided our organization and compensation committee with comparative data showing where our total compensation and each element of our compensation rated among (1) both public and private companies in the biotechnology and life sciences industry generally, according to compensation data from the 2010 Radford Global Life Sciences Survey, and (2) a peer group of publicly traded companies in the life science industry at a stage of development, market capitalization or size comparable to ours with which the organization and

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compensation committee believes we compete against for executive talent. The companies included in this peer group in 2010 were:

Achillion Pharmaceuticals, Inc.	Ariad Pharmaceuticals, Inc.	Pharmasset, Inc.
Acorda Therapeutics, Inc.	Micromet, Inc.	Rigel Pharmaceuticals, Inc.
Affymax Inc.	Oculus Innovative Sciences	Targacept, Inc.
Allos Therapeutics, Inc.	Osiris Therapeutics, Inc.	Trubion Pharmaceuticals, Inc.

In addition, in May 2011, Mercer provided our organization and compensation committee with comparative data with respect to severance and change in control benefits among (1) both public and private companies in general and (2) an updated peer group of publicly traded companies in the life science industry at a stage of development, market capitalization or size comparable to ours with which the organization and compensation committee believes we compete against for executive talent. The companies included in this peer group in 2011 were:

Achillion Pharmaceuticals, Inc.	Exelixis, Inc.	Pharmasset, Inc.
Acorda Therapeutics, Inc.	Ironwood Pharmaceuticals, Inc.	Rigel Pharmaceuticals, Inc.
Allos Therapeutics, Inc.	Micromet, Inc.	Seattle Genetics, Inc.
Ariad Pharmaceuticals, Inc.	Osiris Therapeutics, Inc.	Targacept, Inc.
Aveo Pharmaceuticals, Inc.		

This peer group is subject to further change, and we expect that our organization and compensation committee will continue to periodically review and update the list. The changes made to the peer group between 2010 and 2011 consist of:

the removal of Affymax Inc. and Oculus Innovative Sciences, which our organization and compensation committee deemed to no longer have market capitalizations similar to ours as a result of our growth;

the removal of Trubion Pharmaceuticals, Inc., which was acquired in 2010;

the addition of Aveo Pharmaceuticals, Inc. and Ironwood Pharmaceuticals, Inc., which completed their initial public offerings in 2010; and

the addition of Exelixis, Inc. and Seattle Genetics, Inc., which our organization and compensation committee deemed to have market capitalizations and oncology pipelines similar to ours.

The peer groups are used for purposes of gathering data to compare against our existing executive compensation practices and for guiding future compensation decisions. Our compensation consultant also makes suggestions for changes to our executive compensation practices based on the data they provide to us as well as compensation trends in our industry. However, although the organization and compensation committee may consider peer group and other industry compensation data and the recommendations of our compensation consultant when making decisions related to executive compensation, to date, it has not made and does not intend to make adjustments to overall executive compensation or any element thereof solely or primarily either to target a specified threshold level of compensation or market benchmark within the peer group, our larger industry or some other group of comparable companies or to act on the recommendations of our compensation consultant.

#### *Annual compensation review process*

During the first calendar quarter of each year, we evaluate each executive's performance for the prior year. Our President and Chief Executive Officer, with respect to each executive other than himself, prepares a written evaluation based on his evaluation of the executive and input from others within our company. Our President and Chief Executive Officer also prepares his own self assessment.

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This process leads to a recommendation by our President and Chief Executive Officer to the organization and compensation committee with respect to each executive officer, including himself, as to:

the achievement of stated corporate and individual performance goals;

the level of contributions made to the general management and guidance of the company;

the need for salary increases;

the amount of bonuses to be paid; and

whether or not stock option awards should be made.

These recommendations are reviewed by the organization and compensation committee and taken into account when it makes a final determination on all such matters.

***Components of our executive compensation program***

The primary elements of our executive compensation program are:

base salary;

annual performance-based cash bonuses;

equity incentive awards;

broad-based health and welfare benefits; and

severance and change in control benefits.

We do not have a formal or informal policy for allocating between long-term and short-term compensation, between cash and non-cash compensation or among different forms of non-cash compensation. Instead, our organization and compensation committee, after reviewing information provided by our compensation consultant, and other relevant data, determines subjectively what it believes to be the appropriate level and mix of the various compensation components. We generally strive to provide our named executive officers with a balance of short-term and long-term incentives to encourage consistently strong performance. Ultimately, the objective in allocating between long-term and currently paid compensation is to ensure adequate base compensation to attract and retain personnel, while providing incentives to maximize long-term value for our company and our stockholders. Therefore, we provide cash compensation in the form of base salary to meet competitive salary norms and reward good performance on an annual basis and in the form of bonus compensation to incent and reward superior performance based on specific annual goals. To further focus our executives on longer-term performance and the creation of stockholder value, we rely upon equity-based awards that vest over a meaningful period of time. In addition, we provide our executives with benefits that are generally available to our salaried employees, including medical, dental, group life insurance, accidental death, dismemberment insurance, long and short term disability insurance, medical and dependent care flexible spending accounts, personal welfare reimbursement stipends and matching contributions in our 401(k) plan. Finally, we offer our executives severance benefits to incentivize them to continue to strive to achieve stockholder value in connection with change in control situations.

*Base salary*

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We use base salaries to recognize the experience, skills, knowledge and responsibilities of our employees, including our executive officers. Base salaries for our named executive officers typically are established through arm's length negotiation at the time the executive is hired, taking into account the position for which the executive is being considered and the executive's qualifications, prior experience

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and prior salary. None of our executive officers is currently party to an employment agreement that provides for automatic or scheduled increases in base salary. However, on an annual basis, our organization and compensation committee reviews and evaluates, with input from our President and Chief Executive Officer, the need for adjustment of the base salaries of our executives based on changes and expected changes in the scope of an executive's responsibilities, including promotions, the individual contributions made by and performance of the executive during the prior fiscal year, the executive's performance over a period of years, overall labor market conditions, the relative ease or difficulty of replacing the executive with a well-qualified person, our overall growth and development as a company and general salary trends in our industry and among our peer group and where the executive's salary falls in the salary range presented by that data. In making decisions regarding salary increases, we may also draw upon the experience of members of our board of directors with other companies. No formulaic base salary increases are provided to our named executive officers, and we do not target the base salaries of our named executive officers at a specified compensation level within our peer group or other market benchmark.

The following table sets forth the annual base salary for 2010 and 2011 for our named executive officers:

<b>Executive</b>	<b>2010 Base salary(1)</b>	<b>2011 Base salary(1)</b>
Robert J. Mulroy <i>President and Chief Executive Officer</i>	\$ 432,253	\$ 457,330
William A. Sullivan <i>Chief Financial Officer and Treasurer</i>	240,000	247,200
Fazal R. Khan <i>Senior Vice President of Manufacturing</i>	309,811	319,932
Ulrik B. Nielsen <i>Senior Vice President and Chief Scientific Officer</i>	287,370	302,940
Clet M. Niyikiza <i>Executive Vice President of Development</i>	329,892	341,651

- (1) The adjustments to the 2010 base salaries were effective February 1, 2010 (July 1, 2010 for Mr. Sullivan) and the adjustments to the 2011 base salaries were effective April 1, 2011.

For 2011, the organization and compensation committee determined to adjust the base salaries of each of our named executive officers based on their overall performance in 2010, their increased level of experience and, as a result of our continued growth in our industry, to ensure that their salaries remained competitive with those of similarly situated executives in our peer group.

We expect that, in the first half of 2012, the organization and compensation committee will evaluate whether to adjust the base salaries of each named executive officer for 2012.

*Annual performance-based cash bonus*

We have designed our annual performance-based cash bonus program to emphasize pay-for-performance and to reward our named executive officers for (1) the achievement of specified annual corporate objectives, (2) the achievement of specified annual individual performance objectives and (3) the achievement of specified objectives that support the overall management of the company and the creation of long-term value for our stockholders, which we refer to as the general management contribution. Each executive officer is eligible to receive an annual performance-based cash bonus,

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which we refer to as an annual cash bonus, in an amount up to a fixed percentage of his base salary, or bonus percentage, and each of the foregoing three elements is weighted equally in determining the percentage of the annual cash bonus that the executive will receive.

The annual corporate objectives component of the annual cash bonus focuses on the achievement of specific research, clinical, regulatory, operational and financial milestones. The corporate objectives are proposed by senior management each year in the company's annual operating plan that is reviewed and approved by our board of directors at its regularly scheduled meeting in the fourth quarter of our fiscal year, with such modifications as the board deems appropriate. The annual individual performance objectives component of the annual cash bonus focuses on contributions made by each individual executive officer within their respective areas of responsibility that facilitate the achievement of our corporate objectives. Each executive officer, including our President and Chief Executive Officer, proposes his own annual individual objectives prior to the start of the company's fiscal year relating to building our long-term capabilities, which are then reviewed and approved by the organization and compensation committee, with such modifications as the committee deems appropriate. Achievement of the corporate and individual objectives is measured on a successful/unsuccessful basis and proportionate achievement of a particular goal is not taken into account. Our organization and compensation committee has the authority to shift both corporate and individual goals to subsequent fiscal years and eliminate them from the current year's bonus calculation if it determines that circumstances that were beyond the control of the executive were the primary cause of a goal being unattainable. The corporate and individual objectives established by our board of directors and the organization and compensation committee are designed to require significant effort and operational success on the part of our executives and our company, but also to be achievable with hard work and dedication.

The general management contribution of each executive officer, including our President and Chief Executive Officer, is evaluated retrospectively by our President and Chief Executive Officer, who reports his findings to the organization and compensation committee. Historically, each executive has been evaluated on his contributions to the following areas:

the improvement of processes and efficiency;

the development of human and scientific capacity; and

the development and management of stakeholders, including partners, collaborators, investigators, stockholders and licensees.

Each executive's contributions are evaluated on a scale of 0 to 3, with 0 meaning that the executive made no contribution, 1 meaning that the executive's contributions were below expectations, 2 meaning that the executive's contributions met expectations and 3 meaning that the executive's contributions exceeded expectations. The executive's scores in each of the categories for the particular year are totaled and the ratio of the executive's score to the maximum number of points that the executive could have earned across all categories is used to determine what portion of this element of the annual cash bonus that the executive will earn. The organization and compensation committee reviews and has the authority to approve the evaluation prepared by our President and Chief Executive Officer or to adjust it in a manner that it sees fit. While this element of the annual cash bonus is inherently subjective in nature, we believe it is important to recognize the contributions made by our executives that do not appear in the operating plan, via objective individual goals or on our financial statements. These contributions may have an impact beyond the current fiscal year, and we believe that giving a partial weighting in the annual cash bonus calculation to these intangible contributions made by an executive is appropriate in light of our long-term goal of developing a motivated workforce and creating stockholder value.

The bonus percentages for each executive are set by the organization and compensation committee. The bonus percentages that are proposed by our organization and compensation committee

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are derived from peer group data that is adjusted to match the level of qualification and experience of the executive candidate, but are guided by our overarching "team-based" philosophy. Our organization and compensation committee believes that our executive officers should function as a team and that one way to foster a collaborative, team-based environment is to provide for each executive officer to have a similar bonus percentage.

Our organization and compensation committee has authority to, in its sole discretion, adjust the bonus percentage each year in connection with its review of the executive's performance and has authority to allow an executive to receive a bonus payment in excess of his or her annual cash bonus for exceptional performance. Further, our organization and compensation committee reviews the assessment of each executive's performance conducted by the organization and compensation committee with respect to the annual cash bonus and retains the authority, in its sole discretion, to modify the amount of the annual cash bonus above or below the amount recommended by the organization and compensation committee.

*2011 bonuses*

For 2011, Mr. Mulroy is eligible to receive an annual cash bonus of up to 50% of his 2011 base salary and each of Dr. Khan, Dr. Nielsen, Dr. Niyikiza and Mr. Sullivan are eligible to receive annual cash bonuses of up to 40% of their 2011 base salaries. The bonus percentages for our named executive officers for 2011 are the same as in 2010.

For 2011, the annual corporate objectives, which account for one-third of the annual cash bonus for each of our named executive officers, were as follows:

advance our five most advanced product candidates in clinical development;

implement and advance a diagnostic strategy in all clinical stage programs;

deliver three lead molecules that were designed using Network Biology into preclinical development;

expand the application and capabilities of Network Biology across therapeutic, diagnostic and technology applications; and

secure additional funding through financings and business development.

For 2011, the individual goals for each of our named executive officers account for one-third of their annual cash bonus. The individual goals for our named executive officers are primarily related to the corporate goals for which they are most responsible and, to a lesser extent, individual development goals or department specific goals.

Mr. Mulroy's individual objectives for 2011 related to developing a commercial strategy, securing a partner to support our diagnostic efforts, positioning us for additional subsidiaries based on Network Biology, completing a series G convertible preferred stock financing and preparing us for our initial public offering.

Mr. Sullivan's individual objectives for 2011 related to implementing an improved materials control system, preparing our operating plan for 2012, preparing us for our initial public offering and implementing the necessary public company reporting and other structures for after the completion of our initial public offering.

Mr. Khan's individual objectives for 2011 related to completing various manufacturing and process development milestones related to MM-398, MM-121, MM-111, MM-151 and MM-141.

Dr. Nielsen's individual objectives for 2011 related to advancing our preclinical product candidates, overseeing the organizational development and scientific advancement of Silver Creek and extending Network Biology into additional therapeutic fields.

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Dr. Niyikiza's individual objectives for 2011 related to the initiation and advancement of clinical trials of MM-398, MM-121, MM-111, MM-302 and MM-151 and gaining the support for our clinical strategies from our clinical advisory group.

We expect that, in the first half of 2012, the organization and compensation committee will evaluate the achievement of the 2011 corporate objectives, the achievement of the 2011 individual performance objectives and the general management contribution of each named executive officer for purposes of determining actual bonus amounts for our executive officers for 2011.

The following table sets forth each named executive officer's annual cash bonus eligibility (both as a percentage of annual base salary and in actual dollars). As disclosed above, notwithstanding the annual cash bonus assessment performed by the organization and compensation committee for each executive officer, our organization and compensation committee retains full discretion to adjust each executive officer's annual cash bonus beyond the amount calculated.

Name	2011 Base salary	Annual bonus percentage range	Target cash bonus
Robert J. Mulroy	\$ 457,330	0-50%	\$ 228,665
William A. Sullivan	247,200	0-40	98,880
Fazal R. Khan	319,932	0-40	127,973
Ulrik B. Nielsen	302,940	0-40	121,176
Clet M. Niyikiza	341,651	0-40	136,660

*Equity incentive awards*

Our equity award program is the primary vehicle for offering long-term incentives to our executives. While we do not currently have any equity ownership guidelines for our executives, we believe that equity grants provide our executives with a strong link to our long-term performance, create an ownership culture and help to align the interests of our executives and our stockholders. Because our executives profit from stock options only if our stock price increases relative to the stock option's exercise price, we believe stock options provide meaningful incentives to our executives to achieve increases in the value of our stock over time. In addition, the vesting feature of our equity grants contributes to executive retention by providing an incentive to our executives to remain employed by us during the vesting period. Prior to our initial public offering, our executives were eligible to participate in the 2008 plan and the 1999 plan. During 2011, all stock options were granted pursuant to the 2008 plan. Following the closing of our initial public offering, our employees and executives will be eligible to receive stock-based awards pursuant to the 2011 stock incentive plan, or the 2011 plan. Under the 2011 plan, executives will be eligible to receive grants of stock options, restricted stock, restricted stock units, stock appreciation rights and other stock-based equity awards at the discretion of our organization and compensation committee.

We use stock options to compensate our named executive officers both in the form of initial grants in connection with the commencement of employment and generally on an annual basis thereafter. Our organization and compensation committee may also make additional discretionary grants, typically in connection with the promotion of an employee, to reward an employee, for retention purposes or for other circumstances recommended by management. Typically, the stock options we grant to our executives vest quarterly over a three year period. Vesting and exercise rights cease shortly after termination of employment except in the case of death or disability. Prior to the exercise of an option, the holder has no rights as a stockholder with respect to the shares subject to such option, including voting rights or the right to receive dividends or dividend equivalents.

In determining the size of the annual stock option grants to our executives, our organization and compensation committee is guided by our overarching team-based philosophy. To help foster

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collaboration among our named executive officers, our organization and compensation committee has historically aimed to make equal annual grants of options to each executive officer. In determining the amount of the annual stock option grants, our organization and compensation committee considers recommendations developed by our compensation consultant, including information regarding comparative stock ownership and equity grants received by the executives in our peer group and our industry. In addition, our organization and compensation committee considers our corporate performance, the potential for enhancing the creation of value for our stockholders, the amount of equity previously awarded to the executives and the vesting of such awards.

We have historically granted stock options with exercise prices that are set at no less than the fair market value of shares of our common stock on the date of grant as determined by our organization and compensation committee with the assistance and recommendation of management, in good faith based on a number of objective and subjective factors, including contemplating valuations prepared by an external consultant. The exercise price of all stock options granted after the closing of our initial public offering will be equal to the fair market value of shares of our common stock on the date of grant, which generally will be determined by reference to the closing market price of our common stock on the date of grant. Following our initial public offering, we intend to grant equity awards annually.

*2011 grants*

In May 2011, as part of our annual grant process and consistent with our team-based approach, our organization and compensation committee granted an option to purchase 50,000 shares of our common stock to each of our named executive officers. In addition, in May 2011, our organization and compensation committee granted an option to purchase an additional 50,000 shares to each of Dr. Khan, Dr. Nielsen and Dr. Niyikiza, reflecting the balance of annual grants that we intended to make in December 2010 but could not grant at that time due to an insufficient number of authorized shares of common stock available for issuance under our 2008 plan. Each of these options vests quarterly over a three year period. The exercise price of each option grant is \$5.54, the fair market value of our common stock on the date of grant as determined by our organization and compensation committee.

*Benefits and other compensation*

We believe that establishing competitive benefit packages for our employees is an important factor in attracting and retaining highly qualified personnel. We maintain broad-based benefits that are provided to all employees, including medical, dental, group life insurance, accidental death, dismemberment insurance, long and short term disability insurance, medical and dependent care flexible spending accounts, personal welfare reimbursement stipends and matching contributions in our 401(k) plan. All of our executives are eligible to participate in all of our employee benefit plans, in each case on the same basis as other employees. Under our 401(k) plan, we are permitted to make discretionary contributions and matching contributions, subject to established limits and a vesting schedule. Currently, we match 50% of employee contributions up to a maximum contribution by us of 3% of the employee's salary. The match vests at 25% per year over four years. We also provide each employee, including our executives, with an annual \$1,250 work welfare stipend that can be used to pay for services such as personal professional development, public transportation passes, gym memberships and medical insurance co-pays. Our executives are also entitled to supplemental long-term disability insurance coverage that is not available to our other employees. We provide a tax-gross up payment to our executives to compensate them for the additional tax cost of receiving this benefit. Consistent with our compensation philosophy, we intend to continue to maintain our current benefits for our named executive officers. The organization and compensation committee in its discretion may revise, amend or add to the named executive officer's benefits and perquisites if it deems it advisable.

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In particular circumstances, we sometimes award cash signing bonuses when executives first join us. Such cash signing bonuses typically must be repaid in full if the executive voluntarily terminates employment with us prior to the first anniversary of the date of hire. Whether a signing bonus is paid and the amount of the bonus is determined on a case-by-case basis under the specific hiring circumstances. For example, we will consider paying signing bonuses to compensate for amounts forfeited by an executive upon terminating prior employment, to assist with relocation expenses or to create additional incentive for an executive to join our company in a position where there is high market demand.

*Severance and change in control benefits*

Pursuant to employment agreements we have entered into with our executives, our executives are entitled to specified benefits in the event of the termination of their employment under specified circumstances, including termination following a change in control of our company. Please refer to " Employment agreements" for a more detailed discussion of these benefits. We have provided estimates of the value of the severance payments made and other benefits provided to executives under various termination circumstances, under the caption " Potential payments upon termination or change in control" below.

We believe providing these benefits helps us compete for executive talent. After reviewing the practices of companies represented in the compensation peer group, we believe that our severance and change in control benefits are generally in line with severance packages offered to executives of the companies in our peer group.

We have structured our change in control benefits as "double trigger" benefits. In other words, the change in control does not itself trigger benefits. Rather, benefits are paid only if the employment of the executive is terminated during a specified period after the change in control. We believe a "double trigger" benefit maximizes stockholder value because it prevents an unintended windfall to executives in the event of a friendly change in control, while still providing them appropriate incentives to cooperate in negotiating any change in control in which they believe they may lose their jobs.

*Risk considerations in our compensation program*

Our organization and compensation committee has reviewed and evaluated the philosophy and standards on which our compensation plans have been developed and implemented across our company. It is our belief that our compensation programs do not encourage inappropriate actions or risk taking by our executive officers. We do not believe that any risks arising from our employee compensation policies and practices are reasonably likely to have a material adverse effect on our company. In addition, we do not believe that the mix and design of the components of our executive compensation program encourage management to assume excessive risks. We believe that our current business process and planning cycle fosters the behaviors and controls that would mitigate the potential for adverse risk caused by the action of our executives.

We believe that our current business process and planning cycle fosters the following behaviors and controls that mitigate the potential for adverse risk caused by the action of our executives:

annual establishment of corporate and individual objectives for our performance-based cash bonus programs for our executive officers that are consistent with our annual operating and strategic plans, that are designed to achieve the proper risk/reward balance, and that should not require excessive risk taking to achieve;

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the mix between fixed and variable, annual and long-term and cash and equity compensation are designed to encourage strategies and actions that balance the company's short-term and long-term best interests; and

stock option awards vest over a period of time, which we believe encourages executives to take a long-term view of our business.

***Tax and accounting considerations***

Section 162(m) of the Internal Revenue Code of 1986, as amended, which will become applicable to us upon the closing of our initial public offering, subject to certain transition rules, generally disallows a tax deduction for compensation in excess of \$1.0 million paid to our chief executive officer, our chief financial officer and our three other most highly paid executive officers (other than our chief executive officer and chief financial officer). Qualifying performance-based compensation is not subject to the deduction limitation if specified requirements are met. We intend to periodically review the potential consequences of Section 162(m) and we generally intend to structure the performance-based portion of our executive compensation, where feasible, to comply with exemptions in Section 162(m) so that the compensation will remain tax deductible to us. However, the organization and compensation committee may, in its judgment, authorize compensation payments that do not comply with the exemptions in Section 162(m) when it believes that such payments are appropriate to attract and retain executive talent and are in the best interests of our stockholders.

We account for equity compensation paid to our employees in accordance with FASB Accounting Standards Codification Topic 718, *Compensation - Stock Compensation*, or ASC 718, which requires us to measure and recognize compensation expense in our financial statements for all stock-based payments based on an estimate of their fair value over the service period of the award. We record cash compensation as an expense at the time the obligation is accrued.

**Summary compensation table**

The following table sets forth the total compensation awarded to, earned by or paid to our named executive officers during 2010 and 2011.

<b>Name and principal position</b>	<b>Year</b>	<b>Salary (\$)</b>	<b>Option awards \$(1)</b>	<b>Non-equity incentive plan compensation \$(2)</b>	<b>All other compensation \$(3)</b>	<b>Total (\$)</b>
Robert J. Mulroy(4) <i>President and Chief Executive Officer</i>	2011	451,886	181,000		12,913	645,799
	2010	432,253		217,776	12,892	662,921
William A. Sullivan <i>Chief Financial Officer and Treasurer</i>	2011	245,400	181,000		9,282	435,682
	2010	205,485	260,714	76,800	5,496	548,495
Fazal R. Khan(5) <i>Senior Vice President of Manufacturing</i>	2011	317,603	362,000		11,167	690,770
Ulrik B. Nielsen <i>Senior Vice President and Chief Scientific Officer</i>	2011	299,334	362,000		9,287	670,621
	2010	287,370	334,125	105,596	8,985	736,076
Clet M. Niyikiza <i>Executive Vice President of Development</i>	2011	339,163	362,000		1,246	702,409
	2010	329,892	230,852	121,402	2,184	684,330

(1)

The amounts in the "Option awards" column reflect the aggregate grant date fair value of stock options granted during the year computed in accordance with the provisions of ASC 718, excluding the impact of estimated forfeitures related to service-based vesting conditions (which in our case



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were none). The assumptions that we used to calculate these amounts are discussed in Note 16 to our financial statements appearing at the end of this Annual Report on Form 10-K.

- (2) The amounts in the "Non-equity incentive plan compensation" column represent awards to our named executive officers under our annual cash bonus program. Annual bonus compensation for 2011 will be determined and paid in 2012, at which time we will disclose such amounts in a filing under Item 5.02(f) of Form 8-K.
- (3) Amounts represent the value of perquisites and other personal benefits, which are further detailed below for 2011.

Name	401(k) Match (\$)	Group life and disability insurance premium (\$)	Tax gross-ups \$(a)	Stipend \$(b)	Total (\$)
Robert J. Mulroy	3,345	9,120	448		12,913
William A. Sullivan	7,350	234	448	1,250	9,282
Fazal R. Khan	7,350	2,119	448	1,250	11,167
Ulrik B. Nielsen	7,350	239	448	1,250	9,287
Clet M. Niyikiza		798	448		1,246

(a) Represents the value of the tax gross-up payment provided to executives to compensate them for the additional tax cost of receiving supplemental long-term disability insurance coverage.

(b) Represents the value of the work welfare stipend, described above in "Benefits and other compensation" provided to the executive.

- (4) Mr. Mulroy is also a member of our board of directors, but does not receive any additional compensation in his capacity as a director.
- (5) Dr. Khan was not a named executive officer for 2010.

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**Grants of plan-based awards in 2011**

The following table sets forth information regarding grants of plan-based awards to our named executive officers during 2011.

Name	Grant date	Estimated future payouts under non-equity incentive plan awards			All other option awards: number of securities underlying options (#)	Exercise or base price of option awards (\$/share)(2)	Grant date fair value of option awards (\$)(3)
		Threshold (\$)	Target (\$)(1)	Maximum (\$)			
Robert J. Mulroy	5/3/2011		228,665				
	5/3/2011				50,000	5.54	181,000
William A. Sullivan	5/3/2011		98,880				
	5/3/2011				50,000	5.54	181,000
Fazal R. Khan	5/3/2011		127,973				
	5/3/2011				100,000	5.54	362,000
Ulrik B. Nielsen	5/3/2011		121,176				
	5/3/2011				100,000	5.54	362,000
Clet M. Niyikiza	5/3/2011		136,660				
	5/3/2011				100,000	5.54	362,000

- (1) The target amounts in the "Estimated future payouts under non-equity incentive plan awards" column represent the amount determined by our organization and compensation committee as the target annual cash bonus payable to each executive officer for 2011. On May 3, 2011, our organization and compensation committee established the annual cash bonus targets for 2011, as a percentage of annual base salary, for each executive officer.
- (2) The exercise price per share of each option award is equal to the fair value per share of our common stock on the date of grant as determined by our board of directors.
- (3) The amounts in the "Grant date fair value of option awards" column reflect the grant date fair value of option awards granted in 2011 calculated in accordance with ASC 718.

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*Outstanding equity awards at December 31, 2011*

The following table sets forth information regarding outstanding stock options held by our named executive officers as of December 31, 2011.

Name	Number of securities underlying unexercised options exercisable (#)	Number of securities underlying unexercised options unexercisable (#)	Option exercise price (\$/share)	Option expiration date
Robert J. Mulroy	75,000		2.19	8/2/2012
	50,000		2.19	5/8/2013
	158,048		1.25	8/30/2014
	141,952		1.25	8/30/2014
	25,837		1.25	8/2/2015
	224,163		1.25	8/2/2015
	43,247		1.71	8/3/2015
	456,753		1.71	8/3/2015
	52,985		2.47	1/23/2017
	97,015		2.47	1/23/2017
	26,689		2.59	10/4/2017
	248,311		2.59	10/4/2017
	581,249	193,751(1)	2.12	11/4/2019
8,333	41,667(2)	5.54	5/2/2021	
William A. Sullivan	75,000		2.12	12/4/2017
	16,500		2.12	5/4/2018
	35,000		1.81	9/21/2018
	45,000	15,000(1)	2.12	11/4/2019
	62,500	87,500(3)	2.69	12/21/2020
	8,333	41,667(2)	5.54	5/2/2021
Fazal R. Khan	150,000		1.71	2/24/2016
	23,412		2.47	10/3/2016
	11,588		2.47	10/3/2016
	21,946		2.59	10/4/2017
	93,054		2.59	10/4/2017
	262,500		1.81	9/21/2018
	135,000	45,000(1)	2.12	11/4/2019
	20,833	29,167(3)	2.69	12/21/2020
16,666	83,334(2)	5.54	5/2/2021	
Ulrik B. Nielsen	4,368		2.19	8/2/2012
	10,483		2.19	5/8/2013
	150,000		1.25	8/30/2014
	82,977		1.71	8/3/2015
	17,023		1.71	8/3/2015
	48,175		2.47	10/3/2016
	26,825		2.47	10/3/2016
	53,378		2.59	10/4/2017
	146,622		2.59	10/4/2017
	250,000		1.81	9/21/2018
	135,000	45,000(1)	2.12	11/4/2019
	58,333	41,667(4)	2.12	1/31/2020
	25,000	35,000(3)	2.69	10/14/2020
	20,833	29,167(3)	2.69	12/21/2020
16,666	83,334(2)	5.54	5/2/2021	
Clet M. Niyikiza	133,333	66,667(1)	2.12	11/4/2019

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58,333	41,667(4)	2.12	1/31/2020
20,833	29,167(3)	2.69	12/21/2020
16,666	83,334(2)	5.54	5/2/2021

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- (1) The unvested shares under this option are scheduled to vest in approximately equal quarterly installments through August 1, 2012.

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- (2) The unvested shares under this option are scheduled to vest in approximately equal quarterly installments through May 1, 2014.
- (3) The unvested shares under this option are scheduled to vest in approximately equal quarterly installments through July 1, 2013.
- (4) The unvested shares under this option are scheduled to vest in approximately equal quarterly installments through January 1, 2013.

**Option exercises and stock vested**

The following table sets forth information regarding stock options exercised by our named executive officers during 2011.

Name	Option awards	
	Number of shares acquired on exercise (#)	Value realized on exercise (\$)
Robert J. Mulroy	82,481	209,311

None of our named executive officers held any restricted stock that vested in 2011.

**Employment agreements**

In August and September 2011, we entered into amended and restated employment agreements with each of our executive officers. Each of these agreements provides for an employment term continuing until December 31, 2012, unless earlier terminated in accordance with the agreement. Each agreement renews automatically thereafter for successive one-year terms, unless either we or the executive officer gives notice of non-renewal.

These employment agreements prohibit our executive officers, during the term of employment and any severance period and for a period of one year thereafter, from competing with us and soliciting or hiring our employees. Our executive officers also are bound by the terms of separate non-competition, non-solicitation, non-disclosure and developments agreements.

Pursuant to the terms of these employment agreements, our named executive officers who were serving as executive officers as of December 31, 2011 receive the following base salaries and are eligible for the following bonus percentages.

Name	Annual base salary	Bonus percentage
Robert J. Mulroy	\$ 457,330	50%
William A. Sullivan	247,200	40
Fazal R. Khan	319,932	40
Ulrik B. Nielsen	302,940	40
Clet M. Niyikiza	341,651	40

Upon execution and effectiveness of a severance agreement and release of claims, each executive officer is entitled to severance payments if we terminate the executive officer's employment without cause, as defined in the employment agreement, including our decision not to renew the executive officer's term of employment, or the executive officer terminates employment with us for good reason, as defined in the employment agreement.

If an executive officer's employment terminates under these circumstances, in each case prior to a change in control, as defined in the employment agreement, we are obligated for a period of 12 months to pay such executive officer his base salary, pay for coverage for such executive officer under any company sponsored insurance and benefit programs available to our senior management employees and, to the extent allowed by applicable law and the applicable plan documents, continue to provide to

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such executive officer all company employee benefit plans and arrangements available to our senior management employees. In addition, we would be obligated to pay to each of our executive officers a pro-rata bonus for the portion of the year in which such executive officer was employed by us based on his average annual bonus payments over each of the three years prior to the year of termination, or such lesser period during which such executive officer served as one of our executive officers.

If an executive officer's employment terminates under these circumstances, in each case within 18 months following a change in control, we are obligated to pay such executive officer a lump sum amount equal to 36 months of his base salary plus a bonus equal to three times the average of his annual bonus payments over each of the three years prior to the year of termination, or such lesser period during which such executive officer served as one of our executive officers, accelerate the vesting of all outstanding stock options, restricted stock or other equity awards granted to the executive officer, pay for coverage for such executive officer under any company sponsored insurance and benefit programs available to our senior management employees for a period of 18 months and, to the extent allowed by applicable law and the applicable plan documents, continue to provide to such executive officer all company employee benefit plans and arrangements available to our senior management employees for a period of 18 months.

If we terminate an executive officer's employment due to disability, the executive officer will be eligible to receive a pro-rata bonus for the portion of the year in which such executive officer was employed by us based on his average annual bonus payments over each of the three years prior to the year of termination, or such lesser period during which such executive officer served as one of our executive officers.

**Potential payments upon termination or change in control**

The following tables set forth information regarding potential payments that each named executive officer who was serving as an executive officer as of December 31, 2011 would have received if the executive officer's employment had terminated as of December 31, 2011 under the circumstances set forth below.

Name	Termination without cause or for good reason prior to a change in control	
	Cash payment	Value of benefits
Robert J. Mulroy	\$ 642,424	\$ 22,271
William A. Sullivan	324,000	13,874
Fazal R. Khan	425,381	13,270
Ulrik B. Nielsen	403,700	1,095
Clet M. Niyikiza	452,352	13,270

Name	Termination without cause or for good reason within 18 months following a change in control		
	Cash payment	Value of stock options with accelerated vesting(1)	Value of benefits
Robert J. Mulroy	\$ 1,927,273	\$ 1,006,339	\$ 33,406
William A. Sullivan	972,000	511,159	20,812
Fazal R. Khan	1,276,143	466,977	19,904
Ulrik B. Nielsen	1,211,099	821,162	1,643
Clet M. Niyikiza	1,357,056	776,047	19,904

(1) The value of stock options with accelerated vesting represents the value of unvested stock options based on the difference between the exercise price of the options per share and the initial public offering price of \$7.00 per share.

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Name	Termination for disability Cash payment
Robert J. Mulroy	\$ 185,094
William A. Sullivan	76,800
Fazal R. Khan	105,449
Ulrik B. Nielsen	100,760
Clet M. Niyikiza	110,701

**Pension benefits**

We do not maintain any defined benefit pension plans.

**Nonqualified deferred compensation**

We do not maintain any nonqualified deferred compensation plans.

**401(k) retirement plan**

We maintain a defined contribution employee retirement plan for our employees. Our 401(k) retirement plan, or 401(k) plan, is intended to qualify as a tax-qualified plan under Section 401 of the Internal Revenue Code so that contributions to our 401(k) plan, and income earned on such contributions, are not taxable to participants until withdrawn or distributed from the 401(k) plan. Our 401(k) plan provides that each participant may contribute up to 100% of his or her pre-tax compensation, up to a statutory limit, which is \$16,500 for 2011. Participants who are at least 50 years old can also make "catch-up" contributions, which in 2011 may be up to an additional \$5,500 above the statutory limit. Under our 401(k) plan, each employee is fully vested in his or her deferred salary contributions. Employee contributions are held and invested by the plan's trustee. Our 401(k) plan also permits us to make discretionary contributions and matching contributions, subject to established limits and a vesting schedule. For 2010, we made an employer matching contribution equal to 50% of employee deferral contributions up to a maximum deferral rate of 3% of compensation.

Table of Contents**Director compensation****Compensation for 2011**

The following table sets forth information regarding the total compensation awarded to, earned by or paid to each of our current non-employee directors during the year ended December 31, 2011 for their service on our board of directors. The compensation amounts presented in the table below are historical and are not indicative of the amounts we may pay our directors in the future. Robert J. Mulroy, our Chief Executive Officer, has not received and will not receive any additional compensation for his services as a director. The compensation that we pay to Mr. Mulroy is discussed under "Executive compensation" above.

Name	Fees earned or paid in cash \$(1)	Option awards \$(2)	Total (\$)
Gary L. Crocker	62,750	224,588	287,338
James van B. Dresser	51,000	179,670	230,670
Gordon J. Fehr	65,500	179,670	245,170
Robert C. Gay, Ph.D.	42,000	179,670	221,670
Walter M. Lovenberg, Ph.D.	51,000	179,670	230,670
Sarah E. Nash	61,000	179,670	240,670
Michael E. Porter, Ph.D.	38,000	84,750	122,750
Anthony J. Sinskey, Sc.D.	50,000	179,670	229,670

(1)

Fees earned or paid in cash consist of:

for Mr. Crocker, \$38,000 for serving as chairman of the board, \$18,000 for attending board meetings and \$6,750 for attending committee meetings;

for Mr. Dresser, \$25,000 as a retainer for board service, \$18,000 for attending board meetings and \$8,000 for attending committee meetings;

for Mr. Fehr, \$25,000 as a retainer for board service, \$18,000 for attending board meetings and \$22,500 for attending committee meetings;

for Dr. Gay, \$25,000 as a retainer for board service, \$16,000 for attending board meetings and \$1,000 for attending committee meetings;

for Dr. Lovenberg, \$25,000 as a retainer for board service, \$18,000 for attending board meetings and \$8,000 for attending committee meetings;

for Ms. Nash, \$25,000 as a retainer for board service, \$16,000 for attending board meetings and \$20,000 for attending committee meetings;

for Mr. Porter, \$25,000 as a retainer for board service, \$10,000 for attending board meetings and \$3,000 for attending committee meetings; and

for Dr. Sinskey, \$25,000 as a retainer for board service, \$18,000 for attending board meetings and \$7,000 for attending committee meetings.

(2)

The amounts in the "Option awards" column reflect the aggregate grant date fair value of stock options granted during the year to directors for their service as directors computed in accordance with the provisions of ASC 718, excluding the impact of estimated forfeitures related to service-based vesting conditions (which in our case were none). The assumptions that we used to calculate these amounts are discussed in Note 16 to our financial statements appearing at the end of this Annual Report on Form 10-K.

As of December 31, 2011, the aggregate number of shares of our common stock subject to each non-employee director's outstanding option awards was as follows: Mr. Crocker 356,250;

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Mr. Dresser 248,462; Mr. Fehr 218,462; Dr. Gay 153,000; Dr. Lovenberg 218,462; Ms. Nash 193,000; Dr. Porter 145,000; and Dr. Sinskey 218,462.

### ***Director compensation arrangements***

For 2011, each non-employee director, other than the chairman of the board, received an annual retainer for board service of \$25,000. The chairman of the board received an annual retainer for board service of \$38,000. Our non-employee directors were paid an additional \$2,000 for each board meeting that they attended. In addition, the members of each of our four board committees received a fee for each committee meeting that they attended. The chairs of each of our four board committees received an additional fee for each meeting of such committee that they attended. Each non-employee director, other than the chairman of the board, was also granted a stock option to purchase 25,000 shares of our common stock. The chairman of the board was granted a stock option to purchase 31,250 shares of our common stock.

In 2011, our non-employee directors also received stock option grants that were intended to be granted during 2010, but were not able to be granted at that time because we did not have a sufficient number of shares of common stock available for grant under the 2008 plan. For their service in 2010, each non-employee director, other than the chairman of the board and Mr. Porter, who joined the board in December 2010, was granted a stock option to purchase 28,000 shares of our common stock. The chairman of the board was granted a stock option to purchase 35,000 shares of our common stock.

For 2012, our non-employee directors will be compensated for their services to the board as follows:

an annual retainer for board service of \$25,000 (\$47,500 for the chairman of the board);

a fee of \$2,000 for each meeting of the board that each non-employee director attends;

an annual stock option grant with a grant date fair value of approximately \$90,500 (approximately \$113,125 for the chairman of the board);

for members of the audit committee, a fee of \$1,700 per meeting of the audit committee that each non-employee director attends (\$3,000 per meeting for the chair);

for members of the organization and compensation committee, a fee of \$1,000 per meeting of the organization and compensation committee that each non-employee director attends (\$2,500 per meeting for the chair);

for members of the corporate governance and nominating committee, a fee of \$750 per meeting of the corporate governance and nominating committee that each non-employee director attends (\$1,000 per meeting for the chair); and

for members of the executive committee, a fee of \$1,000 per meeting of the executive committee that each non-employee director attends (\$1,500 per meeting for the chair).

In addition, we have reimbursed, and will continue to reimburse, our non-employee directors for their travel, lodging and other reasonable expenses incurred in attending meetings of our board and committees of our board.

### **Compensation Committee Interlocks and Insider Participation**

None of our executive officers serves as a member of the board of directors or compensation committee, or other committee serving an equivalent function, of any other entity that has one or more of its executive officers serving as a member of our board of directors or our organization and compensation committee. None of the members of our organization and compensation committee has ever been our employee.



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**Compensation Committee Report**

The organization and compensation committee has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b) of Regulation S-K with management. Based on such review and discussions, the organization and compensation committee recommended to the board that the Compensation Discussion and Analysis be included in this Annual Report on Form 10-K.

*Organization and Compensation Committee*

Gordon J. Fehr (Chair)

Walter M. Lovenberg, Ph.D.

Anthony J. Sinskey, Sc.D.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

**Securities Authorized for Issuance under Equity Compensation Plans**

See "Securities Authorized for Issuance under Equity Compensation Plans" in Item 5 of this Annual Report on Form 10-K.

**Security Ownership of Certain Beneficial Owners and Management**

The following table sets forth information with respect to the beneficial ownership of our common stock as of February 29, 2012 by:

each of our directors;

each of our named executive officers;

all of our directors and executive officers as a group; and

each person, or group of affiliated persons, who is known by us to beneficially own more than 5% of our common stock.

The column entitled "Percentage of shares beneficially owned before offering" is based on a total of 78,096,254 shares of our common stock outstanding as of February 29, 2012, assuming the automatic conversion of all outstanding shares of our preferred stock into an aggregate of 66,255,529 shares of our common stock upon the closing of our initial public offering. The column entitled "Percentage of shares beneficially owned after offering" is based on 92,396,254 shares of our common stock to be outstanding after our initial public offering, including the 14,300,000 shares of our common stock that we are selling in our initial public offering, but not including any additional shares issuable upon exercise of outstanding options or warrants.

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Beneficial ownership is determined in accordance with the rules and regulations of the SEC and includes voting or investment power with respect to our common stock. Shares of our common stock subject to options that are currently exercisable or exercisable within 60 days after February 29, 2012 are considered outstanding and beneficially owned by the person holding the options or warrants for the purpose of calculating the percentage ownership of that person but not for the purpose of calculating the percentage ownership of any other person. Except as otherwise noted, the persons and entities in this table have sole voting and investing power with respect to all of the shares of our common stock beneficially owned by them, subject to community property laws, where applicable. Except as otherwise set forth below, the address of the beneficial owner is c/o Merrimack Pharmaceuticals, Inc., One Kendall Square, Suite B7201, Cambridge, Massachusetts 02139.

Entities affiliated with Fidelity Investments, one of our existing principal stockholders, have indicated an interest in purchasing an aggregate of up to approximately \$28.7 million in shares of our common stock in our initial public offering at the initial public offering price. However, because indications of interest are not binding agreements or commitments to purchase, these entities may determine to purchase fewer shares than they have indicated an interest in purchasing or not to

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purchase any shares in our initial public offering. The following table does not reflect any potential purchases by these entities.

Name and address of beneficial owner	Number of shares beneficially owned	Percentage of shares beneficially owned	
		Before offering	After offering
<b>5% Stockholders:</b>			
Fidelity Investments(1) 82 Devonshire St. Boston, MA 02109	5,524,135	7.07%	5.98%
CSFB Next Fund, Inc.(2) Eleven Madison Avenue New York, NY 10010	4,818,562	6.17	5.22
Fred Alger Management, Inc.(3) 111 Fifth Avenue New York, NY 10003	4,349,368	5.57	4.71
TPG-Axon Partners(4) 888 Seventh Avenue, 38th Floor New York, NY 10019	4,183,005	5.36	4.53
<b>Directors and executive officers:</b>			
Robert J. Mulroy(5)	2,864,151	3.56	3.03
Fazal R. Khan, Ph.D.(6)	766,666	*	*
Ulrik B. Nielsen, Ph.D.(7)	1,351,459	1.71	1.45
Clet M. Niyikiza, Ph.D.(8)	279,164	*	*
William A. Sullivan(9)	276,499	*	*
Gary L. Crocker(10)	3,573,592	4.56	3.85
James van B. Dresser(11)	351,974	*	*
Gordon J. Fehr(12)	381,715	*	*
Robert C. Gay, Ph.D.(13)	806,878	1.03	*
Walter M. Lovenberg, Ph.D.(14)	295,605	*	*
Sarah E. Nash(15)	1,122,494	1.43	1.21
Michael E. Porter, Ph.D.(16)	374,114	*	*
Anthony J. Sinskey, Sc.D.(17)	592,376	*	*
All executive officers and directors as a group (15 persons)(18)	13,578,904	15.96%	13.67%

\* Represents beneficial ownership of less than one percent of our outstanding common stock.

(1) Consists of (i) 1,428,572 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Mt. Vernon Street Trust: Fidelity Growth Company Fund, (ii) 2,142,858 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Securities Fund: Fidelity Blue Chip Growth Fund, (iii) 380,800 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Securities Fund: Fidelity Series Small Cap Opportunities Fund, (iv) 80,373 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Advisor Series VII: Fidelity Advisor Health Care Fund, (v) 123,883 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Central Investment Portfolios LLC: Fidelity Health Care Central Fund, (vi) 14,977 shares of common stock underlying shares of series G convertible preferred stock held by Variable Insurance Products Fund IV: Health Care Portfolio, (vii) 391,134 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Capital Trust: Fidelity Stock Selector Small Cap Fund, (viii) 350,000 shares of common stock underlying

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shares of series G convertible preferred stock held by Fidelity Select Portfolios: Health Care Portfolio and (ix) 611,538 shares of common stock underlying shares of series G convertible preferred stock held by Fidelity Destiny Portfolios: Fidelity Advisor Capital Development Fund.

Fidelity Management & Research Company, or Fidelity, a wholly-owned subsidiary of FMR LLC, acts as investment adviser for the beneficial owners set forth above, or the funds. Edward C. Johnson 3d, the Chairman of FMR LLC, and his family members, directly or through trust, are parties to a shareholders' agreement and may be deemed, under the Investment Act of 1940, to form a controlling group with respect to FMR LLC and therefore to be persons with the indirect control of Fidelity. Fidelity has the ability to make decisions with respect to the voting and disposition of the shares set forth above, subject to the oversight of the board of trustees (or similar entity) of each fund. The board of trustees of each fund has enacted a policy with respect to the voting of any investment property owned thereby and shares are voted for the funds by Fidelity in accordance with such policies. Under the terms of its management contract with each fund, Fidelity has overall responsibility for directing the investments of the fund in accordance with the fund's investment objective, policies and limitations. Each fund has one or more portfolio managers appointed by and serving at the pleasure of Fidelity who make the decisions with respect to the disposition of the shares.

The percentage of shares beneficially owned after our initial public offering would be 10.42%, assuming the purchase of all of the shares that entities affiliated with Fidelity Investments have indicated an interest in purchasing in our initial public offering.

- (2) Consists of (i) 2,857,778 shares of common stock underlying shares of series E convertible preferred stock and (ii) 1,960,784 shares of common stock underlying shares of series F convertible preferred stock.
- (3) Consists of (i) 396,775 shares of common stock underlying shares of series G convertible preferred stock held by Alger Capital Appreciation Fund, (ii) 496,510 shares of common stock underlying shares of series G convertible preferred stock held by Alger Capital Appreciation Institutional Fund, (iii) 129,055 shares of common stock underlying shares of series G convertible preferred stock held by Alger Capital Appreciation Portfolio, (iv) 17,984 shares of common stock underlying shares of series B convertible preferred stock and 12,149 shares of common stock underlying shares of series C convertible preferred stock held by Alger Dynamic Opportunities Fund, (v) 6,366 shares of common stock underlying shares of series B convertible preferred stock and 4,300 shares of common stock underlying shares of series C convertible preferred stock held by Alger Dynamic Return Fund, (vi) 268,966 shares of common stock underlying shares of series B convertible preferred stock and 181,700 shares of common stock underlying shares of series C convertible preferred stock held by Alger Health Sciences Fund, (vii) 343,768 shares of common stock underlying shares of series B convertible preferred stock and 232,232 shares of common stock underlying shares of series C convertible preferred stock held by Alger Mid Cap Growth Fund, (viii) 905,574 shares of common stock underlying shares of series B convertible preferred stock and 611,759 shares of common stock underlying shares of series C convertible preferred stock held by Alger Mid Cap Growth Institutional Fund, (ix) 200,531 shares of common stock underlying shares of series B convertible preferred stock and 135,469 shares of common stock underlying shares of series C convertible preferred stock held by Alger Mid Cap Growth Portfolio and (x) 406,230 shares of common stock underlying shares of series G convertible preferred stock held by Alger Spectra Fund. Fred Alger Management, Inc. is the investment advisor of each of the above listed funds and as such has sole voting and sole dispositive control over the securities owned by such funds.
- (4) Consists of (i) 1,466,667 shares of common stock underlying shares of series E convertible preferred stock and 1,313,725 shares of common stock underlying shares of series F convertible

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preferred stock held by TPG-Axon International, L.P. and (ii) 755,555 shares of common stock underlying shares of series E convertible preferred stock and 647,058 shares of common stock underlying shares of series F convertible preferred stock held by TPG-Axon Partners, LP.

- (5) Consists of (i) 474,603 shares of common stock, (ii) 40,397 shares of common stock underlying shares of series B convertible preferred stock, (iii) 29,019 shares of common stock underlying shares of series C convertible preferred stock and (iv) 2,258,332 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date. Mr. Mulroy's wife, Jean Mulroy, holds (i) 57,143 shares of common stock underlying shares of series D convertible preferred stock and (ii) 4,657 shares of common stock underlying shares of series E convertible preferred stock. Mr. and Mrs. Mulroy share voting and investment control over the securities held by Mrs. Mulroy and, as a result, Mr. Mulroy may be deemed to be the beneficial owner of the securities held by Mrs. Mulroy.
- (6) Consists of 766,666 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (7) Consists of (i) 247,443 shares of common stock and (ii) 1,104,016 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (8) Consists of 279,164 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (9) Consists of 276,499 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (10) Mr. Crocker owns directly 59,863 shares of common stock underlying shares of series C convertible preferred stock. Mr. Crocker also owns jointly with his wife, Ann Crocker, (i) 463,654 shares of common stock underlying shares of series D convertible preferred stock, (ii) 46,676 shares of common stock underlying shares of series E convertible preferred stock, (iii) 41,900 shares of common stock underlying shares of series F convertible preferred stock and (iv) 313,266 shares of common stock underlying shares of Series G convertible preferred stock. In addition, Mr. and Mrs. Crocker, certain members of Mr. Crocker's family, certain trusts established for members of Mr. Crocker's family and certain entities controlled by Mr. Crocker or members of his family are parties to a Shareholder Voting Agreement, dated December 20, 2010, or the Crocker voting agreement, pursuant to which the parties to the agreement have agreed to vote his, her or its shares as directed by Crocker Ventures, LLC. Mr. Crocker is the President, Manager and chairman of Crocker Ventures, LLC and in connection therewith shares voting control over all of the shares subject to the Crocker voting agreement. As a result, in addition to the shares of common stock underlying shares of convertible preferred stock held by Mr. Crocker individually and by Mr. and Mrs. Crocker jointly, Mr. Crocker may be deemed the beneficial owner of (i) 783,838 shares of common stock underlying shares of series C convertible preferred stock, (ii) 215,717 shares of common stock underlying shares of series D convertible preferred stock, (iii) 509,324 shares of common stock underlying shares of series E convertible preferred stock, (iv) 613,100 shares of common stock underlying shares of series F convertible preferred stock and (v) 170,004 shares of common stock underlying shares of series G convertible preferred stock held by the parties to the Crocker voting agreement. The number of shares beneficially owned by Mr. Crocker also includes 356,250 shares of common stock underlying options that have been issued to Mr. Crocker and are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (11) Consists of (i) 87,500 shares of common stock, (ii) 11,111 shares of common stock underlying shares of series E convertible preferred stock, (iii) 4,901 shares of common stock underlying shares of series F convertible preferred stock and (iv) 248,462 shares of common stock underlying options

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that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.

- (12) Consists of (i) 141,031 shares of common stock, (ii) 22,222 shares of common stock underlying shares of series E convertible preferred stock and (iii) 218,462 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (13) Includes (i) 175,316 shares of common stock underlying shares of series B convertible preferred stock, (ii) 142,857 shares of common stock underlying shares of series D convertible preferred stock, (iii) 8,766 shares of common stock issuable upon the exercise of common stock warrants outstanding and (iv) 153,000 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date. Dr. Gay is also the trustee of the Robert C. Gay 1998 Family Trust and has voting and investment control over, and may be deemed to be the beneficial owner of, (i) 175,316 shares of common stock underlying shares of series B convertible preferred stock, (ii) 142,857 shares of common stock underlying shares of series D convertible preferred stock and (iii) 8,766 shares of common stock issuable upon the exercise of common stock warrants outstanding held by the Robert C. Gay 1998 Family Trust.
- (14) Consists of (i) 70,000 shares of common stock, (ii) 7,143 shares of common stock underlying shares of series D convertible preferred stock and (iii) 218,462 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.
- (15) Includes (i) 44,440 shares of common stock, (ii) 120,161 shares of common stock underlying shares of series C convertible preferred stock, (iii) 28,571 shares of common stock underlying shares of series D convertible preferred stock, (iv) 222,222 shares of common stock underlying shares of series E convertible preferred stock, (v) 142,610 shares of common stock underlying shares of series F convertible preferred stock, (vi) 25,000 shares of common stock underlying shares of series G convertible preferred stock and (vii) 193,000 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date. Ms. Nash is also the trustee of the Sarah E. Nash 2009 Grantor Retained Annuity Trust and, as such, has voting and investment control over, and may be deemed the beneficial owner of, 64,448 shares of common stock underlying shares of Series F convertible preferred stock held by the Sarah E. Nash 2009 Grantor Retained Annuity Trust. Ms. Nash's husband, Michael Sylvester, holds (i) 22,220 shares of common stock, (ii) 30,040 shares of common stock underlying shares of Series C convertible preferred stock, (iii) 14,286 shares of common stock underlying shares of Series D convertible preferred stock, (iv) 188,889 shares of common stock underlying shares of Series E convertible preferred stock, (v) 19,607 shares of common stock underlying shares of series F convertible preferred stock and (vi) 7,000 shares of common stock underlying shares of series G convertible preferred stock. Mr. Sylvester and Ms. Nash share voting and investment control over the securities held by Mr. Sylvester and, as a result, Ms. Nash may be deemed the beneficial owner of the securities held by Mr. Sylvester.
- (16) Includes (i) 63,000 shares of common stock, (ii) 56,509 shares of common stock underlying shares of series C convertible preferred stock, (iii) 34,286 shares of common stock underlying shares of series D convertible preferred stock, (iv) 25,000 shares of common stock underlying shares of series E convertible preferred stock, (v) 33,000 shares of common stock underlying shares of series F convertible preferred stock, (vi) 28,570 shares of common stock underlying shares of series G convertible preferred stock and (vii) 133,749 shares of common stock underlying options that are exercisable as February 29, 2012 or will become exercisable within 60 days after such date.

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- (17) Consists of (i) 237,431 shares of common stock and (ii) 218,462 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 dates after such date. Dr. Sinskey also owns jointly with his wife, Chokyun Rha-Sinskey, (i) 36,723 shares of common stock underlying shares of Series B convertible preferred stock and (ii) 18,024 shares of common stock underlying shares of series C convertible preferred stock. Dr. Sinskey is also the trustee of the Anthony J. Sinskey 2010 Grat I and, as such, has voting and investment control over, and may be deemed the beneficial owner of, 81,736 shares of common stock held by the Anthony J. Sinskey 2010 Grat I.
- (18) Includes 6,966,741 shares of common stock underlying options that are exercisable as of February 29, 2012 or will become exercisable within 60 days after such date.

Table of Contents**Item 13. Certain Relationships and Related Transactions, and Director Independence**

Since January 1, 2011, we have engaged in the following transactions with our directors, executive officers and holders of more than 5% of our voting securities, and affiliates or immediate family members of our directors, executive officers and holders of more than 5% of our voting securities. We believe that all of these transactions were on terms as favorable as could have been obtained from unrelated third parties.

**Series G convertible preferred stock financing**

In April 2011, we issued and sold an aggregate of 11,000,000 shares of our series G convertible preferred stock at a price per share of \$7.00 for an aggregate purchase price of \$77,000,000. The following table sets forth the number of shares of our series G convertible preferred stock that we issued to our directors, executive officers and 5% stockholders and their affiliates and immediate family members.

Name	Shares of series G convertible preferred stock
<b>5% Stockholders:</b>	
Fidelity Investments(1)	5,524,135
Fred Alger Management, Inc.(2)	1,428,570
<b>Directors and executive officers:</b>	
Robert J. Mulroy(3)	82,855
Gary Crocker(4)	483,270
Sarah E. Nash(5)	32,000
Michael E. Porter	28,570

(1)

Consists of (i) 1,428,572 shares of series G convertible preferred stock held by Fidelity Mt. Vernon Street Trust: Fidelity Growth Company Fund, (ii) 2,142,858 shares of series G convertible preferred stock held by Fidelity Securities Fund: Fidelity Blue Chip Growth Fund, (iii) 380,800 shares of series G convertible preferred stock held by Fidelity Securities Fund: Fidelity Series Small Cap Opportunities Fund, (iv) 80,373 shares of series G convertible preferred stock held by Fidelity Advisor Series VII: Fidelity Advisor Health Care Fund, (v) 123,883 shares of series G convertible preferred stock held by Fidelity Central Investment Portfolios LLC: Fidelity Health Care Central Fund, (vi) 14,977 shares of series G convertible preferred stock held by Variable Insurance Products Fund IV: Health Care Portfolio, (vii) 391,134 shares of series G convertible preferred stock held by Fidelity Capital Trust: Fidelity Stock Selector Small Cap Fund, (viii) 350,000 shares of series G convertible preferred stock held by Fidelity Select Portfolios: Health Care Portfolio and (ix) 611,538 shares of series G convertible preferred stock held by Fidelity Destiny Portfolios: Fidelity Advisor Capital Development Fund.

Fidelity Management & Research Company, or Fidelity, a wholly-owned subsidiary of FMR LLC, acts as investment adviser for the beneficial owners set forth above, or the funds. Edward C. Johnson 3d, the Chairman of FMR LLC, and his family members, directly or through trust, are parties to a shareholders' agreement and may be deemed, under the Investment Act of 1940, to form a controlling group with respect to FMR LLC and therefore to be persons with the indirect control of Fidelity. Fidelity has the ability to make decisions with respect to the voting and disposition of the shares set forth above, subject to the oversight of the board of trustees (or similar entity) of each fund. The board of trustees of each fund has enacted a policy with respect to the voting of any investment property owned thereby and shares are voted for the funds by Fidelity in accordance with such policies. Under the terms of its management contract with each fund, Fidelity has overall responsibility for directing the investments of the fund in accordance with the fund's investment objective, policies and limitations. Each fund has one or more portfolio

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managers appointed by and serving at the pleasure of Fidelity who make the decisions with respect to the disposition of the shares.

- (2) Consists of (i) 396,775 shares of series G convertible preferred stock held by Alger Capital Appreciation Fund, (ii) 496,510 shares of series G convertible preferred stock held by Alger Capital Appreciation Institutional Fund, (iii) 129,055 shares of series G convertible preferred stock held by Alger Capital Appreciation Portfolio and (iv) 406,230 shares of series G convertible preferred stock held by Alger Spectra Fund. Fred Alger Management, Inc. is the investment advisor of each of the above listed funds and, as such, has sole voting and sole dispositive control over the securities owned by such funds.
- (3) Consists of 4,285 shares of series G convertible preferred stock held by Mr. Mulroy's brother, Richard D. Mulroy, Jr., 61,428 shares of series G convertible preferred stock held by Mr. Mulroy's brother, William F. Mulroy, and 17,142 shares of series G convertible preferred stock held by the Mulroy family irrevocable trust, of which Mr. Mulroy's brother, Richard D. Mulroy, Jr. is a trustee, each of whom is deemed to be a person related to us.
- (4) Consists of 313,266 shares of series G convertible preferred stock held by Mr. Crocker jointly with his wife, Ann Crocker. In addition, Mr. and Mrs. Crocker, certain members of Mr. Crocker's family, certain trusts established for members of Mr. Crocker's family and certain entities controlled by Mr. Crocker or members of his family are parties to a Shareholder Voting Agreement, dated December 20, 2010, or the Crocker voting agreement, pursuant to which the parties to the agreement have agreed to vote his, her or its shares as directed by Crocker Ventures, LLC. Mr. Crocker is the President, Manager and chairman of Crocker Ventures, LLC and in connection therewith shares voting control over all of the shares subject to the Crocker voting agreement. As a result, in addition to the shares of series G convertible preferred stock held by Mr. and Mrs. Crocker jointly, the 170,004 shares of series G convertible preferred stock held by the parties to the Crocker voting agreement are deemed to be shares held by a person related to us.
- (5) Consists of 25,000 shares of series G convertible preferred stock held by Ms. Nash. Ms. Nash's husband, Michael Sylvester, holds 7,000 shares of series G convertible preferred stock. Mr. Sylvester is deemed to be a person related to us.

**Participation in initial public offering**

Entities affiliated with Fidelity Investments, one of our existing principal stockholders, have indicated an interest in purchasing an aggregate of up to approximately \$28.7 million in shares of our common stock in our initial public offering at the initial public offering price. However, because indications of interest are not binding agreements or commitments to purchase, these entities may determine to purchase fewer shares than they have indicated an interest in purchasing or not to purchase any shares in our initial public offering.

**Registration rights**

We are a party to an investor rights agreement with certain holders of our common stock, certain holders of our series B convertible preferred stock, series C convertible preferred stock, series D convertible preferred stock, series E convertible preferred stock, series F convertible preferred stock and series G convertible preferred stock and certain holders of warrants to purchase our common stock, including some of our 5% stockholders and their affiliates and entities affiliated with our directors. In addition, we have agreed to grant to the holder of the warrant to purchase shares of our Series D convertible preferred stock the same registration rights as are provided under the investor rights agreement. The investor rights agreement provides these holders the right, following the

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completion of our initial public offering, to demand that we file a registration statement or request that their shares be covered by a registration statement that we are otherwise filing.

**Policies and procedures for related person transactions**

Our board of directors has adopted written policies and procedures for the review of any transaction, arrangement or relationship in which Merrimack is a participant, the amount involved exceeds \$120,000 and one of our executive officers, directors, director nominees or 5% stockholders, or their immediate family members, each of whom we refer to as a "related person," has a direct or indirect material interest.

If a related person proposes to enter into such a transaction, arrangement or relationship, which we refer to as a "related person transaction," the related person must report the proposed related person transaction to our corporate counsel. The policy calls for the proposed related person transaction to be reviewed and, if deemed appropriate, approved by our audit committee. Whenever practicable, the reporting, review and approval will occur prior to entry into the transaction. If advance review and approval is not practicable, the committee will review, and, in its discretion, may ratify the related person transaction. The policy also permits the chairman of the committee to review and, if deemed appropriate, approve proposed related person transactions that arise between committee meetings, subject to ratification by the committee at its next meeting. Any related person transactions that are ongoing in nature will be reviewed annually.

A related person transaction reviewed under the policy will be considered approved or ratified if it is authorized by the committee after full disclosure of the related person's interest in the transaction. As appropriate for the circumstances, the committee will review and consider:

the related person's interest in the related person transaction;

the approximate dollar value of the amount involved in the related person transaction;

the approximate dollar value of the amount of the related person's interest in the transaction without regard to the amount of any profit or loss;

whether the transaction was undertaken in the ordinary course of our business;

whether the terms of the transaction are no less favorable to us than terms that could have been reached with an unrelated third party;

the purpose of, and the potential benefits to us of, the transaction; and

any other information regarding the related person transaction or the related person in the context of the proposed transaction that would be material to investors in light of the circumstances of the particular transaction.

The committee may approve or ratify the transaction only if the committee determines that, under all of the circumstances, the transaction is in, or is not inconsistent with, Merrimack's best interests. The committee may impose any conditions on the related person transaction that it deems appropriate.

In addition to the transactions that are excluded by the instructions to the SEC's related person transaction disclosure rule, our board of directors has determined that the following transactions do not create a material direct or indirect interest on behalf of related persons and, therefore, are not related person transactions for purposes of this policy:

interests arising solely from the related person's position as an executive officer of another entity (whether or not the person is also a director of such entity), that is a participant in the transaction, where (a) the related person and all other related persons own in the aggregate less than a 10% equity interest in such entity, (b) the related person and his or her immediate family



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members are not involved in the negotiation of the terms of the transaction and do not receive any special benefits as a result of the transaction and (c) the amount involved in the transaction equals less than the greater of \$200,000 or 5% of the annual gross revenues of the company receiving payment under the transaction; and

a transaction that is specifically contemplated by provisions of our charter or bylaws.

The policy provides that transactions involving compensation of executive officers shall be reviewed and approved by the organization and compensation committee in the manner specified in its charter.

**Director Independence**

Our board of directors has determined that all of our directors, other than Mr. Mulroy, are independent directors, as defined by the applicable NASDAQ Marketplace Rules. Our board of directors has also determined that all of the members of the audit committee, the corporate governance and nominating committee and the organization and compensation committee are independent as defined by applicable NASDAQ Marketplace Rules, including, in the case of all the members of our audit committee, the independence requirements contemplated by Rule 10A-3 under the Exchange Act.

**Item 14. Principal Accountant Fees and Services**

The following table summarizes the fees of PricewaterhouseCoopers LLP, our registered public accounting firm, billed to us for each of the last two fiscal years.

Fee category	2010	2011
Audit Fees(1)	\$ 159,492	\$ 981,423
All Other Fees(2)	1,500	1,800
Total Fees	\$ 160,992	\$ 983,223

(1) Audit fees for 2010 and 2011 consist of fees for the audit of our consolidated financial statements, reviews of our interim financial statements, fees related to our initial public offering and a restatement of our 2007 and 2008 audited financial statements.

(2) All other fees for 2010 and 2011 consist of a subscription to an online accounting research tool.

All such accountant services and fees were pre-approved by our audit committee in accordance with the "Pre-Approval Policies and Procedures" described below.

**Pre-Approval Policies and Procedures**

Our audit committee has adopted policies and procedures relating to the approval of all audit and non-audit services that are to be performed by our registered public accounting firm. This policy generally provides that we will not engage our registered public accounting firm to render audit or non-audit services unless the service is specifically approved in advance by our audit committee or the engagement is entered into pursuant to a *de minimis* exception in accordance with applicable SEC rules.

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**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

The following consolidated financial statements are filed as part of this Annual Report on Form 10-K:

	<b>Page</b>
<u>Report of independent registered public accounting firm</u>	<u>F-2</u>
<u>Consolidated balance sheets</u>	<u>F-3</u>
<u>Consolidated statements of operations</u>	<u>F-4</u>
<u>Consolidated statements of convertible preferred stock, non-controlling interest and stockholders' deficit</u>	<u>F-5</u>
<u>Consolidated statements of cash flows</u>	<u>F-6</u>
<u>Notes to consolidated financial statements</u>	<u>F-7</u>

No financial statement schedules have been filed as part of this Annual Report on Form 10-K because they are not applicable, not required or because the information is otherwise included in our consolidated financial statements or notes thereto.

The exhibits filed as part of this Annual Report on Form 10-K are set forth on the Exhibit Index immediately following our consolidated financial statements. The Exhibit Index is incorporated herein by reference.



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<b>Signature</b>	<b>Title</b>	<b>Date</b>
<hr/> <i>/s/ SARAH E. NASH</i> Sarah E. Nash	Director	March 30, 2012
<hr/> <i>/s/ MICHAEL E. PORTER, PH.D.</i> Michael E. Porter, Ph.D.	Director	March 30, 2012
<hr/> <i>/s/ ANTHONY J. SINSKEY, SC.D.</i> Anthony J. Sinskey, Sc.D.	Director	March 30, 2012

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**MERRIMACK PHARMACEUTICALS, INC.  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

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<u>Report of independent registered public accounting firm</u>	<u>F-2</u>
<u>Consolidated balance sheets</u>	<u>F-3</u>
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**Report of independent registered public accounting firm**

To the Board of Directors and Stockholders of  
Merrimack Pharmaceuticals, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, statements of convertible preferred stock, non-controlling interest and stockholders' deficit, and statements of cash flows present fairly, in all material respects, the financial position of Merrimack Pharmaceuticals, Inc. and its subsidiaries ("the Company") at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring losses from operations and has insufficient capital resources available as of December 31, 2011 to fund planned operations through 2012, which raises substantial doubt about its ability to continue as a going concern. Management's plans in regard to this matter are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ PricewaterhouseCoopers LLP

Boston, Massachusetts  
March 5, 2012

Table of Contents**Merrimack Pharmaceuticals, Inc.****Consolidated balance sheets**

(in thousands, except par value amounts)	December 31,	
	2010	2011
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 30,713	\$ 50,454
Accounts receivable	3,745	7,426
Deferred financing costs		1,946
Prepaid expenses and other current assets	1,830	5,763
<b>Total current assets</b>	<b>36,288</b>	<b>65,589</b>
Restricted cash	381	381
Property and equipment, net	7,458	6,206
Other assets	30	23
Intangible assets, net	2,805	2,485
In-process research and development	7,010	7,010
Goodwill	3,605	3,605
<b>Total assets</b>	<b>\$ 57,577</b>	<b>\$ 85,299</b>
<b>Liabilities, Convertible Preferred Stock, Non-controlling Interest and Stockholders' Deficit</b>		
Current liabilities:		
Accounts payable	\$ 1,440	\$ 4,656
Accrued expenses	7,256	12,855
Capital lease obligations	443	48
Deferred revenue	6,462	7,712
Deferred lease benefit	454	125
Deferred tax incentives	270	755
Accrued dividends		
<b>Total current liabilities</b>	<b>16,325</b>	<b>26,151</b>
Capital lease obligations	48	
Deferred revenues	67,320	78,033
Deferred lease benefits	102	23
Deferred tax incentives	810	1,267
Convertible preferred stock warrants	652	1,516
<b>Total liabilities</b>	<b>\$ 85,257</b>	<b>\$ 106,990</b>
Commitments and contingencies (Note 18)		
Convertible preferred stock	191,257	268,225
Non-controlling interest	1,027	574
Stockholders' deficit:		
Common stock, 125,000 and 138,500 authorized \$0.01 par value shares at December 31, 2010 and 2011, respectively, 11,073 and 11,834 issued and outstanding at December 31, 2010 and 2011, respectively	111	118
Additional paid-in capital	51,541	60,231
Accumulated deficit	(271,616)	(350,839)
<b>Total stockholders' deficit</b>	<b>\$ (219,964)</b>	<b>\$ (290,490)</b>
<b>Total liabilities, convertible preferred stock, non-controlling interest and stockholders' deficit</b>	<b>\$ 57,577</b>	<b>\$ 85,299</b>

The accompanying notes are an integral part of these consolidated financial statements.

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Table of Contents**Merrimack Pharmaceuticals, Inc.****Consolidated statements of operations**

(in thousands, except per share amounts)	Years ended December 31,		
	2009	2010	2011
Research and development revenues	\$ 2,148	\$ 20,305	\$ 34,215
Operating expenses			
Research and development	37,658	58,278	100,630
General and administrative	12,178	11,381	14,454
Contingent consideration		(178)	
Total operating expenses	49,836	69,481	115,084
Loss from operations	(47,688)	(49,176)	(80,869)
Other income and expenses			
Interest income	81	74	56
Interest expense	(4,909)	(3,726)	(13)
Other, net	41	2,669	1,150
Net loss before income taxes and non-controlling interest	(52,475)	(50,159)	(79,676)
Benefit from income taxes	3,402		
Net loss	(49,073)	(50,159)	(79,676)
Less net loss attributable to non-controlling interest		(55)	(453)
Net loss attributable to Merrimack Pharmaceuticals, Inc.	\$ (49,073)	\$ (50,104)	\$ (79,223)
Net loss per share available to common stockholders basic and diluted	\$ (7.28)	\$ (5.57)	\$ (7.67)
Weighted-average common shares used in computing net loss per share available to common stockholders basic and diluted	7,387	10,994	11,343

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Consolidated statements of convertible preferred stock, non-controlling interest  
and stockholders' deficit**

(in thousands)	Series B-G convertible preferred stock		Non- controlling interest	Common stock		Additional paid-in capital	Accumulated deficit	Total stockholders' deficit
	Shares	Amount		Shares	Amount			
<b>Balance at December 31, 2008</b>	42,028	\$ 132,739	\$	6,223	\$ 7,889	\$ 10,082	\$ (172,439)	\$ (154,468)
Exercise of employee stock options				262	183			183
Stock-based compensation						3,304		3,304
Return of Series C stock as a result of license agreement	(662)	(1,469)						
Issuance of Series C stock as a result of warrant exercise	2	3						
Issuance of common stock in connection with acquisition				4,383	9,292			9,292
Net loss							(49,073)	(49,073)
<b>Balance at December 31, 2009</b>	41,368	\$ 131,273	\$	10,868	\$ 17,364	\$ 13,386	\$ (221,512)	\$ (190,762)
Exercise of employee stock options				205	294			294
Stock-based compensation						4,551		4,551
Issuance of Series F stock	11,776	59,973						
Issuance of Series C stock as a result of warrant exercises	4	11						
Series F amount interest						12,974		12,974
Change in par value					(17,547)	17,547		
Ownership change in non-controlling interest				1,082		3,083		3,083
Loss attributable to non-controlling interest				(55)			55	55
Net loss							(50,159)	(50,159)
<b>Balance at December 31, 2010</b>	53,148	\$ 191,257	\$ 1,027	11,073	\$ 111	\$ 51,541	\$ (271,616)	\$ (219,964)
Exercise of employee stock options				467	4	1,025		1,029
Exercise of common stock warrants				294	3	713		716
Stock-based compensation						6,952		6,952
Issuance of Series G stock	11,000	76,949						
Issuance of Series C stock as a result of warrant exercises	3	19						
Loss attributable to non-controlling interest				(453)			453	453
Net loss							(79,676)	(79,676)
<b>Balance at December 31, 2011</b>	64,151	\$ 268,225	\$ 574	11,834	\$ 118	\$ 60,231	\$ (350,839)	\$ (290,490)

The accompanying notes are an integral part of these consolidated financial statements.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Consolidated statements of cash flows**

(in thousands)	Years ended December 31,		
	2009	2010	2011
<b>Cash flows from operating activities</b>			
Net loss	\$ (49,073)	\$ (50,159)	\$ (79,676)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities			
Noncash benefit on release of tax valuation allowance	(3,402)		
Noncash interest expense	4,805	3,673	
Loss (gain) on mark-to-market on preferred stock warrants and contingent consideration	10	(104)	864
Loss (gain) on disposal of property and equipment	32	(26)	
Amortization of deferred lease benefits and tax incentives	(317)	(751)	(730)
Depreciation and amortization	2,755	4,379	5,326
Stock-based compensation	3,304	4,551	6,952
Changes in operating assets and liabilities, net of effect of acquisition			
Accounts receivable	(1,770)	(1,975)	(3,681)
Prepaid expenses and other current assets	(94)	(571)	(3,933)
Accounts payable	(220)	(830)	3,216
Accrued expenses	2,768	1,024	5,599
Deferred revenues	59,469	12,845	11,963
Deferred lease benefits	786	217	52
Deferred tax incentive		1,350	1,212
Other assets and liabilities, net	2	8	19
Net cash provided by (used in) operating activities	19,055	(26,369)	(52,817)
<b>Cash flows from investing activities</b>			
Purchase of property and equipment	(5,038)	(5,025)	(3,754)
Proceeds from sale of property and equipment		26	
Cash acquired in acquisition	92		
Release of restricted cash	95	95	
Other investing activities, net		4	7
Net cash used in investing activities	(4,851)	(4,900)	(3,747)
<b>Cash flows from financing activities</b>			
Proceeds from issuance of Series G, net of offering costs			76,949
Proceeds from issuance of common stock	183	294	1,745
Proceeds from issuance of convertible preferred stock of Silver Creek Pharmaceuticals, Inc.		4,165	
Deferred financing costs			(1,946)
Principal payment on capital lease obligations	(974)	(864)	(443)
Net cash (used in) provided by financing activities	(791)	3,595	76,305
Net increase (decrease) in cash and cash equivalents	13,413	(27,674)	19,741
Cash and cash equivalents, beginning of period	44,974	58,387	30,713
Cash and cash equivalents, end of period	\$ 58,387	\$ 30,713	\$ 50,454
<b>Noncash financing and investing activities</b>			
Accrued interest on Series F amount relieved to additional paid-in capital (Note 13)	\$	\$ 12,974	\$
Issuance of shares from Series F amount (Note 13)		59,973	
Series C convertible preferred stock received for technology license	1,469		
Fair value of assets acquired in acquisition	10,252		
Fair value of liabilities assumed in acquisition	4,479		
Fair value of equity issued in acquisition	9,292		
<b>Supplemental disclosure of cash flows</b>			
Cash paid for interest	\$ 109	\$ 55	\$ 13

The accompanying notes are an integral part of these consolidated financial statements.

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements**

**December 31, 2009, 2010 and 2011**

**1. Nature of the business**

Merrimack Pharmaceuticals, Inc. (the "Company") is a biopharmaceutical company discovering, developing and preparing to commercialize innovative medicines consisting of novel therapeutics paired with companion diagnostics. The Company has five targeted therapeutic oncology candidates in clinical development (MM-398, MM-121, MM-111, MM-302 and MM-151), multiple product candidates in preclinical development and a discovery effort advancing additional candidate medicines. The Company uses its interdisciplinary Network Biology approach in drug discovery and development. The Company was incorporated in the Commonwealth of Massachusetts in 1993 and reincorporated in the State of Delaware in October 2010.

The Company is subject to risks and uncertainties common to companies in the biopharmaceutical industry, including, but not limited to, ability to secure additional capital to fund operations, development by competitors of new technological innovations, dependence on collaborative arrangements, protection of proprietary technology, compliance with government regulations and dependence on key personnel. Product candidates currently under development will require significant additional research and development efforts, including extensive preclinical and clinical testing and regulatory approval prior to commercialization. These efforts require significant amounts of additional capital, adequate personnel infrastructure and extensive compliance reporting capabilities.

The accompanying consolidated financial statements have been prepared on a basis which assumes that the Company will continue as a going concern and which contemplates the realization of assets and satisfaction of liabilities and commitments in the normal course of business. However, the Company has incurred significant losses and does not have commercial operations underway. As of December 31, 2011, the Company had cash and cash equivalents of \$50,454,000. Present capital resources are not sufficient to fund the Company's planned operations for a twelve month period from December 31, 2011, and therefore, raise substantial doubt about the Company's ability to continue as a going concern. The Company will, during 2012, require significant additional funding to continue operations. Failure to receive additional funding could cause the Company to cease operations, in part or in full. The consolidated financial statements do not include any adjustments that may result from the outcome of these uncertainties.

Management of the Company is currently pursuing a public offering to raise the additional capital needed to continue planned operations. In the event that the Company is unable to complete a sufficient public offering, the Company would need to pursue other financing alternatives during 2012, which could include a private financing or bridge financing. The Company may not be able to obtain financing on acceptable terms, or at all, and the Company may not be able to enter into additional collaborative arrangements. The terms of any financing may adversely affect the holdings or the rights of the Company's stockholders. Arrangements with collaborators or others may require the Company to relinquish rights to certain of its technologies or product candidates. If the Company is unable to obtain funding, the Company could be forced to delay, reduce or eliminate its research and development programs or commercialization efforts, which could adversely affect its business prospects.

**2. Initial public offering (unaudited)**

On March 28, 2012, the Company signed an underwriting agreement and agreed to pricing terms on an initial public offering of 14,300,000 shares of common stock at a price of \$7.00 per share, which is expected to generate net proceeds of approximately \$93.5 million. The Company expects the

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**2. Initial public offering (unaudited) (Continued)**

transaction to close on April 3, 2012. The net proceeds provided upon closing of the initial public offering transaction, together with existing cash and cash equivalents, is expected to provide the Company sufficient capital resources to fund the Company into the second half of 2013 and is expected to address the substantial doubt about the Company's ability to continue as a going concern through 2012.

**3. Summary of significant accounting policies**

Significant accounting policies followed by the Company in the preparation of its consolidated financial statements are as follows:

**Principles of consolidation**

These consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary Hermes Biosciences, Inc. ("Hermes"), which was merged with and into the Company during 2011, its wholly-owned subsidiary Merrimack Pharmaceuticals (Bermuda) Ltd., which was incorporated during 2011, and its 74% majority-owned subsidiary Silver Creek Pharmaceuticals, Inc. ("Silver Creek"). All intercompany transactions and balances have been eliminated in consolidation.

**Use of estimates**

The accompanying consolidated financial statements have been prepared in conformity with generally accepted accounting principles ("GAAP") in the United States of America. GAAP requires the Company's management to make estimates and judgments that may affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. The Company bases estimates and judgments on historical experience and on various other factors that it believes to be reasonable under the circumstances. The significant estimates in these consolidated financial statements include revenue recognition, useful lives with respect to long-lived assets and intangibles, valuation of stock options, convertible preferred stock warrants, contingent consideration, accrued expenses, intangible assets, goodwill, in-process research and development and tax valuation reserves. The Company's actual results may differ from these estimates under different assumptions or conditions. The Company evaluates its estimates on an ongoing basis. Changes in estimates are reflected in reported results in the period in which they become known by the Company's management.

**Segment and geographic information**

Operating segments are defined as components of an enterprise engaging in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company views its operations and manages its business in one operating segment and the Company operates in only one geographic segment.

**Cash, cash equivalents and restricted cash**

Cash and cash equivalents are short-term, highly liquid investments with an original maturity of three months or less at the date of purchase. Investments qualifying as cash equivalents primarily consist of money market funds.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****3. Summary of significant accounting policies (Continued)**

Cash accounts with any type of restriction are classified as restricted cash. If restrictions are expected to be lifted in the next twelve months, the restricted cash account is classified as current. As of both December 31, 2010 and 2011, the Company recorded restricted cash of \$381,000.

**Concentration of credit risk**

Financial instruments that subject the Company to credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents in accredited financial institutions and therefore the Company's management believes these funds are subject to minimal credit risk. The Company has no significant off-balance sheet concentrations of credit risk such as foreign currency exchange contracts, option contracts or other hedging arrangements. For the years ended December 31, 2010 and 2011, Sanofi represented 98% and greater than 99% of research and development revenues, respectively. As of December 31, 2010 and 2011, Sanofi represented 98% and greater than 99% of accounts receivable, respectively.

**Property and equipment**

Property and equipment are recorded at cost and depreciated when placed into service using the straight-line method, based on their estimated useful lives as follows:

Asset classification	Estimated useful life (in years)
Lab equipment	3
IT equipment	3 - 7
Leaseholds improvements	Lesser of useful life or lease term
Furniture and fixtures	3

Upon retirement or sale, the cost of assets disposed of and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is recognized. Repairs and maintenance costs are expensed as incurred.

The Company reviews its long-lived assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of assets may not be fully recoverable or that the useful lives of these assets are no longer appropriate. Each impairment test is based on a comparison of the undiscounted cash flow to the recorded value of the asset. If an impairment is indicated, the asset will be written down to its estimated fair value on a discounted cash flow basis.

**Non-controlling interest**

Non-controlling interest represents the non-controlling stockholders' proportionate share of preferred stock and net loss of the Company's majority-owned consolidated subsidiary Silver Creek. On August 20, 2010, the Company acquired a controlling interest in Silver Creek (Note 7). The non-controlling stockholders' proportionate share of the preferred stock in Silver Creek of \$1,027,000 and \$574,000 was reflected as non-controlling interest in the Company's consolidated balance sheets as of December 31, 2010 and 2011, respectively, as a component of mezzanine equity.

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**3. Summary of significant accounting policies (Continued)**

**Revenue recognition**

The Company enters into biopharmaceutical product development agreements with collaborative partners for the research and development of therapeutic and diagnostic products. The terms of the agreements may include nonrefundable signing and licensing fees, funding for research, development and manufacturing, milestone payments and royalties on any product sales derived from collaborations. These multiple element arrangements are analyzed to determine whether the deliverables can be separated or whether they must be accounted for as a single unit of accounting.

In January 2011, the Company adopted new authoritative guidance on revenue recognition for multiple element arrangements. This guidance, which applies to multiple element arrangements entered into or materially modified on or after January 1, 2011, amends the criteria for separating and allocating consideration in a multiple element arrangement by modifying the fair value requirements for revenue recognition and eliminating the use of the residual method. The fair value of deliverables under the arrangement may be derived using a best estimate of selling price if vendor specific objective evidence and third-party evidence are not available. Deliverables under the arrangement will be separate units of accounting provided that a delivered item has value to the customer on a stand-alone basis and if the arrangement does not include a general right of return relative to the delivered item and delivery or performance of the undelivered item is considered probable and substantially in the control of the vendor. The Company also adopted guidance that permits the recognition of revenue contingent upon the achievement of a milestone in its entirety, in the period in which the milestone is achieved, only if the milestone meets certain criteria and is considered to be substantive. The Company did not enter into any significant multiple element arrangements or materially modify any of its existing multiple element arrangements during the year ended December 31, 2011. The Company's existing license and collaboration agreements continue to be accounted for under previously issued revenue recognition guidance for multiple element arrangements and milestone revenue recognition, as described below.

The Company recognized upfront license payments as revenue upon delivery of the license only if the license had stand-alone value and the fair value of the undelivered performance obligations could be determined. If the fair value of the undelivered performance obligations could be determined, such obligations were accounted for separately as the obligations were fulfilled. If the license was considered to either not have stand-alone value or have stand-alone value but the fair value of any of the undelivered performance obligations could not be determined, the arrangement was accounted for as a single unit of accounting and the license payments and payments for performance obligations were recognized as revenue over the estimated period of when the performance obligations would be performed.

Whenever the Company determined that an arrangement should be accounted for as a single unit of accounting, it determined the period over which the performance obligations would be performed and revenue would be recognized. If the Company could not reasonably estimate the timing and the level of effort to complete its performance obligations under the arrangement, then revenue under the arrangement was recognized on a straight-line basis over the period the Company expected to complete its performance obligations, which is reassessed at each subsequent reporting period.

The Company's collaboration agreements may include additional payments upon the achievement of performance-based milestones. As milestones are achieved, a portion of the milestone payment,

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**3. Summary of significant accounting policies (Continued)**

equal to the percentage of the total time that the Company has performed the performance obligations to date over the total estimated time to complete the performance obligations, multiplied by the amount of the milestone payment, will be recognized as revenue upon achievement of such milestone. The remaining portion of the milestone will be recognized over the remaining performance period. Milestones that are tied to regulatory approval are not considered probable of being achieved until such approval is received. Milestones tied to counter-party performance are not included in the Company's revenue model until the performance conditions are met.

Royalty revenue will be recognized upon the sale of the related products provided the Company has no remaining performance obligations under the arrangement.

**Research and development expenses**

Research and development expenses are charged to expense as incurred. Research and development expenses comprise costs incurred in performing research and development activities, including personnel-related costs, stock-based compensation, facilities, research-related overhead, clinical trial costs, contracted services, manufacturing, license fees and other external costs. The Company accounts for nonrefundable advance payments for goods and services that will be used in future research and development activities as expenses when the service has been performed or when the goods have been received rather than when the payment is made.

**Stock-based compensation**

The Company expenses the fair value of employee stock options over the vesting period. Compensation expense is measured using the fair value of the award at the grant date, net of estimated forfeitures, and is adjusted annually to reflect actual forfeitures. The fair value of each stock-based award is estimated using the Black-Scholes option valuation model and is expensed straight-line over the vesting period.

The Company records stock options issued to nonemployees at fair value, periodically remeasures to reflect the current fair value at each reporting period, and recognizes expense over the related service period. When applicable, these equity instruments are accounted for based on the fair value of the consideration received or the fair value of the equity instrument issued, whichever is more reliably measurable.

**Convertible preferred stock**

Preferred stock is initially recorded at the proceeds received, net of issuance costs and warrants, where applicable.

**Accumulated other comprehensive income (loss)**

GAAP establishes standards for reporting and displaying a full set of general purpose financial statements to be expanded to include the reporting of comprehensive income, which includes net income and other comprehensive income. For all periods presented the comprehensive loss was equal to the net loss.

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**3. Summary of significant accounting policies (Continued)**

**Convertible preferred stock warrants**

The Company accounts for freestanding warrants as liabilities at their fair value. The Company measures the fair value of the preferred stock warrants at the end of each reporting period and records the change in fair value to other income (expense). For the years ended December 31, 2009, 2010 and 2011, the Company recorded other income (expense) related to this remeasurement of \$(10,000), \$(74,000), and \$(864,000), respectively.

**Other income (expense)**

The Company records gains and losses on the change in value and time to expiration of preferred stock warrants, the recognition of federal and state sponsored tax incentives and other one-time income or expense-related items in other income (expense) on the Company's consolidated statement of operations. Other income for the year ended December 31, 2011 included a cash settlement of \$1.8 million from a former service provider.

**Deferred financing costs**

The Company capitalizes certain legal, accounting and other fees that are directly associated with in-process equity financings as current assets until such financings occur. After occurrence, these costs are recorded in equity or mezzanine equity net of proceeds received. As of December 31, 2011, the Company recorded deferred financing costs of \$1,946,000 in current assets on the accompanying consolidated balance sheet in contemplation of a 2012 equity financing.

**Income taxes**

The Company accounts for income taxes under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted rates in effect for the year in which these temporary differences are expected to be recovered or settled. Valuation allowances are provided if based on the weight of available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

The Company provides reserves for potential payments of tax to various tax authorities related to uncertain tax positions and other issues. Reserves are based on a determination of whether and how much of a tax benefit taken by the Company in its tax filing is more likely than not to be realized following resolution of any potential contingencies present related to the tax benefit. Potential interest and penalties associated with such uncertain tax positions are recorded as components of income tax expense. To date, the Company has not taken any uncertain tax positions or recorded any reserves, interest or penalties.

**Goodwill and intangible assets**

Goodwill and indefinite-lived intangible assets, including in-process research and development, are evaluated for impairment on an annual basis or more frequently if an indicator of impairment is present. No impairment of goodwill or indefinite-lived intangible assets resulted from the Company's

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**3. Summary of significant accounting policies (Continued)**

most recent evaluation which occurred in the third quarter of 2011. The Company's next annual impairment evaluation will be made in the third quarter of 2012 unless indicators arise that would require the Company to evaluate at an earlier date. The Company commences amortization of indefinite-lived intangible assets once the assets have reached technological feasibility or are determined to have an alternative future use and amortizes the assets over their estimated future life.

Definite-lived intangible assets, such as core technology, are evaluated for impairment whenever events or circumstances indicate that the carrying value may not be fully recoverable. Definite-lived intangible assets are separate from goodwill and indefinite-lived intangible assets and are deemed to have a definite life. The Company amortizes these assets over their estimated useful life.

**Reclassification**

Certain prior year amounts have been reclassified to conform with the current year presentation.

**Recent accounting pronouncements**

In September 2011, the FASB amended the authoritative guidance regarding the testing for goodwill impairment. Under the amendments, an entity has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, an entity determines it is not more likely than not that the fair value reporting of a reporting unit is less than the carrying amount, then performing the two-step impairment test is unnecessary. The changes are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, however, early adoption is permitted. The Company adopted this authoritative guidance on January 1, 2012 with no impact.

**4. Net loss per common share**

Basic net loss per share is calculated by dividing the net loss attributable to common stockholders by the weighted-average number of common shares outstanding during the period, without consideration for common stock equivalents. Diluted net loss per share is computed by dividing the net loss attributable to common stockholders by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, convertible preferred stock, stock options and warrants are considered to be common stock equivalents and are only included in the calculation of diluted net loss per share when their effect is dilutive.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****4. Net loss per common share (Continued)**

The following table presents the computation of basic and diluted net loss per share available to common stockholders:

(in thousands, except per share amount)	Years ended December 31,		
	2009	2010	2011
<b>Net Loss Per Share:</b>			
Numerator:			
Net loss attributable to Merrimack Pharmaceuticals, Inc.	\$ (49,073)	\$ (50,104)	\$ (79,223)
Plus: Unaccreted dividends on convertible preferred stock	(4,684)	(11,185)	(7,789)
Net loss available to common stockholders basic and diluted	(53,757)	(61,289)	(87,012)
Denominator:			
Weighted-average common shares basic and diluted	7,387	10,994	11,343
Net loss per share available to common stockholders basic and diluted	\$ (7.28)	\$ (5.57)	\$ (7.67)

The following common stock equivalents of potentially dilutive securities have been excluded from the computation of diluted weighted average shares outstanding as of December 31, 2009, 2010 and 2011 as the Company recorded a net loss in all periods and, therefore, they would be anti-dilutive:

(in thousands)	Years ended December 31,		
	2009	2010	2011
Convertible preferred stock	43,473	55,253	66,256
Options to purchase common stock	14,660	16,214	17,617
Preferred stock warrants	317	306	302
Common stock warrants	2,937	2,937	2,640

**5. License and collaboration agreements****Sanofi**

On September 30, 2009, the Company entered into a license and collaboration agreement with Sanofi for the development and commercialization of a drug candidate being developed by the Company under the name MM-121. The agreement became effective on November 10, 2009 and Sanofi paid the Company a nonrefundable, noncreditable upfront license fee of \$60.0 million. During the third quarter of 2010, the Company received a milestone payment of \$10.0 million associated with the dosing of the first patient in a Phase 2 clinical trial in breast cancer. During the fourth quarter of 2011, the Company received a milestone payment of \$10.0 million associated with the dosing of the first patient in a Phase 2 clinical trial in non-small cell lung cancer. The Company is eligible to receive additional future development, regulatory and sales milestone payments as well as future royalty payments depending on the success of MM-121.

Under the agreement, Sanofi is responsible for all MM-121 development and manufacturing costs. The Company retained the right to participate in the development of MM-121 through Phase 2 proof of concept trials. The Company also has the option to co-promote MM-121 in the United States. Sanofi reimburses the Company for direct costs incurred in development and compensates the Company for

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****5. License and collaboration agreements (Continued)**

its internal development efforts based on a full time equivalent ("FTE") rate. Also as part of the agreement, the Company was required to manufacture certain quantities of MM-121 and, at Sanofi's and the Company's option, may continue to manufacture additional quantities of MM-121 in the future. Sanofi reimburses the Company for direct costs incurred in manufacturing and compensates the Company for its internal manufacturing efforts based on a FTE rate. The Company satisfied its manufacturing obligations during 2010 and has elected to continue to manufacture quantities of MM-121.

The Company applied revenue recognition guidance to determine whether the performance obligations under this collaboration including the license, the right to future technology, back-up compounds, participation on steering committees, development services and manufacturing services could be accounted for separately or as a single unit of accounting. The Company determined that its development services performance obligation is considered a separate unit of accounting as it is set at the Company's option, has stand-alone value and the FTE rate is considered fair value. Therefore, the Company recognizes cost reimbursements for MM-121 development services as incurred. The Company determined that the license, the right to future technology, back-up compounds, participation on steering committees and manufacturing services performance obligations represented a single unit of accounting. As the Company cannot reasonably estimate its level of effort over the collaboration, the Company recognizes revenue from the upfront payment, milestone payment and manufacturing services payments using the contingency-adjusted performance model over the expected development period, which is currently estimated to be 12 years from the effective date of the agreement. Under this model, when a milestone is earned or manufacturing services are rendered and product is delivered, revenue is immediately recognized on a pro-rata basis in the period the milestone was achieved or product was delivered based on the time elapsed from the effective date of the agreement. Thereafter, the remaining portion is recognized on a straight-line basis over the remaining development period. During the years ended December 31, 2009, 2010 and 2011, the Company recognized revenue based on the following components of the Sanofi agreement:

(in thousands)	Years ended December 31,		
	2009	2010	2011
Upfront payment	\$ 694	\$ 5,000	\$ 5,000
Milestone payment		949	2,616
Development services	1,410	13,279	25,053
Manufacturing services and other		630	1,456
<b>Total</b>	<b>\$ 2,104</b>	<b>\$ 19,858</b>	<b>\$ 34,125</b>

As of December 31, 2009, 2010 and 2011, the Company had deferred revenue of \$59,505,000, \$72,426,000 and \$84,466,000, respectively, related to the collaboration. As of December 31, 2009, 2010 and 2011, the Company had accounts receivable of \$1,610,000, \$3,683,000 and \$7,403,000, respectively, under the collaboration of which \$783,000, \$2,796,000 and \$2,925,000 were unbilled as of December 31, 2009, 2010 and 2011, respectively.

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**5. License and collaboration agreements (Continued)**

**GTC Biotherapeutics, Inc.**

In July 2009, the Company entered into a license agreement with GTC Biotherapeutics, Inc. ("GTC") for the development of MM-093 by GTC. As consideration, GTC returned 662,000 shares of the Company's Series C convertible preferred stock to the Company. The Company determined the fair value of the consideration transferred to be \$1,469,000. The Company applied revenue recognition guidance to determine that the performance obligations under this agreement, including the license, the right to future technology, and manufacturing support should be accounted for as a single unit of accounting. The consideration received is being recognized on a straight-line basis over the expected performance period, which is currently estimated to be 19 years from the effective date of the agreement. During the years ended December 31, 2009, 2010 and 2011 the Company recognized revenue of \$37,000, \$76,000 and \$76,000, respectively. As of December 31, 2009, 2010 and 2011, the Company had \$1,432,000, \$1,356,000 and \$1,279,000 of deferred revenue, respectively, and accounts receivable related to the reimbursement of intellectual property costs of \$153,000, \$42,000 and \$13,000, respectively.

**PharmaEngine, Inc.**

On May 5, 2011, the Company entered into an assignment, sublicense and collaboration agreement with PharmaEngine, Inc. ("PharmaEngine") under which the Company reacquired rights in Europe and certain countries in Asia to a drug being developed under the name MM-398. In exchange, the Company agreed to pay PharmaEngine a nonrefundable, noncreditable upfront payment of \$10.0 million and will be required to make up to an aggregate of \$80.0 million in development and regulatory milestone payments and \$130.0 million in sales milestone payments upon the achievement of specified development, regulatory and annual net sales milestones. PharmaEngine is also entitled to tiered royalties on net sales of MM-398 in Europe and certain countries in Asia. The Company is responsible for all future development costs of MM-398 except those required specifically for regulatory approval in Taiwan. The Company determined that PharmaEngine is a variable interest entity based on an analysis of PharmaEngine's capitalization. However, the Company determined that the Company cannot control the activities of PharmaEngine, and therefore, the Company is not the primary beneficiary and should not consolidate the financial results of PharmaEngine.

During the year ended December 31, 2011, the Company recognized research and development expenses of \$11.2 million related to the agreement with PharmaEngine, which consisted of a \$10.0 million upfront payment and \$1.2 million of research and development expense reimbursement. As of December 31, 2011, the Company had amounts payable of \$280,000 related to the agreement with PharmaEngine.

**6. Fair value of financial instruments**

The carrying amounts of cash and cash equivalents, restricted cash, prepaid expenses, accounts receivable, accounts payable and accrued expenses approximates fair value due to the short-term nature of these instruments. The capital lease obligations, convertible preferred stock warrants and contingent consideration are also carried at fair value.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****6. Fair value of financial instruments (Continued)**

Fair value is an exit price, representing the amount that would be received from the sale of an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value is determined based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect certain market assumptions. As a basis for considering such assumptions, GAAP establishes a three-tier value hierarchy, which prioritizes the inputs used to develop the assumptions and for measuring fair value as follows: (Level 1) observable inputs such as quoted prices in active markets for identical assets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value.

The following tables show assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 and 2011 and the input categories associated with those assets and liabilities:

<b>As of December 31, 2010</b> <b>(in thousands)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>			
Cash equivalents	\$ 15,500	\$	\$
<b>Liabilities</b>			
Convertible preferred stock warrants			652

<b>As of December 31, 2011</b> <b>(in thousands)</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
<b>Assets</b>			
Cash equivalents	\$ 35,076	\$	\$
<b>Liabilities</b>			
Convertible preferred stock warrants			1,516

The Company's cash and cash equivalents are invested in a U.S. treasury and federal agency-backed money market fund that approximates its face value. The fair value of the convertible preferred stock warrants was determined using the Black-Scholes option valuation model. The fair value of contingent consideration was determined by performing a probability weighted analysis of the likelihood of occurrence of potential future financing events.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****6. Fair value of financial instruments (Continued)**

The following table provides a roll-forward of the fair value of the convertible preferred stock warrants and contingent consideration, categorized as Level 3 instruments, for the years ended December 31, 2009, 2010 and 2011:

(in thousands)	Contingent consideration	Convertible preferred stock warrants
Balance, December 31, 2009	178	578
Realized gain	(178)	
Unrealized loss included in other expense		74
Balance, December 31, 2010		652
Unrealized loss included in other expense		864
Balance, December 31, 2011	\$	\$ 1,516

**7. Consolidated subsidiaries****Hermes BioSciences, Inc.**

On October 6, 2009, (the "Acquisition Date"), the Company completed the acquisition of all outstanding shares of Hermes BioSciences, Inc. ("Hermes"), a privately-held biotechnology company developing lipidic nano-carriers to allow for targeted delivery of small molecule drugs, including chemotherapies, with the goal of improving cancer treatment safety and efficacy.

As consideration for the acquisition, the Company issued 4,383,000 shares of common stock with an estimated fair value of \$9,292,000 based on an internal valuation prepared by the Company. The acquisition also included a contingent consideration arrangement that required additional shares to be issued by the Company to Hermes' former stockholders based on the occurrence and timing of certain potential future financing events. The range of additional shares that the Company could have been required to issue on the Acquisition Date as contingent consideration was between 0 and 1,100,000 and issuance could have occurred up to 24 months after the Acquisition Date. The estimated fair value of the contingent consideration recognized on the acquisition date of \$178,000 was determined by performing a probability weighted analysis of the likelihood of occurrence of potential future financing events. That estimate was based on significant inputs not observable in the market, which FASB Accounting Standards Codification ("ASC") No. 820, *Fair Value Measurements and Disclosures* ("ASC 820"), refers to as Level 3 inputs. Key assumptions included management's estimates of the probabilities of such potential future financing events occurring.

As of December 31, 2010, 400,000 additional shares could have been issued as contingent consideration. However, the Company determined a zero probability that the contingent consideration would ultimately be paid and recognized a gain of \$178,000 for the year ended December 31, 2010. On July 8, 2011, the Company satisfied the contingent consideration triggering event, which reduced the shares that could be issued from 400,000 to zero.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****7. Consolidated subsidiaries (Continued)**

The following table summarizes the consideration transferred to Hermes and the amounts of identified assets acquired and liabilities assumed on the Acquisition Date:

Fair value of consideration transferred:

<b>(in thousands)</b>	
Common shares of Merrimack Pharmaceuticals, Inc.	\$ 9,292
Contingent consideration	178
	<b>\$ 9,470</b>

Recognized amounts of identifiable assets acquired and liabilities assumed:

<b>(in thousands)</b>	
Cash acquired from Hermes	\$ 92
Prepaid expenses	9
Other long-term assets	33
In-process research and development ("IPR&D")	7,010
Intangible assets	3,200
Accounts payable	(1,042)
Accrued expenses	(35)
Deferred tax liabilities, net of deferred tax assets	(3,402)
<b>Total identifiable net assets</b>	<b>5,865</b>
Goodwill	3,605
<b>Total net assets</b>	<b>\$ 9,470</b>

The value assigned to IPR&D of \$7,010,000 related to several development programs: an antibody-targeted nanotherapeutic which contains a chemotherapy drug, a nanotherapeutic which contains a chemotherapy drug and other programs in the amounts of \$2,800,000, \$3,400,000 and \$810,000, respectively. The value assigned to intangible assets of \$3,200,000 related to core nano-carrier technology acquired from Hermes. These values were estimated by applying an income approach which includes significant inputs not observable in the market, which ASC 820 refers to as Level 3 inputs. These values were determined by estimating the costs to develop the acquired IPR&D into commercially viable products, estimating the net cash flows from such projects and discounting the net cash flows back to their present values. The probability of success factors and discount rates used for each project considered the uncertainty surrounding the successful development of the acquired IPR&D. Key assumptions included estimated forecasted future product revenues based on actual sales from similar marketed products, estimated expenses necessary to bring these products to market and margins based on historical company and industry data, application of a company specific discount rate in the range of 25% to 30%, program specific probability of success factors based on management's estimate of the likelihood of occurrence of future events and the estimated timing of product approvals, which were assumed no earlier than 2016, based on company and industry data for similar products in similar markets. The goodwill recognized is not tax deductible.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****7. Consolidated subsidiaries (Continued)**

The following unaudited pro forma summary presents consolidated information of the Company after applying the Company's accounting policies as if the business combination had occurred on January 1, 2009:

(in thousands)	Pro forma year ended December 31, 2009
Research and development revenues	\$ 3,100
Net loss	\$ 49,257

In 2009, the Company incurred \$309,000 of third party acquisition-related costs. These expenses are included in general and administrative expense in the Company's consolidated statement of operations for the year ended December 31, 2009.

As of December 31, 2010 and 2011, none of the IPR&D projects have reached technological feasibility nor do they have any alternative future use; therefore, the Company has not commenced amortization of those assets. The core technology asset is being amortized on a straight-line basis over a period of ten years which is management's best estimate of the useful life of this technology.

**Silver Creek Pharmaceuticals, Inc.**

Silver Creek was incorporated on June 22, 2010 and commenced operations on August 20, 2010. On August 20, 2010, the Company purchased 12,000,000 shares of Silver Creek Convertible Series A Preferred Stock ("Silver Creek Series A") in exchange for technology licenses. On August 20, 2010 and December 17, 2010, Silver Creek issued a total of 4,190,000 shares of Silver Creek Series A to other investors in exchange for \$4,165,000, net of \$25,000 of issuance costs. The Company consolidated Silver Creek on August 20, 2010 as the Company concluded that Silver Creek is a variable interest entity and the Company is the primary beneficiary. The Company has the ability to direct the activities of Silver Creek through its ownership percentage and through the board of director seats controlled by the Company and its related parties and de facto agents. As of December 31, 2010 and 2011, the Company owned 74% of the voting stock of Silver Creek and as of December 31, 2010 and 2011, the Company recorded a non-controlling interest of \$1,027,000 and \$574,000, respectively, as a component of mezzanine equity on the Company's consolidated balance sheets based on the terms of the Silver Creek Series A.

As of December 31, 2010, the Company consolidated Silver Creek total assets and total liabilities of \$3,976,000 and \$61,000, respectively. As of December 31, 2011, the Company consolidated Silver Creek total assets and total liabilities of \$2,302,000 and \$39,000, respectively.

As of December 31, 2010 and 2011, employees and directors of the Company owned approximately 7% of Silver Creek Series A.

**Merrimack Pharmaceuticals (Bermuda) Ltd.**

Merrimack Pharmaceuticals (Bermuda) Ltd. was incorporated in Bermuda during 2011, is wholly-owned by the Company and holds certain intellectual property rights with respect to MM-398.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****8. Goodwill and intangible assets, net**

Changes in the carrying value of goodwill, IPR&D and intangible assets for the years ended December 31, 2009, 2010 and 2011 were as follows:

(in thousands)	Intangible assets	IPR&D	Goodwill
Balance, December 31, 2008	\$	\$	\$
Acquisition of Hermes	3,200	7,010	3,605
Amortization	(75)		
Balance, December 31, 2009	3,125	7,010	3,605
Amortization	(320)		
Balance, December 31, 2010	2,805	7,010	3,605
Amortization	(320)		
Balance, December 31, 2011	\$ 2,485	\$ 7,010	\$ 3,605

Definite-lived intangible assets subject to amortization consist of core technology acquired from Hermes. The Company commenced amortization of these assets as of the Acquisition Date on a straight-line basis over a period of ten years, which is the estimated useful life of this technology. Amortization expense is expected to be as follows for the next five-year period:

Year Ended December 31,	(in thousands)
2012	\$ 320
2013	320
2014	320
2015	320
2016	320

Indefinite-lived intangible assets not subject to amortization consist of IPR&D acquired from Hermes. As of December 31, 2010 and 2011, the Company had not commenced amortization of IPR&D as it has not yet reached technological feasibility and has no alternative future use; accordingly, the full value of the IPR&D recorded at the Acquisition Date remained recorded as of December 31, 2010 and 2011.

**9. Cash equivalents**

The Company's investment portfolio consists of investments classified as cash equivalents. All highly liquid investments with an original maturity of three months or less when purchased are considered to be cash equivalents. All cash equivalents are carried at cost, which approximates fair value. Cash equivalents included in cash and cash equivalents were \$15,500,000 and \$35,076,000 as of December 31, 2010 and 2011, respectively.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****10. Property and equipment, net**

Property and equipment consisted of the following:

(in thousands)	December 31,	
	2010	2011
Lab equipment	\$ 9,221	\$ 11,757
IT equipment	1,301	2,204
Leasehold improvements	7,564	7,698
Furniture and fixtures	314	329
Construction in process	182	348
	18,582	22,336
Less: Accumulated depreciation and amortization	(11,124)	(16,130)
	\$ 7,458	\$ 6,206

Depreciation expense was \$2,680,000, \$4,059,000 and \$5,006,000 for the years ended December 31, 2009, 2010 and 2011, respectively.

During 2010, the Company disposed of fixed assets of \$106,000 with accumulated depreciation of \$106,000. During 2010, the Company sold fully depreciated fixed assets of \$26,000, resulting in a gain on disposal. During 2009, the Company disposed of fixed assets of \$658,000 with accumulated depreciation of \$626,000. This resulted in a loss on disposal of \$32,000. No fixed assets were disposed of or sold during the year ended December 31, 2011.

In August 2004, the Company entered into an equipment financing agreement with a leasing company. The agreement involved the sale of some of the Company's fixed assets to and the leasing of those assets back from the leasing company. The Company's option to draw further on this lease facility expired during 2008. Property and equipment under capital leases as of December 31, 2010 and 2011 was \$2,669,000 and \$4,114,000, respectively. For the years ended December 31, 2009, 2010 and 2011, depreciation of property and equipment under capital lease totaled \$1,067,000, \$409,000 and \$26,000, respectively.

**11. Accrued expenses**

Accrued expenses as of December 31, 2010 and 2011 consisted of the following:

(in thousands)	December 31,	
	2010	2011
Goods and services	\$ 4,395	\$ 9,189
Payroll and related benefits	2,861	3,666
Total accrued expenses	\$ 7,256	\$ 12,855

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****12. Convertible preferred stock**

The following is a summary of the Company's convertible and nonconvertible redeemable preferred stock:

(in thousands, except per share amounts)	Shares authorized	Shares issued and outstanding	Carrying value	Liquidation preference (per share)	Conversion price (per share)
<b>As of December 31, 2009</b>					
Series A	86		\$	\$	\$
Series B	6,000	3,874	14,046	4.40	2.85
Series C	15,100	14,417	24,429	1.89	1.89
Series D	11,500	8,086	28,267	3.50	3.50
Series E	15,000	14,991	64,531	4.50	4.50
	47,686	41,368	\$ 131,273		
<b>As of December 31, 2010</b>					
Series B	6,000	3,874	\$ 14,046	\$ 4.40	\$ 2.85
Series C	15,100	14,421	24,440	1.89	1.89
Series D	11,500	8,086	28,267	3.50	3.50
Series E	15,000	14,991	64,531	4.50	4.50
Series F	15,680	11,776	59,973	5.10	5.10
	63,280	53,148	\$ 191,257		
<b>As of December 31, 2011</b>					
Series B	6,000	3,874	\$ 14,046	\$ 4.40	\$ 2.85
Series C	15,100	14,424	24,459	1.89	1.89
Series D	11,500	8,086	28,267	3.50	3.50
Series E	15,000	14,991	64,531	4.50	4.50
Series F	15,680	11,776	59,973	5.10	5.10
Series G	11,000	11,000	76,949	7.00	7.00
	74,280	64,151	\$ 268,225		

During 2010, the Company amended its articles of organization to remove Series A nonconvertible redeemable preferred stock and as a result, as of December 31, 2010, Series A was no longer authorized.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****12. Convertible preferred stock (Continued)**

The following is the carrying value activity of convertible preferred stock for the years ended December 31, 2009, 2010 and 2011:

(in thousands)	Convertible preferred stock						Total
	Series B convertible preferred stock amount	Series C convertible preferred stock amount	Series D convertible preferred stock amount	Series E convertible preferred stock amount	Series F convertible preferred stock amount	Series G convertible preferred stock amount	
<b>Balance at December 31, 2008</b>	\$ 14,046	\$ 25,895	\$ 28,267	\$ 64,531	\$	\$	\$ 132,739
Return of Series C stock as result of license agreement		(1,469)					(1,469)
Issuance of Series C stock as result of warrant exercises		3					3
<b>Balance at December 31, 2009</b>	14,046	24,429	28,267	64,531			131,273
Issuance of Series F stock					59,973		59,973
Issuance of Series C stock as result of warrant exercises		11					11
<b>Balance at December 31, 2010</b>	14,046	24,440	28,267	64,531	59,973		191,257
Issuance of Series C stock as result of warrant exercises		19					19
Issuance of Series G stock						76,949	76,949
<b>Balance at December 31, 2011</b>	\$ 14,046	\$ 24,459	\$ 28,267	\$ 64,531	\$ 59,973	\$ 76,949	\$ 268,225

The following is the issued and outstanding share activity of the Company's convertible preferred stock for the years ended December 31, 2009, 2010 and 2011:

(in thousands)	Convertible preferred stock						Total
	Series B convertible preferred stock shares	Series C convertible preferred stock shares	Series D convertible preferred stock shares	Series E convertible preferred stock shares	Series F convertible preferred stock shares	Series G convertible preferred stock shares	
<b>Balance at December 31, 2008</b>	3,874	15,077	8,086	14,991			42,028
Return of Series C stock as result of license agreement		(662)					(662)
Issuance of Series C stock as result of warrant exercises		2					2
<b>Balance at December 31, 2009</b>	3,874	14,417	8,086	14,991			41,368
Issuance of Series F stock					11,776		11,776
Issuance of Series C stock as result of warrant exercises		4					4
<b>Balance at December 31, 2010</b>	3,874	14,421	8,086	14,991	11,776		53,148
Issuance of Series C stock as result of warrant exercises		3					3
Issuance of Series G stock						11,000	11,000
<b>Balance at December 31, 2011</b>	3,874	14,424	8,086	14,991	11,776	11,000	64,151



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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**12. Convertible preferred stock (Continued)**

The rights and preferences at December 31, 2011 of the Series B, Series C, Series D, Series E, Series F and Series G (collectively, the "Preferred Stock") are as follows:

***Voting rights***

Series B, Series C, Series D, Series E, Series F and Series G stockholders are entitled to vote together with all other classes and series of stock as a single class on all matters and are entitled to the number of votes equal to the number of shares of common stock into which each share of Preferred Stock is then convertible.

***Dividends***

Shares of Series B, Series C, Series D, Series E, Series F and Series G accrue cumulative dividends at the annual rate of 4% of the respective purchase prices of each series, up to a maximum of 25% of the respective purchase prices, as provided in the Company's Restated Certificate of Incorporation (the "Accrued Dividends"). The Accrued Dividends are payable only upon an actual liquidation, dissolution or winding-up of the Company, a Deemed Liquidation (as defined in the Company's Restated Certificate of Incorporation), or as to the Series B, a conversion of the Series B into common stock. No dividends shall be declared, paid or set aside on any other series or class of capital stock unless a comparable dividend is declared, paid or set aside for each share of Preferred Stock on an as-converted basis. As of December 31, 2011, no dividends have been declared or paid by the Company.

***Liquidation preference***

In the event of an actual liquidation, dissolution or winding-up of the Company, the holders of the Preferred Stock shall be entitled to elect to convert their respective shares and/or any Accrued Dividends into common stock or receive a payment out of the assets of the Company available for distribution to its stockholders and prior to any distributions to the holders of common stock, in the amount of \$4.40 per share of Series B plus applicable, unpaid Accrued Dividends (the "Series B Liquidation Preference") in the case of Series B, \$1.89 per share of Series C plus applicable, unpaid Accrued Dividends (the "Series C Liquidation Preference") in the case of Series C, \$3.50 per share of Series D plus applicable, unpaid Accrued Dividends (the "Series D Liquidation Preference") in the case of Series D, \$4.50 per share of Series E plus applicable, unpaid Accrued Dividends (the "Series E Liquidation Preference") in the case of Series E, \$5.10 per share of Series F plus applicable, unpaid Accrued Dividends (the "Series F Liquidation Preference") in the case of Series F and \$7.00 per share of Series G plus applicable, unpaid Accrued Dividends (the "Series G Liquidation Preference") in the case of Series G.

Unless the holders of at least two thirds of the outstanding shares of Series B, Series C, Series D, Series E, Series F and Series G each vote (as a separate class) that such events shall not be a deemed liquidation, upon the occurrence of (i) a consolidation of the Company with, or merger of the Company with or into, another business organization, other than a merger with an affiliate of the Company or a merger in which the Company is the surviving Company and the stockholders of the Company prior to such merger continue to hold a majority of the voting power, or (ii) the sale of all or substantially all of the Company's business assets (a "Deemed Liquidation"), the holders of shares of Preferred Stock will be entitled to either elect (A) to convert the shares of Preferred Stock and/or any Accrued Dividends into common stock or (B) to receive, prior to any distribution to holders of

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**12. Convertible preferred stock (Continued)**

common stock, a liquidation preference less the amount of any Accrued Dividends converted into common stock; provided that the aggregate amount received by the holders of Series B, Series C, Series D, Series E, Series F and Series G for each share of Series B, Series C, Series D, Series E, Series F and Series G shall not exceed 125% of the Series B, Series C, Series D, Series E, Series F and Series G purchase price (each as defined in the Company's Restated Certificate of Incorporation), as applicable. After payment of Series B Liquidation Preference, Series C Liquidation Preference, Series D Liquidation Preference, Series E Liquidation Preference, Series F Liquidation Preference and Series G Liquidation Preference, the holders of common stock shall be entitled to receive the remaining assets of the Company available for distributions.

***Conversion***

Each share of the Preferred Stock is convertible at the option of the holder into common stock of the Company based on a defined conversion ratio, adjustable for certain standard antidilution adjustments. At December 31, 2010 and 2011, the conversion prices for shares of Series B, Series C, Series D, Series E, Series F and Series G were \$2.85, \$1.89, \$3.50, \$4.50, \$5.10 and \$7.00, respectively. If at any time the Company effects a firm commitment underwritten initial public offering for shares of common stock with a per share offering price equal to or greater than the greater of \$4.40 or 250% of the Series C conversion price, which results in aggregate gross proceeds to the Company of at least \$50 million, then all outstanding shares of the Preferred Stock automatically convert to shares of common stock, with Accrued Dividends of approximately \$4,263,000 on the Series B paid in cash.

**13. Series F amount**

During 2010, management determined that the Company may not have obtained all of the stockholder approvals required with respect to the Restated Articles of Organization that it filed with the Secretary of the Commonwealth of the Commonwealth of Massachusetts (the "Massachusetts Secretary") on November 2, 2007 (the "2007 Restated Articles"). Among other changes, the 2007 Restated Articles were intended to authorize the 11,776,000 shares of Series F Convertible Preferred Stock (the "Series F") that the Company agreed to issue to purchasers in 2007 and 2008. In addition, the Company filed Articles of Amendment to the 2007 Restated Articles with the Massachusetts Secretary on November 5, 2009 (the "2009 Amendment") that the Company believes were ineffective as a result of the failure to obtain the requisite stockholder approvals for the 2007 Restated Articles. As a result, the Series F was not legally issued preferred stock, but rather an unsettled obligation to issue Series F.

In order to properly authorize and issue the Series F, in July and August 2010, the board of directors and stockholders of the Company, respectively, approved new Restated Articles of Organization (the "2010 Restated Articles") that provided for the amendments contemplated by the 2007 Restated Articles and the 2009 Amendment. In order to provide the purchasers with shares of Series F having the economic benefit of the accruing dividends to which they would have been entitled had the Series F been properly authorized and issued as originally intended, the 2010 Restated Articles authorized the Series F in sub-series, with each sub-series corresponding to a closing date in 2007 or 2008. The preferences, limitations and relative rights of the shares of each sub-series of Series F authorized by the 2010 Restated Articles are the same as to the preferences, limitations and relative rights of the shares of Series F intended to be authorized by the 2007 Restated Articles and the 2009 Amendment. The 2010 Restated Articles were filed with the Massachusetts Secretary of State on October 6, 2010.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****13. Series F amount (Continued)**

Following the filing of the 2010 Restated Articles, the Company entered into an Exchange Agreement with each individual and entity that originally agreed to purchase shares of Series F in 2007 or 2008. Pursuant to the Exchange Agreements, the Company agreed to exchange the rights to receive the shares of Series F that it had agreed to issue in 2007 and 2008 for the same number of shares of the applicable sub-series of Series F authorized by the 2010 Restated Articles. Such exchanges were completed on October 6, 2010.

The Company recorded imputed noncash interest expense for financial reporting purposes of \$4,805,000, \$3,673,000 and \$0 for the years ended December 31, 2009, 2010 and 2011, respectively, due to the delayed delivery of Series F. Upon completion of the exchanges of Series F on October 6, 2010, the Company issued 11,776,000 shares of Series F. The Series F amount was relieved and the initial investment of \$5.10 per share was recorded as convertible preferred stock and the accrued noncash interest expense of \$12,974,000 was recorded as additional paid-in capital during the fourth quarter of 2010.

**14. Stock warrants**

The following is a description of the common stock warrant activity of the Company:

<b>(in thousands, except per share amounts)</b>	<b>Warrants for the purchase of common stock</b>	<b>Weighted average exercise price</b>
Balance December 31, 2008	2,937	\$2.35
Balance December 31, 2009	2,937	2.35
Balance December 31, 2010	2,937	2.93
Expired	(1)	2.47
Exercised	(296)	2.46
Balance December 31, 2011	2,640	\$2.98

During the third quarter of 2010, 2,596,000 warrants held by a related party stockholder were modified to extend the expiration dates by 4 years and increase the exercise prices from \$2.12 and \$2.47 to \$3.00 per share. The modification was valued using a Black-Scholes option valuation model and the Company accounted for the \$1,803,000 of incremental value within additional paid-in capital.

During the fourth quarter of 2011, warrants to purchase 290,000 shares of common stock were exercised, and as a result, the Company received \$716,000 in proceeds and issued 290,000 shares of common stock. In addition, warrants to purchase 6,000 shares of common stock were cashless exercised and 4,000 shares of common stock were issued. Warrants to purchase 1,000 shares of common stock expired in the fourth quarter of 2011.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****14. Stock warrants (Continued)**

The following is a description of the preferred stock warrant activity of the Company:

(in thousands, except per share amounts)	Warrants for the purchase of preferred stock			
	Series C	Weighted average exercise price	Series D	Weighted average exercise price
Balance, December 31, 2008	21	\$1.89	302	\$3.50
Exercised	(6)	1.89		
Balance, December 31, 2009	15	1.89	302	3.50
Exercised	(11)	1.89		
Balance, December 31, 2010	4	1.89	302	3.50
Exercised	(4)	1.89		
Balance, December 31, 2011			302	\$3.50

**15. Common stock**

As of December 31, 2010 and 2011, the Company had 125.0 million shares and 138.5 million shares, respectively, of \$0.01 par common stock authorized. During the fourth quarter of 2010, the Company changed the par value of its common stock from no par to \$0.01 par and recognized a \$17,547,000 reduction to common stock and a corresponding increase to additional paid-in capital. There were 11,073,000 and 11,834,000 common shares issued and outstanding as of December 31, 2010 and 2011, respectively. The shares reserved for future issuance as of December 31, 2010 and 2011 consisted of the following:

(in thousands)	December 31, 2010	December 31, 2011
Conversion of Series B, Series C, Series D, Series E, Series F and Series G preferred stock	55,253	66,256
Preferred stock warrants	306	302
Common stock warrants	2,937	2,640
Contingent consideration	400	
1999 Stock Option Plan and 2008 Stock Incentive Plan	16,214	17,617
	75,110	86,815

**16. Stock-based compensation**

Prior to 2008, the Company granted equity awards to employees, officers and consultants under the 1999 Stock Option Plan (the "1999 Plan"). In 2008, the Company adopted the 2008 Stock Incentive Plan (the "2008 Plan") for employees, officers, directors, consultants and advisors and decided that no additional shares of common stock would be issued under the 1999 Plan. The 2008 Plan, which is administered by the Board of Directors of the Company, permitted the Company to grant incentive and nonqualified stock options, restricted stock, restricted stock units and other stock-based awards, up to a

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****16. Stock-based compensation (Continued)**

maximum of 12.4 million shares. In 2009 and 2011, the Board of Directors and Stockholders of the Company amended the 2008 Plan to increase the number of shares that may be issued under the plan by 4.7 million and 2.5 million, respectively, up to a maximum of 19.6 million shares. Awards typically vest over three years for employees and immediately for directors, at the discretion of the Board of Directors, and options typically have a maximum term of ten years. As of December 31, 2010 and 2011, there were 201,000 and 830,000 shares, respectively, available to be issued under the 2008 Plan.

In 2009, as allowed under the 2008 Plan, the Board of Directors of the Company voted to lower the exercise prices of certain outstanding stock options held by nonexecutive employees which had exercise prices greater than the fair market value of the underlying common stock. As a result, options to purchase 1.9 million shares of common stock with exercise prices greater than \$2.12 per share were amended to reflect the new exercise price of \$2.12 per share. Share-based compensation recognized as a result of this amendment was \$59,000, \$103,000 and \$20,000 for the years ended December 31, 2009, 2010 and 2011, respectively.

During 2009, 2010 and 2011, the Company issued options to purchase 4.2 million, 2.9 million and 2.3 million shares of common stock, respectively, to its directors and employees. These options generally vest over a three-year period for employees and immediately for directors.

During 2009, 2010 and 2011, the Company granted options to purchase 85,000, 40,000 and 83,000 shares of common stock, respectively, to nonemployees. The assumptions used to determine the fair value of options granted to nonemployees were consistent with those used for employee grants.

The Company recognized stock-based compensation expense as follows:

(in thousands)	Year ended December 31,		
	2009	2010	2011
Employee awards:			
Research and development	\$ 1,941	\$ 2,787	\$ 3,597
General and administrative	1,314	1,706	2,875
Stock-based compensation for employee awards	3,255	4,493	6,472
Stock-based compensation for nonemployee awards	49	58	480
Total stock-based compensation	\$ 3,304	\$ 4,551	\$ 6,952

The fair value of options granted in 2009, 2010 and 2011 were estimated at the date of grant using the following assumptions:

	Year ended December 31,		
	2009	2010	2011
Risk-free interest rate	2.4 - 3.2%	1.7 - 2.8%	1.3 - 2.5%
Expected dividend yield	0%	0%	0%
Expected term	5 - 5.9 years	5 - 5.9 years	5 - 5.9 years
Expected volatility	69 - 76%	73 - 77%	71 - 73%

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Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****16. Stock-based compensation (Continued)**

The Company uses the simplified method to calculate the expected term as it does not have sufficient historical exercise data to provide a reasonable basis upon which to estimate expected term. The computation of expected volatility is based on the historical volatility of comparable companies from a representative peer group selected based on industry and market capitalization. The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected life of the stock options. Management estimates expected forfeitures based on historical experience and recognizes compensation costs only for those equity awards expected to vest.

The following table summarizes stock option activity, including options issued to nonemployees:

(in thousands, except per share amounts)	Number of shares	Weighted average exercise price	Aggregate intrinsic value
Outstanding, December 31, 2008	11,483	\$ 2.06	\$ (2,858)
Granted	4,239	2.08	
Exercised	(430)	0.99	
Forfeited	(632)	2.20	
Outstanding, December 31, 2009	14,660	\$ 2.02	\$ 1,492
Granted	2,984	2.52	
Exercised	(205)	1.44	
Forfeited	(1,225)	2.26	
Outstanding, December 31, 2010	16,214	\$ 2.10	\$ 9,628
Granted	2,350	5.73	
Exercised	(467)	2.20	
Forfeited	(480)	2.45	
Outstanding, December 31, 2011	17,617	\$ 2.56	\$ 74,329
Exercisable, December 31, 2011	13,571	\$ 2.18	\$ 62,411
Vested and expected to vest, December 31, 2011	17,326	\$ 2.53	\$ 73,636

The aggregate intrinsic value was calculated as the difference between the exercise price of the stock options and the fair value of the underlying common stock as of the respective balance sheet date. The aggregate intrinsic value of options exercised in 2009, 2010 and 2011 was \$226,000, \$145,000 and \$1,392,000, respectively.

As of December 31, 2011, there was \$9,142,000 of total unrecognized compensation cost related to nonvested stock awards. As of December 31, 2011, the Company expects to recognize those costs over weighted average periods of approximately 1.7 years.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****16. Stock-based compensation (Continued)**

The following table summarizes information including the range of exercise prices for stock options outstanding and exercisable at December 31, 2011:

Exercise Price	Options outstanding			Options exercisable		
	Number of shares (in thousands)	Weighted average remaining contractual life (years)	Weighted average exercise price	Number of shares (in thousands)	Weighted average remaining contractual life (years)	Weighted average exercise price
\$1.25	1,380	2.74	\$ 1.25	1,380	2.74	\$ 1.25
1.71	1,425	3.66	1.71	1,425	3.66	1.71
1.81	2,361	6.81	1.81	2,322	6.80	1.81
2.12	5,918	7.30	2.12	4,719	7.13	2.12
2.19	535	0.87	2.19	535	0.87	2.19
2.47	640	4.68	2.47	640	4.68	2.47
2.59	1,036	5.76	2.59	1,036	5.76	2.59
2.69	1,998	8.71	2.69	911	8.58	2.69
5.54	1,942	9.33	5.54	600	9.33	5.54
6.37	67	9.58	6.37	3	9.58	6.37
6.78	315	9.84	6.78			0.00
	17,617	6.64	2.56	13,571	5.99	2.18
Vested and expected to vest	17,326	6.60	2.53			

**17. Income taxes**

As a result of losses incurred, the Company did not provide for any income taxes in the years ended December 31, 2009, 2010 and 2011. A reconciliation of the Company's effective tax rate to the statutory federal income tax rate is as follows:

	Year ended December 31,		
	2009	2010	2011
Federal statutory rate	35.0%	35.0%	35.0%
State taxes, net of Federal benefit	2.5	4.6	4.2
Permanent differences	(3.2)	(2.6)	(0.4)
Stock compensation	(2.0)	(2.9)	(1.2)
Change in valuation allowance	(30.3)	(39.2)	(36.3)
Tax credits	4.5	5.1	3.9
Foreign rate differentials			(4.4)
Other			(0.8)
	6.5%	%	%

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****17. Income taxes (Continued)**

Temporary differences that give rise to significant net deferred tax assets as of December 31, 2010 and 2011 are as follows:

(in thousands)	2010	2011
Deferred tax assets		
Net operating losses	\$ 34,035	\$ 40,633
Capitalized research and development expenses	36,865	47,640
Credit carryforwards	10,262	13,380
Depreciation	1,080	2,337
Deferred compensation	1,603	4,450
Deferred revenue	22,495	26,462
Accrued expenses	608	676
Other	886	922
Total gross deferred tax asset	107,834	136,500
Intangible assets	(3,953)	(3,817)
Valuation allowance	(103,881)	(132,683)
Net deferred taxes	\$	\$

As of December 31, 2011, the Company had federal and state net operating loss ("NOL") carryforwards of \$108.3 million and \$65.7 million, respectively, which began to expire in 2012. As of December 31, 2011, the Company had federal and state research and development ("R&D") and investment tax credit carryforwards of \$11.1 million and \$3.5 million, respectively, which began to expire in 2012. Management has evaluated the positive and negative evidence bearing upon the realizability of its deferred tax assets, which are comprised principally of net operating loss carryforwards. Management has determined that it is more likely than not that the Company will not recognize the benefits of federal and state deferred tax assets and, as a result, a valuation allowance of \$103.9 million and \$132.7 million have been established at December 31, 2010 and 2011, respectively.

At December 31, 2011, \$1.6 million of federal and state net operating loss carryforwards relate to deductions for stock option compensation for which the associated tax benefit will be credited to additional paid-in capital when realized. This amount is tracked separately and not included in the Company's deferred tax assets.

Additionally, the future utilization of the Company's NOL and R&D credit carryforwards to offset future taxable income may be subject to a substantial annual limitation under Section 382 of the Internal Revenue Code due to ownership changes that have occurred previously or that could occur in the future. Ownership changes, as defined in Section 382 of the Internal Revenue Code, may have limited the amount of net operating loss carryforwards and research and development credit carryforwards that the Company can use each year to offset future taxable income and taxes payable. Subsequent ownership changes could impose additional limitations. The Company has not performed a complete 382 study. Any limitation to all or a portion of the NOL or R&D credit carryforwards, before they can be utilized, would reduce the Company's gross deferred tax asset.

The Company adopted the provisions of ASC 740-10, *Accounting for Uncertainty in Income Taxes - an interpretation of ASC 740*, on January 1, 2007. ASC 740-10 clarifies the accounting for uncertainty in

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****17. Income taxes (Continued)**

income taxes recognized in an enterprise's financial statements in accordance with ASC 740, *Income Taxes*, and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740-10 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company concluded that there are no significant uncertain tax positions requiring recognition in the consolidated financial statements. The Company's evaluation was performed for the tax years ended December 31, 2008 through 2011, the tax years which remain subject to examination by major tax jurisdictions as of December 31, 2011. However, to the extent the Company utilizes net operating losses from years prior to 2008, the statute remains open to the extent of the net operating losses utilized.

The change in the valuation allowance against the deferred tax assets in the years ended December 31, 2009, 2010 and 2011 was as follows:

(in thousands)	Balance at beginning of period	Additions	Deductions	Balance at end of period
December 31, 2009	\$ 67,011	17,811	(3,402)	\$ 81,420
December 31, 2010	\$ 81,420	22,461		\$ 103,881
December 31, 2011	\$ 103,881	28,802		\$ 132,683

As a result of the acquisition of Hermes during 2009, the Company recognized a portion of its valuation allowance. The Company recorded intangible assets and IPR&D for which there is no tax basis. As a result, the Company recorded a net deferred tax liability in connection with the acquisition. The net deferred tax liability was offset with deferred tax assets previously recorded by the Company which resulted in a reduction in the valuation allowance. The decrease in the valuation allowance resulted in a \$3,402,000 income tax benefit for the year ended December 31, 2009.

In January 2010, the Massachusetts Life Sciences Center ("MLSC"), an independent agency of The Commonwealth of Massachusetts, awarded the Company \$1,500,000 of tax incentives under its Life Sciences Tax Incentive Program. These incentives allowed the Company to monetize approximately \$1,350,000 of state research and development tax credits. The Company received this monetization in 2010. In exchange for these incentives, the Company pledged to hire 50 employees in 2010 and retain these employees until at least December 31, 2014. Failure to do so could result in repayment of incentives. The Company deferred and is amortizing the benefit of this monetization on a straight-line basis over the 5 year performance period. For both the years ended December 31, 2010 and 2011, the Company recognized \$270,000 of benefit in other income.

In October 2010, the Company received grants totaling \$2,445,000 under the Federal Qualifying Therapeutic Discovery Projects program as provided for under section 48D of the Internal Revenue Code, enacted as part of the Patient Protection and Affordable Care Act of 2010. The Company received \$1,941,000 during 2010 and \$504,000 during the first quarter of 2011 related to these grants. For the year ended December 31, 2010, the Company recognized \$2,445,000 as other income related to these grants.

In January 2011, the MLSC awarded the Company \$1,347,000 of tax incentives under its Life Sciences Tax Incentive Program. These incentives allowed the Company to monetize approximately \$1,212,000 of state research and development tax credits. The Company received this monetization in

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****17. Income taxes (Continued)**

the second quarter of 2011. In exchange for these incentives, the Company has pledged to hire 50 employees in 2011 and retain these employees until at least December 31, 2015. Failure to do so could result in repayment of incentives. As of December 31, 2011, the Company has not yet recognized any benefit associated with these tax incentives.

**18. Commitments and contingencies****Operating leases**

The Company leases its office, laboratory and manufacturing space and certain office equipment under noncancelable operating leases. Total rent expense under these operating leases was \$2,082,000, \$2,846,000 and \$3,235,000 for the years ended December 31, 2009, 2010 and 2011, respectively.

Future minimum lease payments under noncancelable operating leases at December 31, 2011 are as follows:

<b>Year ended December 31,</b>	<b>(in thousands)</b>
2012	2,899
2013	1,879
2014	1,433
2015	482

During 2008, the Company expanded its existing facility and amended its office, laboratory and manufacturing space operating lease. As part of this amendment, the landlord agreed to reimburse the Company for a portion of tenant improvements made to the facility. During 2009, the Company received \$786,000 from the landlord. In January and June 2010, the Company entered into lease amendments to further expand its office, laboratory and manufacturing space. These lease amendments are co-terminous with the Company's existing facility lease which expires in April 2012. As part of these amendments, the landlord agreed to reimburse the Company for a portion of tenant improvements made to the facility. During 2010, the Company received \$217,000 from the landlord. These amounts were recorded in deferred lease benefits on the Company's balance sheets and are being amortized over the term of the lease as reductions to rent expense. On March 31, 2011, the Company amended its existing office, laboratory and manufacturing lease to extend the term on a portion of its leased space until April 2015 and extend the term on the remainder of leased space until April 2013 with options to extend until April 2015. As part of this amendment, the landlord agreed to reimburse the Company for a portion of tenant improvements made to the facility, up to a total of \$381,000. As of December 31, 2011, the Company had received reimbursement of \$52,000 from the landlord.

**Capital leases**

In August 2004, the Company entered into an agreement with a leasing company under which the Company was authorized to borrow up to \$1.4 million of noncourse debt through sale/lease-back and loan structured transactions which were collateralized by equipment. In January 2006, the agreement was amended increasing the Company's total borrowing capacity to \$4.5 million. Each lease is to be repaid over a four year period. The interest rate was established based on a percentage above treasury interest rates. Borrowings made under this agreement were \$675,000 for the year ended December 31, 2008. The Company's option to draw further on this lease facility expired during 2008.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****18. Commitments and contingencies (Continued)**

Future minimum lease payments under noncancelable capital leases at December 31, 2011 are as follows:

<b>Year ended December 31,</b>	<b>(in thousands)</b>
2012	49
Less interest	1
Present value of minimum lease payments	48
Less current portion of capital lease obligations	48
Capital lease obligations, net of current portion	\$

**Contingencies*****Contractual matter***

The Company manufactures MM-121 under a license and collaboration agreement with Sanofi. Under this agreement, Sanofi reimburses the Company for direct costs incurred in manufacturing. During 2009 and 2010, the Company utilized a third party contractor to perform fill-finish manufacturing services. This third party contractor experienced FDA inspection issues with its quality control process that resulted in a formal warning letter from the FDA. Following a review by Sanofi and the Company, some MM-121 was pulled from clinical trial sites and replaced with MM-121 that was filled by a different contractor. Sanofi has requested that the Company assume financial responsibility for the MM-121 material that was pulled from clinical trial sites. The Company has disputed Sanofi's request and is currently following the dispute resolution provisions of the license and collaboration agreement. If the executive officers appointed by Sanofi and the Company are unable to resolve the request, then Sanofi may request that the Company submit the matter to binding arbitration. In the event that binding arbitration is pursued and the Company is found financially responsible for the MM-121 material that was pulled from clinical trial sites, the Company may be required to reimburse Sanofi. The arbitration process is inherently uncertain, and the Company cannot guarantee that the outcome of arbitration, if it were to occur, would be favorable for the Company. The Company does not believe that a loss related to this matter is probable. Accordingly, no accrual related to this matter has been recorded as of December 31, 2011. The Company estimates that the potential payment range for this reimbursement may be between \$0 and \$4.8 million. Based on the revenue recognition model for manufacturing services under the license and collaboration agreement, the Company estimates that a potential reimbursement of between \$0 and \$4.8 million would result in a reduction of revenue of between \$0 and \$0.9 million in the accompanying consolidated statement of operations in the period.

**19. Retirement plan**

On May 31, 2002, the Company established a 401(k) defined contribution savings plan for its employees who meet certain service period and age requirements. Contributions are permitted up to the maximum allowed under the Internal Revenue Code of each covered employee's salary. The savings plan permits the Company to contribute at its discretion. For the years ended December 31, 2009, 2010 and 2011, the Company made contributions of \$270,000, \$380,000 and \$487,000, respectively, to the plan.

Table of Contents**Merrimack Pharmaceuticals, Inc.****Notes to consolidated financial statements (Continued)****December 31, 2009, 2010 and 2011****20. Selected quarterly financial data (unaudited)**

The following table contains quarterly financial information for 2010 and 2011. The Company believes that the following information reflects all normal recurring adjustments necessary for a fair statement of the information for the periods presented. The operating results for any quarter are not necessarily indicative of results for any future period.

	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
	(in thousands, except per share data)			
<b>2010</b>				
Research and development revenues	\$ 3,969	\$ 4,294	\$ 5,733	\$ 6,309
Total operating expenses	15,868	16,345	18,239	19,029
Net loss	(13,064)	(13,249)	(13,715)	(10,131)
Net loss attributable to Merrimack Pharmaceuticals, Inc.	(13,064)	(13,249)	(13,696)	(10,095)
Net loss per share available to common stockholders basic and diluted	\$ (1.31)	\$ (1.30)	\$ (1.33)	\$ (1.63)

	<b>First Quarter</b>	<b>Second Quarter</b>	<b>Third Quarter</b>	<b>Fourth Quarter</b>
	(in thousands, except per share data)			
<b>2011</b>				
Research and development revenues	\$ 6,461	\$ 6,595	\$ 8,582	\$ 12,577
Total operating expenses	21,102	36,019	27,219	30,744
Net loss	(13,535)	(29,196)	(18,724)	(18,221)
Net loss attributable to Merrimack Pharmaceuticals, Inc.	(13,457)	(29,051)	(18,599)	(18,116)
Net loss per share available to common stockholders basic and diluted	\$ (1.34)	\$ (2.76)	\$ (1.81)	\$ (1.76)

**21. Subsequent events**

During the first quarter of 2012, the Company triggered a milestone payment of \$5.0 million, which is payable under the collaboration agreement with PharmaEngine in connection with dosing the first patient in a Phase 3 clinical trial of MM-398 in pancreatic cancer.

During the first quarter of 2012, the Company amended its Restated Certificate of Incorporation to increase the number of authorized shares of common stock from 138,500,000 to 200,000,000.

During the first quarter of 2012, the Company earned a \$5.0 million milestone payment under the license and collaboration agreement with Sanofi in connection with dosing the first patient in a proof of concept Phase 2 clinical trial of MM-121 in ovarian cancer.

During the first quarter of 2012, the Company triggered a payment of \$1.5 million, which is payable to a collaborator associated with dosing the first patient in a Phase 1 clinical trial of MM-151 in solid tumors.

The following six paragraphs are unaudited:

The \$5.0 million milestone payment to PharmaEngine in connection with dosing the first patient in a Phase 3 clinical trial of MM-398 in pancreatic cancer was paid during the first quarter of 2012.

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**Merrimack Pharmaceuticals, Inc.**

**Notes to consolidated financial statements (Continued)**

**December 31, 2009, 2010 and 2011**

**21. Subsequent events (Continued)**

The \$1.5 million payment to a collaborator associated with dosing the first patient in a Phase 1 clinical trial of MM-151 in solid tumors was paid during the first quarter of 2012.

During the first quarter of 2012, the Company accepted antibody discovery efforts performed by a third party, which resulted in a payable of \$400,000. The Company is required to make this payment in the second quarter of 2012.

During the first quarter of 2012, the Company entered into a lease amendment to further expand its office, laboratory and manufacturing space. The amendment leases additional space for a seven year term from the commencement date and increases future minimum lease payments under noncancelable operating leases by approximately \$186,000, \$375,000, \$384,000, \$392,000 and \$401,000 for the years ended December 31, 2012, 2013, 2014, 2015 and 2016, respectively. As part of this lease amendment, the landlord agreed to reimburse the Company for a portion of tenant improvements made to the facility, up to a total of \$464,000.

As described in Note 2, on March 28, 2012, the Company signed an underwriting agreement and agreed to pricing terms on an initial public offering of 14,300,000 shares of common stock at a price of \$7.00 per share, which is expected to generate net proceeds of approximately \$93.5 million. The Company expects the offering to close on April 3, 2012.

The Company is required to pay the holders of Series B convertible preferred stock cash dividends of approximately \$4.3 million upon the closing of the initial public offering, which is expected to close on April 3, 2012.

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**EXHIBIT INDEX**

<b>Exhibit number</b>	<b>Description of exhibit</b>
3.1*	Restated Certificate of Incorporation of the Registrant
3.2*	Bylaws of the Registrant
3.3*	Certificate of Amendment of Restated Certificate of Incorporation of the Registrant
3.4*	Restated Certificate of Incorporation of the Registrant to be effective upon the closing of the Registrant's initial public offering
3.5*	Amended and Restated Bylaws of the Registrant to be effective upon the closing of the Registrant's initial public offering
4.1*	Specimen certificate evidencing shares of common stock
4.2*	Fifth Amended and Restated Investor Rights Agreement, dated April 6, 2011, by and among the Registrant and the other parties thereto
4.3*	Warrant to purchase shares of Series D Convertible Preferred Stock, dated April 6, 2005, issued by the Registrant to Hercules Technology Growth Capital, Inc.
4.4*	Form of warrant to purchase shares of Common Stock issued by the Registrant to General Electric Capital Corporation
4.5*	Form of warrant to purchase shares of Common Stock issued by the Registrant to various parties expiring on December 10, 2015
4.6*	Form of warrant to purchase shares of Common Stock issued by the Registrant to various parties expiring on December 17, 2015
4.7*	Form of warrant to purchase shares of Common Stock issued by the Registrant to various parties expiring on March 10, 2016
10.1*#	1999 Stock Option Plan
10.2*#	2008 Stock Incentive Plan
10.3*#	2011 Stock Incentive Plan
10.4*#	Form of Incentive Stock Option Agreement under 2011 Stock Incentive Plan
10.5*#	Form of Non-Qualified Stock Option Agreement under 2011 Stock Incentive Plan
10.6*#	Amended and Restated Employment Agreement, dated as of August 16, 2011, by and between the Registrant and Fazal R. Khan
10.7*#	Employment Agreement, dated as of September 30, 2011, by and between the Registrant and William M. McClements
10.8*#	Amended and Restated Employment Agreement, dated as of August 16, 2011, by and between the Registrant and Robert J. Mulroy
10.9*#	Amended and Restated Employment Agreement, dated as of August 16, 2011, by and between the Registrant and Ulrik B. Nielsen
10.10*#	Amended and Restated Employment Agreement, dated as of August 16, 2011, by and between the Registrant and Clet M. Niyikiza
10.11*#	Amended and Restated Employment Agreement, dated as of August 16, 2011, by and between the Registrant and Edward J. Stewart
10.12*#	Amended and Restated Employment Agreement, dated as of August 16, 2011, by and between the Registrant and William A. Sullivan
10.13*#	Form of Indemnification Agreement between the Registrant and each director and executive officer

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### Table of Contents

<b>Exhibit number</b>	<b>Description of exhibit</b>
10.14*	Indenture of Lease, dated as of May 16, 2006, by and between the Registrant and RB Kendall Fee, LLC, as amended on March 23, 2007, July 1, 2007, April 1, 2008, November 17, 2008, July 6, 2009, January 27, 2010, June 29, 2010, March 31, 2011 and March 8, 2012
10.15*	Sublease, dated as of August 20, 2010, by and between Silver Creek Pharmaceuticals, Inc. and FibroGen, Inc., as amended on January 20, 2011, May 4, 2011, May 26, 2011 and August 1, 2011
10.16*	Patent License Agreement, dated as of February 20, 2008, by and between the Registrant and the United States Public Health Service
10.17*	License Agreement, dated as of September 26, 2005, by and between the Registrant (as successor-in-interest to Hermes BioSciences, Inc.) and Merrimack Pharmaceuticals (Bermuda) Ltd. (as assignee from PharmaEngine, Inc.), as amended on June 30, 2011
10.18*	Assignment, Sublicense and Collaboration Agreement, dated as of May 5, 2011, by and between Merrimack Pharmaceuticals (Bermuda) Ltd. and PharmaEngine, Inc.
10.19*	License and Collaboration Agreement, dated as of September 30, 2009, by and between the Registrant and Sanofi, as amended on February 18, 2011
10.20*	Commercial License Agreement, dated as of June 6, 2008, by and between the Registrant and Selexis SA, as amended on January 8, 2010
10.21*	Exclusive License Agreement, dated as of November 1, 2000, by and between the Registrant (as successor-in-interest to Hermes BioSciences, Inc.) and The Regents of the University of California, as amended on October 6, 2003, September 13, 2006, June 6, 2007 and September 28, 2007
10.22*	Exclusive License Agreement, dated as of March 16, 2005, by and between the Registrant and The Regents of the University of California, as amended on November 17, 2009
10.23*	Collaboration Agreement, dated as of November 16, 2009, by and between the Registrant and Adimab LLC, as amended on April 27, 2010, June 2, 2010 and October 11, 2011
10.24*	Sublicense Agreement, dated as of June 30, 2008, by and between the Registrant and Dyax Corp.
10.25*	Amended and Restated Collaboration Agreement, dated as of January 24, 2007, by and between the Registrant and Dyax Corp., as amended on July 31, 2008 and November 6, 2009
21.1	Subsidiaries of the Registrant
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14 or 15d-14 of the Exchange Act
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14 or 15d-14 of the Exchange Act
32.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(b) or 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(b) or 15d-14(b) of the Exchange Act and 18 U.S.C. Section 1350

\*

Incorporated by reference to the Registrant's Registration Statement on Form S-1, as amended (File No. 333-175427).

Confidential treatment requested as to portions of the exhibit. Confidential materials omitted and filed separately with the Securities and Exchange Commission.

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Management contract or compensatory plan, contract or agreement.