

BLACKROCK FLOATING RATE INCOME STRATEGIES FUND, INC.

Form 497

December 21, 2017

Table of Contents

Filed Pursuant to Rule 497(h)

Registration No. 333-214530

3,050,000 Shares

BlackRock Floating Rate Income Strategies Fund, Inc.

Common Stock

PART I

INFORMATION ABOUT BLACKROCK FLOATING RATE INCOME STRATEGIES FUND, INC.

Item 1. Outside Front Cover

- 1.a. The registrant's name is BlackRock Floating Rate Income Strategies Fund, Inc. (the "Fund").
- 1.b. The Fund is registered under the Investment Company Act of 1940, as amended (the "1940 Act"), as a diversified, closed-end management investment company. The Fund's investment objective is to provide shareholders with high current income and such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments ("floating rate debt securities"). The Fund's investment objective is a fundamental policy and may not be changed without stockholder approval. No assurance can be given that the Fund's investment objective will be achieved.

The Fund seeks to achieve its investment objective by investing, under normal market conditions, at least 80% of its Managed Assets (as defined herein on page I-6) in floating rate debt securities, including floating or variable rate debt securities that pay interest at rates that adjust whenever a specified interest rate changes and/or which reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund invests a substantial portion of its investments in floating rate debt securities consisting of secured or unsecured senior floating rate loans that are rated below investment grade at the time of investment or, if unrated, are considered by the Fund's Investment Advisor to be of comparable quality. Debt securities rated below investment grade commonly are referred to as "junk bonds." Secured loans may be either fully or partially secured at the time of investment. In addition to senior loans, floating rate debt securities may include, without limitation, instruments such as catastrophe and other event linked bonds, bank capital securities, corporate bonds, notes, money market instruments and certain types of mortgage related and other asset backed securities. Due to their floating or variable rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt security is generally expected to have less sensitivity to fluctuations in market interest rates than a fixed rate debt instrument, although the value of a

floating rate debt security may nonetheless decline as interest rates rise and due to other factors, such as real or perceived changes in credit quality or financial condition of the issuer or borrower, volatility in the capital markets or other adverse market conditions.

The Fund may invest directly in floating rate debt securities or synthetically through the use of derivatives.

- 1.c. The Fund is offering up to 3,050,000 shares of common stock.
- 1.d. You should read this Prospectus, which concisely sets forth information about the Fund, before deciding whether to invest in the Fund's common stock and retain it for future reference. Additional information about the Fund and materials incorporated by reference have been filed with the Securities and Exchange Commission (the SEC) and are available upon either written or oral request, free of charge, by calling 1-800-882-0052, by writing to the Fund, or may be found on the SEC's website at www.sec.gov. You may also request a copy of this Prospectus, annual and semi-annual reports, other information about the Fund, and/or make investor inquiries by calling 1-800-882-0052, or by writing to the Fund. The Fund's annual and semi-annual reports are also available on the Fund's website at www.blackrock.com free of charge. This reference to BlackRock's website is intended to allow public access to information regarding the Fund and does not, and is not intended to, incorporate BlackRock's website into this Prospectus.

You should not construe the contents of this Prospectus as legal, tax or financial advice. You should consult with your own professional advisors as to the legal, tax, financial or other matters relevant to the suitability of an investment in the Fund.

Table of Contents

The Fund's common stock does not represent a deposit or an 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.

- 1.e. This Prospectus is dated December 20, 2017.
- 1.f. Not applicable.
- 1.g. The Fund's common stock is listed on the New York Stock Exchange (NYSE) under the symbol FRA. Sales of the Fund's common stock, if any, under this Prospectus may be made in transactions that are deemed to be at the market as defined in Rule 415 under the Securities Act of 1933, as amended (the Securities Act), which currently would only include sales made directly on the NYSE. The minimum price on any day at which Fund common stock may be sold will not be less than the current net asset value (NAV) per share plus the per share amount of the commission to be paid to the Fund's distributor (the Minimum Price), BlackRock Investments, LLC (the Distributor). The Fund and the Distributor will determine whether any sales of the Fund's common stock will be authorized on a particular day; the Fund and the Distributor, however, will not authorize sales of the Fund's common stock if the per share price of the shares is less than the Minimum Price. The Fund and the Distributor may also not authorize sales of the Fund's common stock on a particular day even if the per share price of the shares is equal to or greater than the Minimum Price, or may only authorize a fixed number of shares to be sold on any particular day. The Fund and the Distributor will have full discretion regarding whether sales of shares of the Fund's common stock will be authorized on a particular day and, if so, in what amounts. As of December 19, 2017 the last reported sale price for the Fund's common stock on the NYSE was \$13.83 per share.

The Distributor has entered into a sub-placement agent agreement, as amended and supplemented (the Sub-Placement Agent Agreement), with UBS Securities LLC (the Sub-Placement Agent) with respect to the Fund relating to the common stock offered by this Prospectus. In accordance with the terms of the Sub-Placement Agent Agreement, the Fund may offer and sell its common stock from time to time through the Sub-Placement Agent as sub-placement agent for the offer and sale of its common stock. The Fund will compensate the Distributor with respect to sales of common stock at a commission rate of 1.00% of the gross proceeds of the sale of the Fund's common stock. Out of this commission, the Distributor will compensate broker-dealers at a rate of up to 0.80% of the gross sales proceeds of the sale of the Fund's common stock sold by that broker-dealer.

- 1.h. **Neither the SEC nor any state securities commission has approved or disapproved of these securities or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense.**
- 1.i. **The Fund's common stock has traded both at a premium and a discount to NAV. The Fund cannot predict whether its common stock will trade at a premium or discount to NAV in the future. The provisions of the 1940 Act generally require that the public offering price of common stock (less any underwriting commissions and discounts) must equal or exceed the NAV per share of a company's common stock (calculated within 48 hours of pricing). The Fund's issuance of common stock may have an adverse effect on prices for the Fund's common stock in the secondary market by increasing the number of shares of common stock available in the market, which may put downward pressure on the market price for the Fund's common stock. Shares of common stock of closed-end investment companies frequently trade at a discount from NAV, which may increase investors' risk of loss.**

- 1.j. **Investing in the Fund's common stock involves certain risks that are described in Item 8.3 beginning on page I-18 of Part I of this Prospectus, and under Item 8 in Part II of this Prospectus under Risk Factors, beginning on page II-37 of Part II. Certain of these risks are summarized in Item 3.2 beginning on page I-5 of Part I of this Prospectus.**
- 1.k. **Not applicable.**
2. Not applicable.

Table of Contents**Item 2. Cover Pages; Other Offering Information**

1. Exchange listing: see Item 1.g.
2. Not applicable.
3. Not applicable.

Item 3. Fee Table and Synopsis**1. Shareholder Transaction Expenses**

Sales load paid by you (as a percentage of offering price)	1.00% ⁽¹⁾
Offering expenses borne by the Fund (as a percentage of offering price)	0.01% ⁽²⁾
Dividend reinvestment plan fees	\$0.02 per share for open-market purchases of common stock ⁽³⁾
	Percentage of net assets attributable to common shares
Annual Expenses	
Management Fee ⁽⁴⁾	1.05%
Interest Expense ⁽⁵⁾	0.67%
Other Expenses ⁽⁶⁾	0.16%
Total Annual Fund Operating Expenses ⁽⁷⁾	1.88%

(1) Represents the estimated commission with respect to the Fund's common stock being sold in this offering. There is no guarantee that there will be any sales of the Fund's common stock pursuant to this Prospectus. Actual sales of the Fund's common stock under this Prospectus, if any, may be less than as set forth under "Capitalization" below. In addition, the price per share of any such sale may be greater or less than the price set forth under "Capitalization" below, depending on market price of the Fund's common stock at the time of any such sale.

(2) Based on a sales price per share of \$15.10, which represents a small premium to the Minimum Price, i.e. NAV plus sales load of the Fund's common stock on November 30, 2017. Assumes all of the shares of common stock being offered by this Prospectus are sold. Represents the initial offering costs incurred by the Funds in connection with this offering, which are estimated to be \$47,435. Initial offering costs generally include, but are not limited to, the preparation, review and filing with the SEC of the Fund's registration statement (including this Prospectus), the preparation, review and filing of any associated marketing or similar materials, costs associated with the printing,

mailing or other distribution of the Prospectus and/or marketing materials, associated filing fees, NYSE listing fees, and legal and auditing fees associated with the offering.

- (3) The Reinvestment Plan Agent's (as defined under Item 10 Dividend Reinvestment Plan in Part II) fees for the handling of the reinvestment of dividends will be paid by the Fund. However, you will pay a \$0.02 per share fee incurred in connection with open-market purchases, which will be deducted from the value of the dividend. You will also be charged a \$2.50 sales fee and pay a \$0.15 per share fee if you direct the Reinvestment Plan Agent to sell your shares of common stock held in a dividend reinvestment account. Per share fees include any applicable brokerage commissions the Reinvestment Plan Agent is required to pay.
- (4) The Fund currently pays BlackRock Advisors, LLC, its investment adviser (the Investment Advisor), a contractual management fee at an annual rate of 0.75% based on an aggregate of (i) the Fund's average daily net assets and (ii) the proceeds of any outstanding borrowings used for leverage (together, average daily Managed Assets). The Fund uses leverage, in the form of a credit facility, which as of August 31, 2017 amounted to approximately 30% of the Fund's Managed Assets (approximately 43% of the Fund's net assets). Managed Assets means the total assets of the Fund (including any assets attributable to money borrowed for investment purposes) minus the sum of the Fund's accrued liabilities (other than money borrowed for investment purposes). The Fund's net assets attributable to common stock are the Fund's Managed Assets minus the value of the Fund's assets attributable to money borrowed for investment purposes. Thus, when the Fund uses leverage, its net assets attributable to common stock are less than its Managed Assets and its expenses (including the management fee) stated as a percentage of its net assets attributable to common stock are greater than they would be if stated as a percentage of its Managed Assets. This table reflects the fact that you, as a common shareholder, bear the expenses of the Fund's use of leverage in the form of higher fees as a percentage of the Fund's net assets attributable to common stock than if the Fund did not use leverage.
- (5) Reflects leverage, in the form of a credit facility, in an amount equal to approximately 30% of the Fund's Managed Assets (approximately 43% of the Fund's net assets) as of August 31, 2017. The interest expense borne by the Fund will vary over time in accordance with the level of the Fund's use of leverage and variations in market interest rates. Interest expense is required to be treated as an expense of the Fund for accounting purposes.
- (6) Estimated based on the fiscal year ended August 31, 2017.

Table of Contents

(7) Represents total annual expenses including interest expense. The total annual expenses excluding interest expense is 1.21%. The total annual expenses after giving effect to fee waivers (including interest expense) is 1.88%. Effective September 1, 2016, the Investment Advisor voluntarily agreed to waive its investment advisory fee with respect to any portion of the Fund's assets invested in affiliated equity and fixed-income mutual funds and affiliated exchange-traded funds that have a contractual management fee. Prior to September 1, 2016, the Investment Advisor did not waive such fees. Effective December 2, 2016, the waiver became contractual (the Fee Waiver Agreement) through December 31, 2017. The Fee Waiver Agreement was subsequently extended through December 31, 2018. Fees waived by the Investment Advisor amounted to less than 0.01% of the Fund's net assets attributable to common stock for the fiscal year ended August 31, 2017. See Item 20 below.

The purpose of the foregoing table and the example below is to help you understand all fees and expenses that you, as a holder of common stock of the Fund, bear directly or indirectly. The foregoing table should not be considered a representation of the Fund's future expenses. Actual future expenses may be greater or less than shown. Except where the context suggests otherwise, whenever this Prospectus contains a reference to fees or expenses paid by you or us or that we will pay fees or expenses, shareholders will indirectly bear such fees or expenses as investors in the Fund.

The following example illustrates the expenses (including the sales load of \$10.00 and offering costs of \$0.08) that you would pay on a \$1,000 investment in common stock, assuming (i) total net annual expenses of 1.88% of net assets attributable to common stock in years 1 through 10, and (ii) a 5% annual return:

	1 Year	3 Years	5 Years	10 Years
Total expenses incurred	\$29	\$69	\$111	\$228

The example should not be considered a representation of future expenses. The example assumes that the Other Expenses set forth in the Annual Expenses table are accurate and that all dividends and distributions are reinvested at NAV. Actual expenses may be greater or less than those assumed. Moreover, the Fund's actual rate of return may be greater or less than the hypothetical 5% return shown in the example.

Capitalization

The Fund may offer and sell up to 3,050,000 shares of its common stock, \$0.10 par value per share, from time to time through the Sub-Placement Agent as sub-placement agent under this Prospectus. There is no guarantee that there will be any sales of the Fund's common stock pursuant to this Prospectus. The table below assumes that the Fund will sell 3,050,000 shares of its common stock at a price of \$15.10 per share (which represents a small premium to the Minimum Price i.e., NAV plus sales load of the Fund's common stock on November 30, 2017). Actual sales, if any, of the Fund's common stock under this Prospectus may be greater or less than \$15.10 per share, depending on the market price of the Fund's common stock at the time of any such sale and/or the Fund's NAV for purposes of calculating the Minimum Price. The Fund and the Distributor will determine whether any sales of the Fund's common stock will be authorized on a particular day; the Fund and the Distributor, however, will not authorize sales of the Fund's common stock if the per share price of the shares is less than the Minimum Price. The Fund and the Distributor may also not authorize sales of the Fund's common stock on a particular day even if the per share price of the shares is equal to or greater than the Minimum Price, or may only authorize a fixed number of shares to be sold on any particular day. The Fund and the Distributor will have full discretion regarding whether sales of shares of the Fund's common stock will be authorized on a particular day and, if so, in what amounts.

The following table sets forth the Fund's capitalization (1) on a historical basis as of August 31, 2017 (audited); and (2) on a pro forma as adjusted basis to reflect the assumed sale of 3,050,000 shares of common stock at \$15.10 per share, in an offering under this Prospectus, after deducting the assumed commission of \$457,500 (representing an

estimated commission to the Distributor of 1.00% of the gross proceeds of the sale of shares of common stock, out of which the Distributor will compensate broker-dealers at a rate of up to 0.80% of the gross sales proceeds of the sale of the Fund's common stock sold by that broker-dealer).

I-4

Table of Contents

	As of August 31, 2017 (audited)	Pro Forma (unaudited) As adjusted
Common shares outstanding, \$0.10 par value per share	37,232,488	40,282,488
Paid-in capital	\$ 629,504,081	\$ 675,101,581
Undistributed net investment income	\$ 2,005,585	\$ 2,005,585
Accumulated net realized loss	\$ (72,143,351)	\$ (72,143,351)
Net unrealized appreciation (depreciation)	\$ (3,394,107)	\$ (3,394,107)
Net Assets	\$ 555,972,208	\$ 601,569,708
Net asset value per share	\$ 14.93	\$ 14.93

2. A summary of this Prospectus is set forth below. This is only a summary of certain information contained in this Prospectus relating to the Fund. This summary may not contain all of the information that you should consider before investing in the Fund's common stock. You should review the more detailed information contained in this Prospectus.

The Fund

BlackRock Floating Rate Income Strategies Fund, Inc. is registered under the 1940 Act, as a diversified, closed-end management investment company and has been operational since 2003. The Fund was known as Floating Rate Income Strategies Fund, Inc. prior to September 29, 2006.

The Offering

The Fund is offering up to 3,050,000 shares of common stock in transactions that are deemed to be at the market as defined in Rule 415 under the Securities Act, which currently would only include sales made directly on the NYSE. The minimum price on any day at which Fund common stock may be sold will not be less than the current NAV per share plus the per share amount of the commission to be paid to the Distributor. The Fund and the Distributor will determine whether any sales of the Fund's common stock will be authorized on a particular day; the Fund and the Distributor, however, will not authorize sales of the Fund's common stock if the per share price of the shares is less than the Minimum Price. The Fund and the Distributor may also not authorize sales of the Fund's common stock on a particular day even if the per share price of the shares is equal to or greater than the Minimum Price, or may only authorize a fixed number of shares to be sold on any particular day. The Fund and the Distributor will have full discretion regarding whether sales of shares of the Fund's common stock will be authorized on a particular day and, if so, in what amounts. As of December 19, 2017 the last reported sale price for the Fund's common stock on the NYSE was \$13.83 per share.

The Distributor has entered into the Sub-Placement Agent Agreement with the Sub-Placement Agent with respect to the Fund relating to the common stock offered by this Prospectus. In accordance with the terms of the Sub-Placement Agent Agreement, the Fund may offer and sell its common stock from time to time through the Sub-Placement Agent as sub-placement agent for the offer and sale of its common stock. The Fund will compensate the Distributor with respect to sales of common stock at a commission rate of 1.00% of the gross proceeds of the sale of the Fund's common stock. Out of this commission, the Distributor will compensate broker-dealers at a rate of up to 0.80% of the gross sales proceeds of the sale of the Fund's

common stock sold by that broker-dealer.

The Fund's common stock has traded both at a premium and a discount to NAV. The Fund cannot predict whether its common stock will trade at a premium or discount to NAV in the future. The provisions of the 1940 Act generally require that the public offering price of common stock (less any underwriting commissions and discounts) must equal or exceed the NAV per share of a company's common stock (calculated within 48 hours of pricing). The Fund's issuance of common stock may have an adverse effect on prices for the Fund's common stock in the secondary market by increasing the number of shares of common stock available in the market, which may put downward pressure on the market price for the Fund's common stock. Shares of common stock of closed-end investment companies frequently trade at a discount from NAV, which may increase investors' risk of loss.

**Investment
Objective**

The Fund's investment objective is to provide shareholders with high current income and such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments (floating rate debt securities). The Fund's investment objective is a fundamental policy and may not be changed without stockholder approval. No assurance can be given that the Fund's investment objective will be achieved.

Table of Contents

**Investment
Strategy**

BlackRock Advisors, LLC is the Fund's investment adviser (the "Investment Advisor").

In selecting floating rate loans or debt and other securities for the Fund, BlackRock will seek to identify issuers and industries that BlackRock believes are likely to experience stable or improving financial conditions. BlackRock's analysis will include:

credit research on the issuers' financial strength;

assessment of the issuers' ability to meet principal and interest payments;

general industry trends;

the issuers' managerial strength;

analysis of deal structure and covenants;

changing financial conditions;

borrowing requirements or debt maturity schedules; and

the issuers' responsiveness to changes in business conditions and interest rates.

BlackRock will consider relative values among issuers based on anticipated cash flow, interest or dividend coverage, asset coverage and earnings prospects. Using these tools, BlackRock will seek to add consistent value and control performance volatility consistent with the Fund's investment objectives and policies. BlackRock believes this strategy should enhance the Fund's ability to achieve its investment objective.

BlackRock's analysis continues on an ongoing basis for any floating rate loan or debt or other securities in which the Fund has invested. Although BlackRock uses due care in making such analysis, there can be no assurance that such analysis will reveal factors that may impair the value of the floating rate loan or debt.

Investment Policies The Fund seeks to achieve its investment objective by investing, under normal market conditions, at least 80% of its Managed Assets in floating rate debt securities, including floating or variable rate debt securities that pay interest at rates that adjust whenever a specified interest rate changes and/or which reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund invests a substantial portion of its investments in floating rate debt securities consisting of secured or unsecured senior floating rate loans that are rated below investment grade at the time of investment or, if unrated, are considered by the Fund's Investment Advisor to be of comparable quality. Secured loans may be either fully or partially secured at the time of investment. In addition to senior loans, floating rate debt securities may include, without limitation, instruments such as catastrophe and other event linked bonds, bank capital securities, corporate bonds, notes, money market instruments and certain types of mortgage related and other asset backed securities. Due to their floating or variable rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt security is generally expected to have less sensitivity to fluctuations in market interest rates than a fixed rate debt instrument, although the value of a floating rate debt security may nonetheless decline as interest rates rise and due to other factors, such as real or perceived changes in credit quality or financial condition of the issuer or borrower, volatility in the capital markets or other adverse market conditions.

Table of Contents

The Fund may invest directly in floating rate debt securities or synthetically through the use of derivatives.

The Fund may invest up to 20% of its total assets in securities other than floating rate debt securities, including, but not limited to, fixed rate debt securities such as convertible securities, bonds, notes, fixed rate loans and mortgage related and other asset backed securities issued on a public or private basis, collateralized debt obligations, preferred securities, commercial paper, U.S. government securities, structured notes, credit linked notes, credit linked trust certificates and other hybrid instruments.

To a limited extent, incidental to and in connection with its investment activities or pursuant to a convertible feature in a security, the Fund may acquire warrants and other debt and equity securities. The Fund may also acquire other debt and equity securities of a borrower or issuer in connection with an amendment, waiver, conversion or exchange of a senior loan or other debt security or in connection with a bankruptcy or workout of the borrower or issuer.

The Fund may invest without limit, and generally intends to invest a substantial portion of its assets, in high yield securities, including senior loans and other floating or fixed rate debt securities, that are rated below investment grade by the established rating services (Ba or lower by Moody's Investor's Service, Inc. (Moody's)) or BB or lower by Standard & Poor's Corporation Ratings Services, a division of The McGraw-Hill Companies, Inc. (S&P)) or, if unrated, are considered by the Investment Advisor to be of comparable quality. The Fund may not, however, invest more than 10% of its total assets (at the time of investment) in securities that are rated Caa1 or lower (if rated by Moody's) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Advisor to be of comparable quality or are otherwise considered to be distressed securities.

The Fund may invest without limitation in debt securities of issuers domiciled outside the United States. The Fund, however, will not invest more than 10% of its total assets in debt securities of issuers located in emerging market countries. The Fund will invest primarily in U.S. dollar denominated debt securities. The Fund will not invest more than 10% of its total assets in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to the Fund in U.S. dollars, including obligations of non-U.S. governments and their respective subdivisions, agencies and government sponsored enterprises. The Investment Advisor generally considers emerging market countries to be any country that is defined as having an emerging or developing economy by the World Bank or its related organizations or the United Nations or its subsidiaries.

The Fund may invest without limit in illiquid securities, which are floating rate debt securities, senior loans, high yield securities and other securities that lack a secondary trading market or are otherwise considered illiquid.

For a discussion of risk factors that may affect the Fund's ability to achieve its investment objective, see "Risk Factors" under Item 8 in Part II.

Leverage

The Fund currently utilizes leverage for investment purposes in the form of a bank credit facility. As of August 31, 2017, this leverage represented approximately 30% of the Fund's Managed Assets (approximately 43% of the Fund's net assets). At times, the Fund could utilize leverage through borrowings, the issuance of short term debt securities, the issuance of shares of preferred stock or a combination thereof. The Fund has the ability to utilize leverage through borrowings or the issuance of short term debt securities in an amount up to 33 1/3% of the value of its Managed Assets (which includes the amount obtained from such borrowings or debt issuance). The Fund also has the ability to utilize leverage through the issuance of shares of preferred stock in an amount up to 50% of the value of its Managed Assets (which includes the amount obtained from such issuance). The Fund may also leverage through the use of reverse repurchase agreements. There can be no assurance that the Fund will borrow in order to leverage its assets or, if it does, what percentage of the Fund's assets such borrowings will represent. The Fund does not currently anticipate issuing any preferred stock.

Table of Contents

See **Leverage** under Item 8 in Part II and the discussion of the Fund's capital structure under Item 10 in Part II.

The use of leverage is subject to numerous risks. When leverage is employed, the NAV and market price of the common stock and the yield to holders of common stock will be more volatile than if leverage were not used. For example, a rise in short-term interest rates, which currently are near historically low levels, will cause the Fund's NAV to decline more than if the Fund had not used leverage. A reduction in the Fund's NAV may cause a reduction in the market price of its common stock. The Fund cannot assure you that the use of leverage will result in a higher yield on the common stock. When the Fund uses leverage, the management fee payable to the Investment Advisor will be higher than if the Fund did not use leverage because these fees are calculated on the basis of the Fund's Managed Assets, which include the proceeds of leverage. The Fund's leveraging strategy may not be successful.

See **Risk Factors - Leverage Risk** under Item 8 in Part II.

**Investment
Advisor**

BlackRock Advisors, LLC is the Fund's investment adviser. The Investment Advisor receives an annual fee, payable monthly, in an amount equal to 0.75% of the average daily value of the Fund's Managed Assets.

Distributions

The Fund intends to make regular monthly cash distributions of all or a portion of its net investment income to holders of the Fund's shares of common stock. The Fund intends to pay any capital gains distributions at least annually. A return of capital distribution may involve a return of the shareholder's original investment. Though not currently taxable, such a distribution may lower a shareholder's basis in the Fund, thus potentially subjecting the shareholder to future tax consequences in connection with the sale of Fund shares, even if sold at a loss to the shareholder's original investment. When total distributions exceed total return performance for the period, the difference will reduce the Fund's total assets and NAV and, therefore, could have the effect of increasing the Fund's expense ratio and reducing the amount of assets the Fund has available for long term investment.

Shareholders will automatically have all dividends and distributions reinvested in common stock of the Fund in accordance with the Fund's dividend reinvestment plan, unless an election is made to receive cash by contacting the Reinvestment Plan Agent (as defined herein), at (800) 699-1236. See **Dividend Reinvestment Plan** under Item 10 in Part II.

The Fund reserves the right to change its distribution policy and the basis for establishing the rate of its monthly distributions at any time and may do so without prior notice to common shareholders. See Item 10.1 in Part I and **Distributions** under Item 10 in Part II.

Listing	The Fund's common stock is listed on the NYSE under the symbol FRA.
Custodian and Transfer Agent	State Street Bank and Trust Company serves as the Fund's custodian, and Computershare Trust Company, N.A. serves as the Fund's transfer agent.
Administrator	State Street Bank and Trust Company serves as the Fund's administrator and fund accountant.
Market Price of Shares	Common shares of closed-end investment companies frequently trade at prices lower than their NAV. The Fund cannot assure you that its common stock will trade at a price higher than or equal to NAV. The Fund's common stock trades in the open market at market prices that are a function of several factors, including dividend levels (which are in turn affected by expenses), NAV, call protection for portfolio securities, portfolio credit quality, liquidity, dividend stability, relative demand for and supply of the common stock in the market, general market and economic conditions and other factors. The Fund's common stock is designed primarily for long-term

Table of Contents

investors and you should not purchase common shares of the Fund if you intend to sell it shortly after purchase. The issuance of additional common stock pursuant to this Prospectus may also have an adverse effect on prices for the Fund's common stock in the secondary market by increasing the supply of common stock available for sale.

Special Risk

An investment in the Fund's common stock involves risk. You should consider carefully the risks identified below, which are described in detail under "Risk Factors" beginning on page II-37 of Part II of this Prospectus.

Considerations

Principal risks of investing in the Fund include:

Interest Rate Risk. Interest rate risk is the risk that prices of bonds and other fixed-income securities will increase as interest rates fall and decrease as interest rates rise. This risk is heightened given that certain interest rates are at historical lows.

Issuer Risk. The value of fixed income securities may decline for a number of reasons which directly relate to the issuer, such as management performance, financial leverage, reduced demand for the issuer's goods and services, historical and prospective earnings of the issuer and the value of the assets of the issuer.

Credit Risk. Credit risk is the risk that one or more fixed income securities in the Fund's portfolio will decline in price or fail to pay interest or principal when due because the issuer of the security experiences a decline in its financial status.

Prepayment Risk. During periods of declining interest rates, borrowers may exercise their option to prepay principal earlier than scheduled.

Reinvestment Risk. Reinvestment risk is the risk that income from the Fund's portfolio will decline if the Fund invests the proceeds from matured, traded or called fixed income securities at market interest rates that are below the Fund portfolio's current earnings rate.

Duration and Maturity Risk. The Fund may incur costs in seeking to adjust the portfolio average duration or maturity. There can be no assurance that the Investment Advisor's assessment of current and projected market conditions will be correct or that any strategy to adjust the portfolio's duration or maturity will be successful at any given time.

Corporate Bonds Risk. The market value of a corporate bond generally may be expected to rise and fall inversely with interest rates. The market value of intermediate and longer-term corporate bonds is generally more sensitive to changes in interest rates than is the market value of shorter-term corporate bonds. The market value of a corporate bond also may be affected by factors directly related to the issuer, such as investors' perceptions of the creditworthiness of the issuer, the issuer's financial performance, perceptions of the issuer in the market place, performance of management of the issuer, the issuer's capital structure and use of financial leverage and demand for the issuer's goods and services.

Mortgage Related Securities Risks. The risks associated with MBS include: credit risk associated with the performance of the underlying mortgage properties and of the borrowers owning these properties; risks associated with their structure and execution (including the collateral, the process by which principal and interest payments are allocated and distributed to investors and how credit losses affect the issuing vehicles and the return to investors in such MBS); whether the collateral represents a fixed set of specific assets or accounts, whether the underlying collateral assets are revolving or closed-end, under what terms (including maturity of the MBS) any remaining balance in the accounts may revert to the issuing entity and the extent to which the entity that is the

Table of Contents

actual source of the collateral assets is obligated to provide support to the issuing vehicles or to the investors in such MBS; risks associated with the servicer of the underlying mortgages; adverse changes in economic conditions and circumstances, which are more likely to have an adverse impact on MBS secured by loans on certain types of commercial properties than on those secured by loans on residential properties; prepayment risk, which can lead to significant fluctuations in the value of the MBS; loss of all or part of the premium, if any, paid; and decline in the market value of the security, whether resulting from changes in interest rates, prepayments on the underlying mortgage collateral or perceptions of the credit risk associated with the underlying mortgage collateral.

Below Investment Grade Securities (Junk Bonds) Risk. The Fund may invest in securities that are rated, at the time of investment, below investment grade quality (rated Ba/BB or below, or unrated but judged to be of comparable quality by the Investment Advisor), which are commonly referred to as high yield or junk bonds and are regarded as predominantly speculative with respect to the issuer's capacity to pay interest and repay principal. Issuers of high yield bonds are not perceived to be as strong financially as those with higher credit ratings. These issuers are more vulnerable to financial setbacks and recession than more creditworthy issuers, which may impair their ability to make interest and principal payments.

Senior Loans Risk. Senior loans typically hold the most senior position in the capital structure of the issuing entity, are typically secured with specific collateral and typically have a claim on the assets and/or stock of the borrower that is senior to that held by subordinated debt holders and stockholders of the borrower. The Fund's investments in senior loans are typically below investment grade and are considered speculative because of the credit risk of their issuer. Although senior loans are typically considered securities for purposes of the 1940 Act, loans and other forms of indebtedness may be structured such that they are not securities under the Securities Act or the Securities Exchange Act of 1933, as amended (The Exchange Act), and may therefore not offer investors, such as the Fund, the protections afforded by the Securities Act and the Exchange Act.

3. Not applicable.

Item 4. Financial Highlights

1. The following table includes selected data for a common share outstanding throughout the period and other performance information derived from the Fund's financial statements. It should be read in conjunction with the Fund's financial statements and notes thereto, which are incorporated by reference into this Prospectus. The following information with respect to the fiscal years ended August 31, 2013, August 31, 2014, August 31, 2015, August 31, 2016 and August 31, 2017 has been audited by Deloitte & Touche LLP, independent registered public accountants, whose report thereon is incorporated by reference into this Prospectus. See Item 24.

Table of Contents

	2017 ¹	2016 ¹	2015 ¹	2014 ¹	2013 ¹	2012 ¹	2011	2010	2009
Operating									
	\$ 14.78	\$ 14.91	\$ 15.38	\$ 15.36	\$ 14.98	14.04	\$ 14.36	\$ 12.93	\$ 16.12
	0.76	0.76	0.81	0.87	0.99	0.97	0.96	0.91	1.14
and									
	0.20	(0.14)	(0.47)	0.04	0.42	0.90	(0.36)	1.48	(3.04)
	0.96	0.62	0.34	0.91	1.41	1.87	0.60	2.39	(1.09)
and									
	(0.81)	(0.75)	(0.81)	(0.89)	(1.03)	(0.93)	(0.86)	(0.94)	(1.29)
	---	---	---	---	---	---	(0.06)	(0.02)	---
	---	---	---	---	---	---	---	---	---
and									
	(0.81)	(0.75)	(0.81)	(0.89)	(1.03)	(0.93)	(0.92)	(0.96)	(1.29)
	\$ 14.93	\$ 14.78	\$ 14.91 ⁴	\$ 15.38	\$ 15.36	\$ 14.98	\$ 14.04	\$ 14.36	\$ 12.93
	\$ 14.10	\$ 13.70	\$ 12.94	\$ 14.26	\$ 14.96	\$ 15.20	\$ 13.33	\$ 14.61	\$ 12.26
ment									
	6.93%	5.00%	2.88% ⁴	6.45%	9.68%	13.91%	4.04%	18.91%	(8.88)%
	8.95%	12.14%	(3.71)%	1.33%	5.28%	21.74%	(2.91)%	27.59%	(3.88)%

Average Net									
	1.88%	1.54%	1.56%	1.48%	1.54% ⁶	1.67% ⁸	1.60%	1.45%	1.96%
er	1.88%	1.54%	1.56%	1.48%	1.52% ⁶	1.67% ⁸	1.60%	1.45%	1.96%
er									
d	1.21%	1.14%	1.19%	1.15%	1.15% ^{6,7}	1.35% ^{7,8}	1.30%	1.22%	1.31%
al	5.08%	5.27%	5.39%	5.65%	6.49%	6.67%	6.44%	6.43%	10.18%
	\$ 555,972	\$ 550,271	\$ 555,104	\$ 572,463	\$ 571,802	\$ 276,990	\$ 259,205	\$ 264,379	\$ 237,160
	\$ 237,000	\$ 225,000	\$ 196,000	\$ 235,000	\$ 214,000	\$ 117,000	\$ 93,000	\$ 53,000	\$ 38,000
	\$ 226,225	\$ 190,486	\$ 221,633	\$ 210,521	\$ 201,830	\$ 88,197	\$ 79,195	\$ 48,258	\$ 50,591
	64%	48%	43%	58%	88%	53%	91%	96%	58%
d	\$ 3,346	\$ 3,446	\$ 3,832	\$ 3,436	\$ 3,672	\$ 3,367	\$ 3,787	\$ 5,988	\$ 7,241

- 1) Consolidated Financial Highlights.
- 2) Based on average shares outstanding.
- 3) Determined in accordance with federal income tax regulations.
- 4) For financial reporting purposes, the market value of certain investments were adjusted as of report date. Accordingly the net asset value (NAV) per share and total return performance presented herein are different than the information previously published on August 31, 2015.
- 5) Total investment returns based on market price, which can be significantly greater or less than the net asset value, may result in substantially different returns. Where applicable, excludes the effects of any sales charges and assumes the reinvestment of dividends and distributions.
- 6) Includes reorganization costs. Without these costs, total expenses, total expenses after fees waived and/or paid indirectly and total expenses after fees waived and/or paid indirectly and excluding interest expense would have been 1.52%, 1.52% and 1.15%, respectively.
- 7) For the years ended August 31, 2013 and August 31, 2012, the total expense ratio after fees waived and/or paid indirectly and excluding interest expense and borrowing costs were 1.14% and 1.26%, respectively.
- 8) Includes reorganization costs. Without these costs, total expenses, total expenses after fees waived and/or paid indirectly and total expenses after fees waived and/or paid indirectly and excluding interest expense would have been 1.61%, 1.61% and 1.29%, respectively.

Table of Contents

2. Not applicable.

3. See Item 4.1., above.

Item 5. Plan of Distribution

1. The Distributor has agreed to underwrite up to 3,050,000 shares of the Fund's common stock on a reasonable efforts basis. See Item 5 in Part II for additional information regarding the Distributor.

2. The Fund's common stock will only be sold on such days as shall be agreed to by the Fund and the Distributor. The Fund's common stock will be sold at market prices, which shall be determined with reference to trades on the NYSE, subject to the Minimum Price. See Item 1.1.g., above.

3. The sum of all compensation paid to FINRA members in connection with this public offering of shares of common stock, including the sales commission paid to or retained by the Distributor and amounts paid to or retained by participating broker-Sub-Placement Agents, will not exceed, in the aggregate, 1.00% of the total public offering price of the shares of common stock sold in this offering. See Item 1.1.g., above, and Item 5 in Part II.

4. See Item 5 in Part II.

5. Not applicable.

6. See Item 5 in Part II.

7. Not applicable.

8. Not applicable.

9. Not applicable.

10. See Item 5 in Part II.

Item 6. Selling Shareholders

Not applicable.

Item 7. Use of Proceeds

The net proceeds from the issuance of common stock hereunder will be invested in accordance with the Fund's investment objectives and policies as set forth in this Prospectus. It is presently anticipated that the Fund will be able to invest substantially all of the net proceeds in accordance with the Fund's investment objectives and policies within three months from the date on which the proceeds from an offering are received by the Fund. Such investments may be delayed if suitable investments are unavailable at the time or for other reasons, such as market volatility and lack of liquidity in the markets of suitable investments. Pending such investment, it is anticipated that the proceeds will be invested in short-term or long-term securities issued by the U.S. government and its agencies or instrumentalities or in high quality, short-term money market instruments.

Item 8. Description of the Fund

1. The Fund was formed under the laws of the State of Maryland on August 14, 2003 and commenced operations on October 31, 2003. The Fund is registered under the 1940 Act as a diversified, closed-end management investment company. The Fund was known as Floating Rate Income Strategies Fund, Inc. prior to September 29, 2006. The Fund's principal office is located at 100 Bellevue Parkway, Wilmington, Delaware 19809, and its telephone number is (800) 882-0052.

Table of Contents

2. Investment Objectives and Principal Investment Policies:

Investment Objectives. The Fund's investment objective is to provide shareholders with high current income and such preservation of capital as is consistent with investment in a diversified, leveraged portfolio consisting primarily of floating rate debt securities and instruments (floating rate debt securities). The Fund's investment objective is a fundamental policy and may not be changed without stockholder approval. No assurance can be given that the Fund's investment objective will be achieved.

Floating Rate Debt Securities and Senior Loans. The Fund seeks to achieve its investment objective by investing, under normal market conditions, at least 80% of its Managed Assets in floating rate debt securities, including floating or variable rate debt securities that pay interest at rates that adjust whenever a specified interest rate changes and/or which reset on predetermined dates (such as the last day of a month or calendar quarter). The Fund invests a substantial portion of its investments in floating rate debt securities consisting of secured or unsecured senior floating rate loans that are rated below investment grade at the time of investment or, if unrated, are considered by the Fund's Investment Advisor to be of comparable quality. Secured loans may be either wholly or partially secured at the time of investment. In addition to senior loans, floating rate debt securities may include, without limitation, instruments such as catastrophe and other event linked bonds, bank capital securities, corporate bonds, notes, money market instruments and certain types of mortgage related and other asset backed securities. Due to their floating or variable rate features, these instruments will generally pay higher levels of income in a rising interest rate environment and lower levels of income as interest rates decline. For the same reason, the market value of a floating rate debt security is generally expected to have less sensitivity to fluctuations in market interest rates than a fixed rate debt instrument, although the value of a floating rate debt security may nonetheless decline as interest rates rise and due to other factors, such as real or perceived changes in credit quality or financial condition of the issuer or borrower, volatility in the capital markets or other adverse market conditions.

The Fund may invest directly in floating rate debt securities or synthetically through the use of derivatives.

The Fund's policy to invest, under normal market conditions, at least 80% of its Managed Assets in floating rate debt securities, as described above, is a non-fundamental policy and may be changed by the Board of Directors of the Fund (the Board, and each member, a Director) provided that stockholders are provided with at least 60 days' prior notice of any change, unless such change was previously approved by shareholders, as required by the rules under the 1940 Act.

Other Investments. The Fund may invest up to 20% of its total assets in securities other than floating rate debt securities, including, but not limited to, fixed rate debt securities such as convertible securities, bonds, notes, fixed rate loans and mortgage related and other asset backed securities issued on a public or private basis, collateralized debt obligations, preferred securities, commercial paper, U.S. government securities, structured notes, credit linked notes, credit linked trust certificates and other hybrid instruments.

To a limited extent, incidental to and in connection with its investment activities or pursuant to a convertible feature in a security, the Fund may acquire warrants and other debt and equity securities. The Fund may also acquire other debt and equity securities of a borrower or issuer in connection with an amendment, waiver, conversion or exchange of a senior loan or other debt security or in connection with a bankruptcy or workout of the borrower or issuer.

High Yield Securities. The Fund may invest without limit, and generally intends to invest a substantial portion of its assets, in high yield securities, including senior loans and other floating or fixed rate debt securities, that are rated below investment grade by the established rating services (Ba or lower by Moody's or BB or lower by S&P) or, if unrated, are considered by the Investment Advisor to be of comparable quality. High yield bonds commonly are referred to as "junk" bonds. The high yield securities in which the Fund invests may include credit linked notes, structured notes, credit linked trust certificates or other instruments evidencing interests in special purpose vehicles or

trusts that hold interests in high yield securities. Other than with respect to Distressed Securities (which are discussed below), the high yield securities in which the Fund may invest do not include securities which, at the time of investment, are in default or the issuers of which are in bankruptcy. The Fund may also invest in investment grade securities, which are securities rated at least BBB as determined by S&P, Baa3 as determined by Moody's or, if unrated, determined to be of comparable quality by the Investment Advisor. See Appendix A Ratings of Securities for information concerning rating categories.

Table of Contents

Distressed Securities. The Fund may not invest more than 10% of its total assets (at the time of investment) in securities that are rated Caa1 or lower (if rated by Moody's) or CCC+ or lower (if rated by S&P) by each agency rating such security or, if unrated, are considered by the Investment Advisor to be of comparable quality or are otherwise considered to be distressed securities (*Distressed Securities*).

Non-U.S. Securities. The Fund may invest without limitation in debt securities of issuers domiciled outside the United States (*Non-U.S. Securities*). The Fund, however, will not invest more than 10% of its total assets in debt securities of issuers located in emerging market countries. The Fund will invest primarily in U.S. dollar denominated debt securities. The Fund will not invest more than 10% of its total assets in debt securities denominated in currencies other than the U.S. dollar or that do not provide for payment to the Fund in U.S. dollars, including obligations of non-U.S. governments and their respective subdivisions, agencies and government sponsored enterprises. The Investment Advisor generally considers emerging market countries to be any country that is defined as having an emerging or developing economy by the World Bank or its related organizations or the United Nations or its subsidiaries.

Bonds. The Fund may invest in bonds of varying maturities issued by U.S. and non-U.S. corporations and other business or governmental entities. Bonds can be variable or fixed rate debt obligations, including bills, notes, debentures, money market instruments and similar instruments and securities. The Fund may also invest in catastrophe or other event linked bonds. The Fund may invest in securities of any maturity.

Preferred Securities. The Fund may invest in preferred securities, including preferred securities that may be converted into common stock or other securities of the same or a different issuer. The types of preferred securities in which the Fund may invest include trust preferred securities.

Convertible Securities. The Fund may invest in convertible securities. A convertible security is a bond, debenture, note, preferred security or other security that may be converted into or exchanged for a prescribed amount of common stock or other equity security of the same or a different issuer within a particular period of time at a specified price or formula.

Illiquid Securities. The Fund may invest without limit in illiquid securities, which are floating rate debt securities, senior loans, high yield securities and other securities that lack a secondary trading market or are otherwise considered illiquid.

1940 Act and Tax Diversification Requirements. The Fund is classified as diversified within the meaning of the 1940 Act, which means that it must satisfy the 5% and 10% requirements described in item (ii) below with respect to 75% of its total assets. The Fund's investments will be limited so as to qualify the Fund as a regulated investment company for purposes of Federal tax laws. Requirements for qualification as a regulated investment company include limiting its investments so that, at the close of each quarter of the taxable year, (i) not more than 25% of the market value of the Fund's total assets will be invested in (A) the securities of a single issuer (other than U.S. government securities and securities of other regulated investment companies), (B) the securities of two or more issuers (other than securities of other regulated investment companies) controlled by the Fund and engaged in the same, similar or related trades or businesses, or (C) the securities of one or more qualified publicly traded partnerships, and (ii) with respect to 50% of the market value of its total assets, not more than 5% of the market value of its total assets will be invested in the securities of a single issuer and the Fund will not own more than 10% of the outstanding voting securities of a single issuer (other than U.S. government securities and securities of other regulated investment companies).

Tax-related limitations may be changed by the Board to the extent appropriate in light of changes to applicable tax requirements.

The Fund will not invest in senior loans that would require the Fund to make any additional investments in connection with such future advances if such commitments would cause the Fund to fail to meet these diversification requirements.

Table of Contents

Other Investment Policies:

Leverage. The Fund currently utilizes leverage for investment purposes in the form of a bank credit facility. As of August 31, 2017, this leverage represented approximately 30% of the Fund's Managed Assets (approximately 43% of the Fund's net assets). At times, the Fund could utilize leverage through borrowings, the issuance of short term debt securities, the issuance of shares of preferred stock or a combination thereof. The Fund has the ability to utilize leverage through borrowings or the issuance of short term debt securities in an amount up to 33 1/3% of the value of its Managed Assets (which includes the amount obtained from such borrowings or debt issuance). The Fund also has the ability to utilize leverage through the issuance of shares of preferred stock in an amount up to 50% of the value of its Managed Assets (which includes the amount obtained from such issuance). The Fund may also leverage through the use of reverse repurchase agreements. There can be no assurance that the Fund will borrow in order to leverage its assets or, if it does, what percentage of the Fund's assets such borrowings will represent. The Fund does not currently anticipate issuing any preferred stock.

Indexed and Inverse Floating Obligations. The Fund may invest in securities whose potential returns are directly related to changes in an underlying index or interest rate, known as indexed securities. The return on indexed securities will rise when the underlying index or interest rate rises and fall when the index or interest rate falls. The Fund also may invest in securities whose return is inversely related to changes in an interest rate (inverse floaters).

Interest Rate Transactions. In order to seek to hedge the value of the Fund's portfolio against interest rate fluctuations or to seek to enhance each Fund's return, the Fund may enter into various interest rate transactions such as interest rate swaps and the purchase or sale of interest rate caps and floors. The Fund may enter into these transactions to seek to preserve a return or spread on a particular investment or portion of its portfolio, to seek to protect against any increase in the price of securities the Fund anticipates purchasing at a later date or to seek to enhance its return. However, the Fund also may invest in interest rate swaps to seek to enhance income or to seek to increase the Fund's yield, for example, during periods of steep interest rate yield curves (i.e., wide differences between short term and long term interest rates). The Fund is not required to pursue these portfolio strategies and may choose not to do so. The Fund cannot guarantee that any strategies it uses will work.

The Fund will not enter into 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.

The Fund will only enter into interest rate swap, cap or floor transactions with counterparties the Investment Advisor believes to be creditworthy at the time they enter into such transactions.

Credit Default Swap Agreements. The Fund may enter into credit default swap agreements for hedging purposes or to seek to enhance its returns. The credit default swap agreement may have as reference obligations one or more securities that are not currently held by the Fund. The protection buyer in a credit default contract may be obligated to pay the protection seller an upfront or a periodic stream of payments over the term of the contract provided that no credit event on a reference obligation has occurred. If a credit event occurs, the seller generally must pay the buyer the par value (full notional value) of the swap in exchange for an equal face amount of deliverable obligations of the reference entity described in the swap, or the seller may be required to deliver the related net cash amount, if the swap is cash settled. The Fund may be either the buyer or seller in the transaction.

The Fund will enter into credit default swap agreements only with counterparties the Investment Advisor believes to be creditworthy at the time they enter into such transactions.

Total Return Swap Agreements. The Fund may enter into total return swap agreements. Total return swap agreements are contracts in which one party agrees to make periodic payments based on the change in market value of the underlying assets, which may include a specified security, basket of securities or securities indices during the specified period, in return for periodic payments based on a fixed or variable interest rate or the total return from other underlying assets. Total return swap agreements may be used to obtain exposure to a security or market without owning or taking physical custody of such security or market.

Credit Linked Trust Certificates. Among the income producing securities in which the Fund may invest are credit linked trust certificates, which are investments in a limited purpose trust or other vehicle which, in turn, invests in a basket of derivative instruments, such as credit default swaps, interest rate swaps and other securities, in order to

Table of Contents

provide exposure to the high yield or another fixed income market. For instance, the Fund may invest in credit linked trust certificates as a cash management tool in order to gain exposure to the high yield markets and/or to remain fully invested when more traditional income producing securities are not available, including during the period when the net proceeds of this offering and any borrowings or offering of preferred stock are being invested.

Call Options. The Fund may purchase call options on any of the types of securities or instruments in which it may invest. The Fund also is authorized to write (i.e., sell) covered call options on the securities or instruments in which it may invest and to enter into closing purchase transactions with respect to certain of such options. The Fund also is authorized to write (i.e., sell) uncovered call options on securities or instruments in which it may invest but that are not currently held by such Fund. The Fund also may purchase and sell call options on indices.

Put Options. The Fund is authorized to purchase put options to seek to hedge against a decline in the value of its securities or to seek to enhance its return. The Fund also has authority to write (i.e., sell) put options on the types of securities or instruments that may be held by the Fund, provided that such put options are covered, meaning that such options are secured by designating liquid assets segregated or earmarked on the Fund's books and records. The Fund will not sell puts if, as a result, more than 50% of the Fund's assets would be required to cover its potential obligations under its hedging and other investment transactions. The Fund is also authorized to write (i.e., sell) uncovered put options on securities or instruments in which it may invest but that the Fund does not currently have a corresponding short position or has not deposited cash equal to the exercise value of the put option with the broker-dealer through which it made the uncovered put option as collateral. In connection with such a transaction, the Fund will designate on its books and records unencumbered liquid assets with a value at least equal to the Fund's exposure, on a marked-to-market basis (as calculated pursuant to requirements of the SEC).

Financial Futures and Options Thereon. The Fund is authorized to engage in transactions in financial futures contracts (futures contracts) and related options on such futures contracts either as a hedge against adverse changes in the market value of its portfolio securities or to seek to enhance the Fund's income. The Fund has authority to purchase and write call and put options on futures contracts. The Fund may engage in options and futures transactions on exchanges and options in the over-the-counter markets (OTC options).

The Fund will engage in transactions in OTC options only with banks or dealers the Investment Advisor believes to be creditworthy at the time they enter into such transactions.

The Fund intends to enter into options and futures transactions, on an exchange or in the over-the-counter market, only if there appears to be a liquid secondary market for such options and futures.

The Commodity Futures Trading Commission (CFTC) subjects advisers to registered investment companies to regulation by the CFTC if a fund that is advised by the investment adviser either (i) invests, directly or indirectly, more than a prescribed level of its liquidation value in CFTC-regulated futures, options and swaps (CFTC Derivatives), or (ii) markets itself as providing investment exposure to such instruments. To the extent the Fund uses CFTC Derivatives, it intends to do so below such prescribed levels and will not market itself as a commodity pool or a vehicle for trading such instruments. Accordingly, The Investment Advisor has claimed an exclusion from the definition of the term commodity pool operator under the Commodity Exchange Act (CEA) pursuant to Rule 4.5 under the CEA. The Investment Advisor is not, therefore, subject to registration or regulation as a commodity pool operator under the CEA in respect of the Fund.

Short Sales. The Fund may make short sales of securities.

Foreign Exchange Transactions. The Fund may engage in spot and forward foreign exchange transactions and currency swaps, purchase and sell options on currencies and purchase and sell currency futures and related options thereon (collectively, Currency Instruments) for purposes of hedging against the decline in the value of currencies in which its portfolio holdings are denominated against the U.S. dollar. The Fund will not speculate in Currency Instruments. Accordingly, the Fund will not hedge a currency in excess of the aggregate market value of the securities which it owns (including receivables for unsettled securities sales), or has committed to or anticipates purchasing, which are denominated in such currency. The Fund may, however, hedge a currency by entering into a transaction in a Currency Instrument denominated in a currency other than the currency being hedged (a cross-hedge). The Fund will only enter into a cross-hedge if the Investment Advisor believes that (i) there is a demonstrable high correlation between the currency in which the cross-hedge is denominated and the currency being

Table of Contents

hedged, and (ii) executing a cross-hedge through the currency in which the cross-hedge is denominated will be significantly more cost-effective or provide substantially greater liquidity than executing a similar hedging transaction by means of the currency being hedged.

Other Investment Strategies. The Fund may also invest in securities pursuant to repurchase agreements and purchase and sale contracts, enter into reverse repurchase agreements with respect to its portfolio investments subject to the investment restrictions set forth herein, purchase interests in senior loans and other portfolio securities on a when-issued basis and purchase or sell such interests or securities on a forward commitment basis, and enter into standby commitment agreements. The Fund may lend securities with a value up to 33 1/3% of its total assets or the limit prescribed by applicable law to banks, brokers and other financial institutions.

Repurchase agreements may be entered into only with a member bank of the Federal Reserve System or primary dealer in U.S. government securities.

Temporary Defensive Strategies. The Fund may vary its investment objective and policies for temporary defensive purposes during periods in which the Investment Advisor believes that conditions in the securities markets or other economic, financial or political conditions warrant and in order to keep the Fund's cash fully invested. The Fund may not achieve its investment objective when it does so.

Investment Process

In selecting floating rate loans or debt and other securities for the Fund, BlackRock will seek to identify issuers and industries that BlackRock believes are likely to experience stable or improving financial conditions. BlackRock's analysis will include:

- credit research on the issuers' financial strength;
- assessment of the issuers' ability to meet principal and interest payments;
- general industry trends;
- the issuers' managerial strength;
- analysis of deal structure and covenants;
- changing financial conditions;
- borrowing requirements or debt maturity schedules; and
- the issuers' responsiveness to changes in business conditions and interest rates.

BlackRock will consider relative values among issuers based on anticipated cash flow, interest or dividend coverage, asset coverage and earnings prospects. Using these tools, BlackRock will seek to add consistent value and control performance volatility consistent with the Fund's investment objectives and policies. BlackRock believes this strategy should enhance the Fund's ability to achieve its investment objective.

BlackRock's analysis continues on an ongoing basis for any floating rate loan or debt or other securities in which the Fund has invested. Although BlackRock uses due care in making such analysis, there can be no assurance that such analysis will reveal factors that may impair the value of the floating rate loan or debt.

Fundamental Investment Restrictions:

The following investment restrictions are considered fundamental by the Fund, which means that they may not be changed without the approval of the holders of a majority of the Fund's outstanding shares of common stock (which

for this purpose and under the 1940 Act means the lesser of (i) 67% of the shares of common stock represented at a meeting at which more than 50% of the outstanding shares of common stock are represented, or (ii) more than 50% of the outstanding shares of common stock). Under the fundamental investment restrictions, the Fund may not:

- (1) make any investment inconsistent with the Fund's classification as a diversified company under the 1940 Act;

Table of Contents

- (2) make investments for the purpose of exercising control or management;
- (3) purchase or sell real estate, commodities or commodity contracts, except that, to the extent permitted by applicable law, the Fund may invest in securities directly or indirectly secured by real estate or interests therein or issued by entities that invest in real estate or interests therein, and the Fund may purchase and sell financial futures contracts and options thereon;
- (4) issue senior securities or borrow money except as permitted by Section 18 of the 1940 Act or otherwise as permitted by applicable law;
- (5) underwrite securities of other issuers, except insofar as the Fund may be deemed an underwriter under the Securities Act in selling portfolio securities;
- (6) make loans to other persons, except (i) to the extent that the Fund may be deemed to be making loans by purchasing senior loans, as a Co-Lender (described in Part II) or otherwise, or other debt securities or enters into repurchase agreements or any similar instruments and (ii) the Fund may lend its portfolio securities in an amount not in excess of 33 1/3% of its total assets, taken at market value, provided that such loans shall be made in accordance with the guidelines set forth in this Prospectus; and
- (7) invest more than 25% of its total assets (taken at market value at the time of each investment) in the securities of issuers in any one industry; 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. For purposes of this restriction, the term issuer includes both a borrower and any lender selling a participation interest (as described under Item 8 Portfolio Contents and Techniques Senior Loans in Part II) to the Fund together with any other person interpositioned between the lender selling such participation interest and the Fund with respect to such participation interest.

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

Non-Fundamental Investment Restrictions:

Any policies of the Fund not described as fundamental in this Prospectus may be changed by its Board without stockholder approval. Additional investment restrictions adopted by the Fund, which may be changed by the Board without stockholder approval, provide that the Fund may not:

- (1) purchase securities of other investment companies, except to the extent that such purchases are permitted by applicable law;
- (2)

mortgage, pledge, hypothecate or in any manner transfer, as security for indebtedness, any securities owned or held by the Fund except as may be necessary in connection with borrowings mentioned in investment restriction (4) above or except as may be necessary in connection with transactions described under Other Investment Policies above;

- (3) purchase any securities on margin, except that the Fund may obtain such short term credit as may be necessary for the clearance of purchases and sales of portfolio securities (the deposit or payment by the Fund of initial or variation margin in connection with financial futures contracts and options thereon is not considered the purchase of a security on margin); or
- (4) change its policy of investing, under normal circumstances, at least 80% of its Managed Assets in floating rate debt securities, unless the Fund provides its stockholders with at least 60 days prior written notice.

Table of Contents

Percentage and Rating Limitations:

All percentage and ratings limitations on securities in which the Fund may invest apply at the time of making an investment and shall not be considered violated if an investment rating is subsequently downgraded to a rating that would have precluded the Fund's initial investment in such security. In the event that the Fund disposes of a portfolio security subsequent to its being downgraded, the Fund may experience a greater risk of loss than if such security had been sold prior to such downgrade.

All references to securities ratings by Moody's and S&P herein shall, unless otherwise indicated, include all securities within each such rating category (i.e., Ba1, Ba2 and Ba3 in the case of Moody's and BB+, BB and BB- in the case of S&P). For securities with split ratings (i.e., a security receiving two different ratings from two different rating agencies), the Fund will apply the lower of the applicable ratings.

Subsidiary:

The Fund wholly owns FRA Subsidiary, LLC, a Delaware-domiciled entity (the Subsidiary). The Subsidiary enables the Fund to hold investments that are organized as an operating partnership and satisfy regulated investment company (RIC) tax requirements. Income earned and gains realized on the investments held by the Subsidiary are taxable to the Subsidiary. The Fund may invest up to 25% of its total assets in the Subsidiary. The Subsidiary's assets are managed by the Investment Advisor and are subject to the same investment policies and restrictions that apply to the Fund.

The Subsidiary is organized as a Delaware limited liability company and taxed as a corporation for Federal income tax purposes. The Subsidiary's limited liability company agreement provides that the business and affairs of the Subsidiary shall be managed by the Investment Advisor, as the manager of the Subsidiary within the meaning of the Delaware Limited Liability Company Act, subject to the supervision of the Board. The Investment Advisor does not receive separate compensation from the Subsidiary for providing investment management or administrative services. The Fund can remove the manager of the Subsidiary at any time. The Subsidiary does not make investments that Section 17 of the 1940 Act would prohibit the Fund or the Subsidiary from making. State Street Bank and Trust Company serves as the Subsidiary's custodian.

Common Stock Repurchase Program:

On October 26, 2016, the Board approved an open market stock repurchase program that allows the Fund to purchase up to 5% of its outstanding shares of common stock from time to time in open market transactions through November 30, 2017, subject to certain conditions. On September 6, 2017, the Board approved a renewal of this program. Commencing on December 1, 2017, the Fund may purchase through November 30, 2018, up to 5% of its shares outstanding as of the close of business on November 30, 2017, subject to certain conditions. The amount and timing of any repurchases under the Fund's stock repurchase program will be determined either at the discretion of the Fund's management or pursuant to predetermined parameters and instructions subject to market conditions.

There is no assurance that the Fund will repurchase shares of common stock in any particular amount. The stock repurchase program seeks to enhance shareholder value by purchasing the Fund's shares of common stock trading at a discount from their NAV per share. For the year ended August 31, 2017, the Fund did not repurchase any shares. For the year ended August 31, 2017, and for the year ended August 31, 2016, shares issued and outstanding remained constant for the Fund.

Additional Information:

Additional information regarding the foregoing securities, instruments and investment techniques are included in Portfolio Contents and Techniques under Item 8 in Part II.

- 3.a. The risk factors associated with an investment in the Fund are set forth in Risk Factors under Item 8 in Part II. Due to the nature of the Fund's investment program, the Fund is particularly susceptible to the risks of fixed-income securities (such as interest rate risk and credit risk), high-yield and distressed securities, senior loans, asset-backed securities, leveraging, illiquid securities, foreign investing, credit and other derivatives (such as options, credit default swaps and interest rate transactions), currency instruments and counterparty default.

Table of Contents

- 3.b. The Fund currently utilizes leverage for investment purposes in the form of a bank credit facility. As of August 31, 2017, this leverage represented approximately 30% of the Fund's Managed Assets (approximately 43% of the Fund's net assets).

Assuming the utilization of leverage by borrowings in the amount of approximately 30% of the Fund's Managed Assets, and an annual interest rate of 2.18% payable on such leverage based on market rates as of the date of this Prospectus, the annual return that the Fund's portfolio must experience (net of expenses) in order to cover such interest payments would be 0.65%.

The following table is designed to illustrate the effect on the return to a holder of common stock of the leverage obtained by borrowings in the amount of approximately 30% of the Fund's Managed Assets, assuming hypothetical annual returns on the Fund's portfolio of minus 10% to plus 10%. As the table shows, leverage generally increases the return to stockholders when portfolio return is positive and greater than the cost of leverage and decreases the return when portfolio return is negative or less than the cost of leverage. The figures appearing in the table are hypothetical and actual returns may be greater or less than those appearing in the table.

Assumed Portfolio Return (net of expenses)	(10)%	(5)%	0%	5%	10%
Corresponding Common Stock Return	(15.19)%	(8.06)%	(0.93)%	6.20%	13.33%

Common share total return is composed of two elements: the common share dividends paid by the Fund (the amount of which is largely determined by the net investment income of the Fund) and gains or losses on the value of the securities the Fund owns. As required by SEC rules, the table assumes that the Fund is more likely to suffer capital losses than to enjoy capital appreciation. For example, to assume a total return of 0% the Fund must assume that the interest it receives on its securities investments is entirely offset by losses in the value of those securities.

Additional information regarding the risks of the Fund's use of leverage is contained under Item 8 Leverage in Part II.

4. See Item 8.2, above, and Item 8 in Part II.
5. The following tables set forth the high and low market prices for shares of common stock of the Fund on the NYSE, for each full quarterly period within the Fund's two most recent fiscal years and each full quarter since the beginning of the Fund's current fiscal year, along with the NAV and discount or premium to NAV for each quotation.

Market Price	Net Asset Value	Premium/(Discount) to Net Asset Value
--------------	-----------------	---------------------------------------

Period Ended	High	Low	High	Low	High	Low
November 30, 2017	\$ 14.40	\$ 13.71	\$ 15.01	\$ 14.92	(4.06)%	(8.11)%
August 31, 2017	\$ 14.42	\$ 13.93	\$ 15.04	\$ 14.93	(4.12)%	(6.70)%
May 31, 2017	\$ 14.84	\$ 14.24	\$ 15.08	\$ 14.99	(1.59)%	(5.00)%
February 28, 2017	\$ 14.82	\$ 14.01	\$ 15.04	\$ 15.00	(1.46)%	(6.60)%
November 30, 2016	\$ 14.02	\$ 13.38	\$ 14.89	\$ 14.76	(5.84)%	(9.35)%
August 31, 2016	\$ 13.70	\$ 12.91	\$ 14.78	\$ 14.43	(7.31)%	(10.53)%
May 31, 2016	\$ 13.37	\$ 12.37	\$ 14.64	\$ 14.02	(8.67)%	(11.77)%
February 29, 2016	\$ 12.95	\$ 12.00	\$ 14.31	\$ 13.92	(9.50)%	(13.79)%
November 30, 2015	\$ 13.15	\$ 12.64	\$ 14.92	\$ 14.51	(11.86)%	(12.89)%
August 31, 2015	\$ 13.82	\$ 12.67	\$ 15.22	\$ 14.89	(9.20)%	(14.91)%

As of December 19, 2017 the NAV per common share of the Fund was \$14.91 and the market price per common share was \$13.83, representing a discount to NAV of 7.24%. Common stock of the Fund has historically traded at both a premium and discount to NAV.

Table of Contents

See Repurchase of Common Stock under Item 8 in Part II for additional information.

6. Not applicable.

Item 9. Management

1. BlackRock Advisors, LLC acts as the investment adviser for the Fund. Pursuant to an investment management agreement between the Investment Advisor and the Fund (the Investment Management Agreement), the Fund pays the Investment Advisor a monthly fee at an annual rate of 0.75% of the Fund's average daily Managed Assets (1.05% of the Fund's net assets, assuming leverage of approximately 30% of the Fund's Managed Assets). Because the management fee is calculated on the basis of Managed Assets, which includes assets attributable to leverage, the fee paid to the Investment Advisor will be higher than if the Fund did not use leverage.

A discussion regarding the basis for the approval of the Investment Management Agreement by the Board is available in the Fund's Annual Report to shareholders for the fiscal year ended August 31, 2017.

The Fund is managed by a team of investment professionals comprised of C. Adrian Marshall, Director at BlackRock and Joshua Tarnow, Managing Director at BlackRock. Each is jointly responsible for the day-to-day management of the registrant's portfolio, which includes setting the registrant's overall investment strategy, overseeing the management of the registrant and/or selection of its investments.

Portfolio Manager	Since	Title and Recent Biography
C. Adrian Marshall	2009	Director of BlackRock, Inc. (also referred to as BlackRock) since 2007; Vice President of BlackRock from 2004 to 2007.
Josh Tarnow	2016	Managing Director of BlackRock, Inc. since 2009; Senior Partner at R3 Capital Partners from 2008 to 2009; Managing Director at Lehman Brothers from 2006 to 2008.

Additional information regarding the Board, the Investment Advisor and the portfolio managers, including the portfolio managers' compensation, other accounts managed and ownership of Fund securities, is included under Item 21, below, and under Item 9, Item 18 and Item 21 in Part II.

State Street Bank and Trust Company provides certain administration and accounting services to the Fund pursuant to an Administrative Services Agreement (the Administration Agreement). State Street Bank and Trust Company is paid a monthly fee at an annual rate ranging from 0.0075% to 0.015% of the Fund's Managed Assets, along with an annual fixed fee ranging from \$3,000 to \$10,000 for the services it provides to the Fund.

Certain legal matters will be passed upon by Miles & Stockbridge P.C., which serves as special Maryland counsel to the Fund.

See Other Service Providers under Item 9 in Part II for additional information about State Street Bank and Trust Company, the Fund's other service providers and other matters relevant to the Fund's management.

2. Not applicable.

3. Not applicable.

Item 10. Capital Stock, Long-Term Debt and Other Securities

1. The Fund is authorized to issue 200,000,000 shares of capital stock, par value \$0.10 per share, all of which shares currently are classified as common stock. The Fund intends to make regular monthly cash distributions of all or a portion of its net investment income to holders of the Fund's shares of common stock. The Fund reserves the right to change its distribution policy and the basis for establishing the rate of its monthly distributions at any time and may do so without prior notice to common shareholders. For additional information about the Fund's common stock, see Item 10 in Part II.

Table of Contents

The Fund is party to a senior committed secured, 360-day rolling line of credit facility and a separate security agreement (the SSB Agreement) with State Street Bank and Trust Company (SSB). The SSB Agreement allows for a maximum commitment amount of \$274,000,000 for the Fund. For the year ended August 31, 2017, the average amount of bank borrowings and the daily weighted average interest rates for FRA with loans under the revolving credit agreements was \$226,224,658 and 1.63%, respectively. See Item 10 Credit Facility in Part II for additional information regarding the SSB Agreement.

The Fund does not have any preferred stock outstanding.

2. See Item 10.1, above, and Item 10 in Part II.
3. See Item 10.1, above, and Item 10 in Part II.
4. See Tax Matters under Item 10 in Part II.
5. Outstanding Securities, as of November 30, 2017:

Title of Class	Amount Authorized	Amount Held by Fund for its Account	Amount Outstanding (Exclusive of Amount Held by Fund for its Account)
Common Stock, par value \$0.10	200,000,000	0	37,232,488

6. Not applicable.
Not applicable.

Item 11. Defaults and Arrears on Senior Securities

Not applicable.

Item 12. Legal Proceedings

Not applicable.

Item 13. Table of Contents of SAI

Not applicable

Item 14. Cover Page

Not applicable

Item 15. Table of Contents

Not applicable

Item 16. General Information and History

Not applicable

Item 17. Investment Objective and Policies

1. See Item 8.2 and Item 8.3, above, and Item 8 in Part II.
2. See Item 8.2 and Item 8.3, above, and Item 8 in Part II.
3. See Item 8.2 and Item 8.3, above, and Item 8 in Part II.
4. Not applicable.

I-22

Table of Contents**Item 18. Management**

1. See Item 18 in Part II.
2. See Item 18 in Part II.
3. See Item 18 in Part II.
4. See Item 18 in Part II.
5. During the Fund's fiscal year ended August 31, 2017, the Board and the Board's committees held the following meetings:

Board or Committee	Number of Meetings
Board (Regular Meetings)	6
Board (Special Meetings)	2
Audit Committee	13
Governance and Nominating Committee	4
Compliance Committee	4
Performance Oversight Committee	4
Executive Committee	0

See Item 18 in Part II.

6. See Item 18 in Part II.
7. The Board of the Fund currently consists of 11 individuals, nine of whom are not interested persons of the Fund as defined in the 1940 Act (the Independent Directors). The registered investment companies advised by the Investment Advisor or its affiliates (the BlackRock-Advised Funds) are organized into one complex of closed-end funds (the Closed-End Complex), two complexes of open-end funds (the Equity-Liquidity Complex and the Equity-Bond Complex) and one complex of exchange-traded funds (the Exchange-Traded Complex; each such complex a BlackRock Fund Complex). The Fund is included in the Closed-End Complex. The Directors also oversee as Board members the operations of the other closed-end registered investment companies included in the Closed-End Complex.

Information relating to each Director's share ownership in the Fund and in the other funds in the Closed-End Complex that are overseen by the respective Director as of December 31, 2016 is set forth in the chart below:

Name of Director	Dollar Range of Equity Securities in the Fund*	Aggregate Dollar Range of Equity Securities and Share Equivalents Overseen by Directors in the Family of Registered Investment Companies*
Independent Directors		
Michael J. Castellano	\$0	over \$100,000
Richard E. Cavanagh	\$1 - \$10,000	over \$100,000
Cynthia L. Egan	\$0	\$0
Frank J. Fabozzi	\$1 - \$10,000	over \$100,000
Jerrold B. Harris	\$1 - \$10,000	over \$100,000
R. Glenn Hubbard	\$0	over \$100,000
W. Carl Kester	\$1 - \$10,000	over \$100,000
Catherine A. Lynch	\$0	\$50,001 - \$100,000
Karen P. Robards	\$0	over \$100,000
Interested Directors		
John M. Perlowski	\$10,001 - \$50,000	over \$100,000
Barbara G. Novick	\$0	over \$100,000

* The term "Family of Registered Investment Companies" refers to all registered investment companies advised by the Investment Advisor or an affiliate thereof. Includes share equivalents owned under the deferred compensation plan in the funds in the Family of Registered Investment Companies by certain Independent Directors who have participated in the deferred compensation plan of the funds in the Family of Registered Investment Companies.

Table of Contents

8. See Item 18 in Part II.
9. See Item 18 in Part II.
10. See Item 18 in Part II.
11. See Item 18 in Part II.
12. See Item 18 in Part II.
13. The following table sets forth the aggregate compensation, including deferred compensation amounts, paid to each Independent Director by the Fund during its most recently completed fiscal year and by the Closed-End Complex for the most recently completed calendar year. Mr. Perlowski and Ms. Novick serve without compensation from the Fund because of their affiliation with BlackRock and the Investment Advisor. See Item 18 in Part II for additional information regarding director compensation.

Name	Aggregate Compensation from the Fund (Most Recently Completed Fiscal Year)	Aggregate Compensation from the Fund and other BlackRock- Advised Funds in the Closed-End Complex(1)(2) (Most Recently Completed Calendar Year)
Independent Directors		
Michael J. Castellano	\$5,285	\$310,000
Richard E. Cavanagh	\$7,013	\$421,250
Cynthia L. Egan ⁽³⁾	\$4,987	\$219,192
Frank J. Fabozzi	\$5,786	\$344,167
Herrold B. Harris	\$5,754	\$337,500
R. Glenn Hubbard	\$5,328	\$312,500
W. Carl Kester	\$5,274	\$314,167
Catherine A. Lynch ⁽⁴⁾	\$5,285	\$258,333
Karen P. Robards	\$7,065	\$419,271

(1) Represents the aggregate compensation earned by such persons from the Closed-End Complex during the calendar year ended December 31, 2016. Of this amount, Mr. Castellano, Mr. Cavanagh, Dr. Fabozzi, Mr. Harris, Dr. Hubbard, Dr. Kester, and Ms. Robards deferred \$93,000, \$42,084, \$0, \$168,750, \$156,250, \$92,000, and \$20,958 respectively, pursuant to the Closed-End Complex's deferred compensation plan.

(2) Total amount of deferred compensation payable by the Closed-End Complex to Mr. Castellano, Mr. Cavanagh, Dr. Fabozzi, Mr. Harris, Dr. Hubbard, Dr. Kester, and Ms. Robards is \$538,695, \$970,972,

\$720,726, \$1,680,234, \$1,725,235, \$967,618, and \$719,289 respectively, as of December 31, 2016.

(3) Ms. Egan did not participate in the deferred compensation plan as of December 31, 2016.

(4) Ms. Lynch did not participate in the deferred compensation plan as of December 31, 2016.

14. Not applicable.

15. See Item 18 in Part II.

16. See Item 18 in Part II.

17. See Item 18 in Part II.

Item 19. Control Persons and Principal Holders of Securities

1. Not applicable.

Table of Contents

2. Unless otherwise indicated, the information set forth below is as of November 30, 2017. To the Fund's knowledge, no person beneficially owned more than 5% of the Fund's outstanding shares of common stock, except as set forth below:

Investor	Address	Common Stock Held	Common Stock % Held
Relative Value Partners Group, LLC	1033 SKOKIE BLVD. SUITE 470, NORTHBROOK, IL 60062	2,775,992 shares	7.46%

The information contained in this table is based on Schedule 13D/13G filings made on or before November 30, 2017.

3. See Item 19 in Part II.

Item 20. Investment Advisory and Other Services

1. The table below sets forth information about the total advisory fees, net of any applicable fee waiver, paid by the Fund to the Investment Advisor for the last three fiscal years.

Year Ended August 31,		
2017	2016	2015
\$5,868,937 ⁽¹⁾⁽²⁾	\$5,474,548 ⁽¹⁾⁽²⁾	\$5,881,813 ⁽¹⁾⁽²⁾

(1) The Investment Advisor has historically voluntarily agreed to waive its investment advisory fees by the amount of investment advisory fees the Fund pays to the Investment Advisor indirectly through its investment in affiliated money market funds. Pursuant to these arrangements, the figures in the table above reflect waivers by the Investment Advisor of its fees in the amounts of \$1,205, \$568 and \$519 for the years ended August 31, 2017, August 31, 2016 and August 31, 2015, respectively.

Effective September 1, 2016, the Investment Advisor voluntarily agreed to waive its investment advisory fee with respect to any portion of the Fund's assets invested in affiliated equity and fixed-income mutual funds and affiliated exchange-traded funds that have a contractual management fee. Prior to September 1, 2016, the Investment Advisor did not waive such fees. Effective December 2, 2016, the waiver became contractual. The Fee Waiver Agreement was in effect for an initial term ending December 31, 2017 and may be continued from year to year thereafter, provided that such continuance is specifically approved by the Investment Advisor and the Fund (including by a majority of the Fund's Independent Directors). The Fee Waiver Agreement was subsequently extended through December 31, 2018. Neither the Investment Advisor nor the Fund is obligated to extend the Fee Waiver Agreement. The Fee Waiver Agreement may be terminated at any time, without the payment of any penalty, only by the Fund (upon the vote of a majority of the Independent Directors of the Fund or a majority of the

outstanding voting securities of the Fund), upon 90 days written notice by the Fund to the Investment Advisor. For the fiscal year ended August 31, 2017, the Investment Advisor waived \$3,513 pursuant to this agreement.

(2) The Investment Advisor provides investment management and other services to the Subsidiary. The Investment Advisor does not receive separate compensation from the Subsidiary for providing investment management or administrative services. However, the Fund pays the Investment Advisor based on the Fund's net assets which includes the assets of the Subsidiary.

See Item 9.1, above, and Item 9 and Item 20 in Part II for additional information regarding the Investment Advisor.

2. See Item 9.1, above, and Item 9 and Item 20 in Part II.
3. Not applicable.
4. State Street Bank and Trust Company provides certain administration and accounting services to the Fund pursuant to the Administration Agreement. The table below shows the amounts paid by the Fund to State Street Bank and Trust Company for such services for the past three fiscal years:

Year Ended August 31,		
2017	2016	2015
\$102,846	\$95,793	\$105,218

See Item 9.1, above, and Item 9 in Part II for additional information regarding the Administration Agreement.

5. Not applicable.
6. See Item 9 in Part II.
7. See Item 9 in Part II.

Table of Contents

8. Not applicable.

Item 21: Portfolio Managers

1. The following table sets forth information about funds and accounts other than the Fund for which the portfolio managers are primarily responsible for the day-to-day portfolio management as of August 31, 2017:

Name of Portfolio Manager	Number of Other Accounts Managed and Assets by Account Type			Number of Other Accounts and Assets for Which Advisor Fee is Performance-Based		
	Other Registered Investment Companies	Other Pooled Investment Vehicles	Other Accounts	Other Registered Investment Companies	Other Pooled Investment Vehicles	Other Accounts
Joshua Tarnow	4 \$4.57 Billion	3 \$291.2 Million	1 \$339.9 Million	0 \$0	0 \$0	0 \$0
C. Adrian Marshall	6 \$6.07 Billion	28 \$10.08 Billion	13 \$1.96 Billion	0 \$0	2 \$0.98 Million	0 \$0

Conflicts of Interest: Messrs. Marshall and Tarnow may be managing certain hedge fund and/or long only accounts, or may be part of a team managing certain hedge fund and/or long only accounts, subject to incentive fees. Messrs. Marshall and Tarnow may therefore be entitled to receive a portion of any incentive fees earned on such accounts. See **Portfolio Managers Potential Material Conflicts of Interest** under Item 21 in Part II.

2. See Item 21 in Part II for a general overview and description of the structure of, and the method used to determine, the compensation of the portfolio managers. The principal components of compensation include a base salary, a performance-based discretionary bonus, participation in various benefits programs and one or more of the incentive compensation programs established by BlackRock. The following sets forth how various components of this compensation structure apply specifically to these portfolio managers as of August 31, 2017.

Discretionary Incentive Compensation. Among other things, BlackRock's Chief Investment Officers make a subjective determination with respect to each portfolio manager's compensation based on the performance of the funds and other accounts managed by each portfolio manager relative to the various benchmarks. Performance of fixed income funds is measured on a pre-tax and/or after-tax basis over various time periods including 1-, 3- and 5- year periods, as applicable. With respect to these portfolio managers, such benchmarks for the Fund and other accounts are a combination of market-based indices (e.g., S&P Leveraged All Loan Index), certain customized indices and certain fund industry peer groups.

Long-Term Incentive Plan Awards. These portfolio managers have invested long-term incentive awards.

Deferred Compensation Program. Any portfolio manager who is either a managing director or director at BlackRock (which would include these portfolio managers) is eligible to participate in the deferred compensation program.

Incentive Savings Plan. All of the eligible portfolio managers are eligible to participate in these plans.

3. As of August 31, 2017, the portfolio managers beneficially own the following dollar ranges of equity securities in the Fund:

Portfolio Manager	Dollar Range of Equity Securities of the Fund Beneficially Owned
C. Adrian Marshall	\$10,001-\$50,000
Josh Tarnow	\$100,001-\$500,000

Table of Contents

Item 22. Brokerage Allocation and Other Practices

1. Information about the brokerage commissions paid by the Fund is set forth in the following table:

For the Fiscal Year

Ended Aggregate Brokerage Commissions Paid

August 31, 2017 \$2,916

August 31, 2016 \$3,279

August 31, 2015 \$3,990

See Item 22 in Part II for additional information about how the Fund effects portfolio transactions.

2. The Investment Advisor may place portfolio transactions, to the extent permitted by law, with brokerage firms affiliated with the Fund and the Investment Advisor, if it reasonably believes that the quality of execution and the commission are comparable to that available from other qualified brokerage firms.

The Fund has not paid any brokerage commissions to affiliated broker-dealers during the three most recent fiscal years.

The Fund paid no security lending agent fees to the security lending agent during the Fund's previous three fiscal years.

3. See Item 22 in Part II.

4. Not applicable.

5. Not applicable.

Item 23. Tax Status

See Item 10.4, above, and Tax Matters under Item 10 in Part II.

Item 24. Financial Statements

The Fund's audited financial statements for the fiscal year ended August 31, 2017 are incorporated by reference herein to the Fund's annual report filed on Form N-CSR on November 3, 2017.

Table of Contents

PART II

ADDITIONAL INFORMATION ABOUT

BLACKROCK FLOATING RATE INCOME STRATEGIES FUND, INC.

Item 5. Plan of Distribution

The Fund has entered into a Distribution Agreement (the "Distribution Agreement") with BlackRock Investments, LLC, an affiliate of the Fund and the Investment Advisor located at 55 East 52nd Street, New York, NY 10055, to provide for distribution of the Fund's common stock on a reasonable efforts basis through various specified transactions, including at-the-market offerings pursuant to Rule 415 under the Securities Act, subject to various conditions. The Distribution Agreement has been filed as an exhibit to the Registration Statement of which this Prospectus is a part. The summary of the Distribution Agreement contained herein is qualified by reference to the Distribution Agreement.

Subject to the terms and conditions of the Distribution Agreement, the Fund may from time to time issue and sell its common stock through the Distributor to certain broker-dealers which have entered into sub-placement agent agreements with the Distributor. Currently, the Distributor has entered into a sub-placement agent agreement with UBS Securities LLC, pursuant to which the Sub-Placement Agent will be acting as the Distributor's sub-placement agent with respect to at-the-market offerings of the Fund's common stock. The Sub-Placement Agent Agreement has been filed as an exhibit to the Registration Statement of which this Prospectus forms a part. The summary of the Sub-Placement Agent Agreement contained herein is qualified by reference to the Sub-Placement Agent Agreement.

Under the Sub-Placement Agent Agreement, upon instructions from the Distributor the Sub-Placement Agent will use its reasonable best efforts to sell, as sub-placement agent, shares of Fund common stock under the terms and subject to the conditions set forth in the Sub-Placement Agent Agreement. The Distributor will instruct the Sub-Placement Agent as to the amount of shares of Fund common stock authorized for sale by the Sub-Placement Agent on any particular day that is a trading day for the exchange on which the Fund's common stock is listed and primarily trades. The Distributor will also instruct the Sub-Placement Agent not to sell shares of Fund common stock if the sales cannot be effected at or above a price designed by the Distributor, which price will at least be equal to the Minimum Price and which price, may, in the discretion of the Distributor and the Fund, be above the Minimum Price. The Distributor and the Fund may, in their discretion, determine not to authorize sales of the Fund's common stock on a particular day even if the per share price of the shares is equal to or greater than the Minimum Price. The Fund and the Distributor will have full discretion regarding whether sales of shares of the Fund's common stock will be authorized on a particular day and, if so, in what amounts. The Fund, the Distributor or the Sub-Placement Agent may suspend a previously authorized offering of the Fund's common stock upon proper notice and subject to other conditions.

The Sub-Placement Agent will provide written confirmation to the Distributor following the close of trading on a day on which shares of Fund common stock are sold under the Sub-Placement Agent Agreement. Each confirmation will include the number of shares sold, the net proceeds to the Fund and the compensation that the Sub-Placement Agent is owed in connection with the sales. There is no guarantee that there will be any sales of the Fund's common stock pursuant to this Prospectus. Actual sales, if any, of the Fund's common stock may be greater or less than the most recent market price set forth in this Prospectus, depending on the market price of the Fund's common stock at the time of any such sale; provided, however, that sales will not be made at less than the Minimum Price.

Settlements of sales of common stock will occur on the second business day following the date on which any such sales are made.

In connection with the sale of common stock on behalf of the Fund, the Distributor may be deemed to be an underwriter within the meaning of the Securities Act, and the compensation of the Distributor may be deemed to be underwriting commissions or discounts.

The offering of the Fund's common stock pursuant to the Distribution Agreement will terminate upon the earlier of (i) the sale of all shares of common stock subject thereto or (ii) termination of the Distribution Agreement. The Fund and the Distributor each have the right to terminate the Distribution Agreement in its discretion upon advance notice to the other party.

II-1

Table of Contents

The Sub-Placement Agent, its affiliates and their respective employees hold or may hold in the future, directly or indirectly, investment interests in BlackRock, the parent company of the Distributor, and funds advised by the Investment Advisor and its affiliates. The interests held by employees of the Sub-Placement Agent or its affiliates are not attributable to, and no investment discretion is held by, the Sub-Placement Agent or its affiliates.

The Fund has agreed to indemnify the Distributor and hold the Distributor harmless against certain liabilities, including certain liabilities under the Securities Act, except for any liability to the Fund or its investors to which the Distributor would otherwise be subject by reason of willful misfeasance, bad faith or gross negligence in the performance of its duties or by its reckless disregard of its obligations and duties under its agreement with the Fund.

Additional information regarding the plan of distribution is set forth under Item 5 in Part I.

Item 8. Description of the Fund

Portfolio Contents and Techniques

The Fund may invest in the following instruments and use the following investment techniques, subject to any limitations set forth in Part I. There is no guarantee the Fund will buy all of the types of securities or use all of the investment techniques that are described herein.

Corporate Bonds. Corporate bonds are debt obligations issued by corporations. Corporate bonds may be either secured or unsecured. Collateral used for secured debt includes real property, machinery, equipment, accounts receivable, stocks, bonds or notes. If a bond is unsecured, it is known as a debenture. Bondholders, as creditors, have a prior legal claim over common and preferred stockholders as to both income and assets of the corporation for the principal and interest due them and may have a prior claim over other creditors if liens or mortgages are involved. Interest on corporate bonds may be fixed or floating, or the bonds may be zero coupons. Interest on corporate bonds is typically paid semi-annually and is fully taxable to the bondholder. Corporate bonds contain elements of both interest rate risk and credit risk. The market value of a corporate bond generally may be expected to rise and fall inversely with interest rates and may also be affected by the credit rating of the corporation, the corporation's performance and perceptions of the corporation in the marketplace. Corporate bonds usually yield more than government or agency bonds due to the presence of credit risk.

High Yield Securities. The Fund may invest in securities rated, at the time of investment, below investment grade quality such as those rated Ba or below by Moody's or BB or below by S&P or Fitch, or securities comparably rated by other rating agencies or in unrated securities determined by the Investment Advisor to be of comparable quality. Such securities, sometimes referred to as high yield or junk bonds, are predominantly speculative with respect to the capacity to pay interest and repay principal in accordance with the terms of the security and generally involve greater price volatility than securities in higher rating categories. Often the protection of interest and principal payments with respect to such securities may be very moderate and issuers of such securities face major ongoing uncertainties or exposure to adverse business, financial or economic conditions which could lead to inadequate capacity to meet timely interest and principal payments.

Lower grade securities, though high yielding, are characterized by high risk. They may be subject to certain risks with respect to the issuing entity and to greater market fluctuations than certain lower yielding, higher rated securities. The secondary market for lower grade securities may be less liquid than that of higher rated securities. Adverse conditions could make it difficult at times for the Fund to sell certain securities or could result in lower prices than those used in calculating the Fund's NAV.

The prices of fixed income securities generally are inversely related to interest rate changes; however, the price volatility caused by fluctuating interest rates of securities also is inversely related to the coupons of such securities. Accordingly, below investment grade securities may be relatively less sensitive to interest rate changes than higher quality securities of comparable maturity because of their higher coupon. The investor receives this higher coupon in return for bearing greater credit risk. The higher credit risk associated with below investment grade securities potentially can have a greater effect on the value of such securities than may be the case with higher quality issues of comparable maturity.

II-2

Table of Contents

Lower grade securities may be particularly susceptible to economic downturns. It is likely that an economic recession could severely disrupt the market for such securities and may have an adverse impact on the value of such securities. In addition, it is likely that any such economic downturn could adversely affect the ability of the issuers of such securities to repay principal and pay interest thereon and increase the incidence of default for such securities.

The ratings of Moody's, S&P, Fitch and other rating agencies represent their opinions as to the quality of the obligations which they undertake to rate. Ratings are relative and subjective and, although ratings may be useful in evaluating the safety of interest and principal payments, they do not evaluate the market value risk of such obligations. Although these ratings may be an initial criterion for selection of portfolio investments, the Investment Advisor also will independently evaluate these securities and the ability of the issuers of such securities to pay interest and principal. To the extent that the Fund invests in lower grade securities that have not been rated by a rating agency, the Fund's ability to achieve its investment objective will be more dependent on the Investment Advisor's credit analysis than would be the case when the Fund invests in rated securities.

Distressed and Defaulted Securities. The Fund may invest in securities of financially distressed and bankrupt issuers, including debt obligations that are in covenant or payment default. Such investments generally trade significantly below par and are considered speculative. The repayment of defaulted obligations is subject to significant uncertainties. Defaulted obligations might be repaid only after lengthy workout or bankruptcy proceedings, during which the issuer might not make any interest or other payments. Typically such workout or bankruptcy proceedings result in only partial recovery of cash payments or an exchange of the defaulted obligation for other debt or equity securities of the issuer or its affiliates, which may in turn be illiquid or speculative.

Senior Loans. The senior loans in which the Fund invests may consist of direct obligations of a borrower undertaken to finance the growth of the borrower's business, internally or externally, or to finance a capital restructuring. Senior loans may also include debtor in possession financings pursuant to Chapter 11 of the U.S. Bankruptcy Code and obligations of a borrower issued in connection with a restructuring pursuant to Chapter 11 of the U.S. Bankruptcy Code. A significant portion of such senior loans are highly leveraged loans such as leveraged buy-out loans, leveraged recapitalization loans and other types of acquisition loans. Such senior loans may be structured to include both term loans, which are generally fully funded at the time of the Fund's investment, and revolving credit facilities or delayed draw term loans, which would require the Fund to make additional investments in the senior loans as required under the terms of the credit facility. Such senior loans may also include receivables purchase facilities, which are similar to revolving credit facilities secured by a borrower's receivables, senior loans designed to provide bridge financing to a borrower pending the sale of identified assets or the arrangement of longer-term loans or the issuance and sale of debt obligations or senior loans of borrowers that have obtained bridge loans from other parties. Senior loans generally are issued in the form of senior syndicated loans, but the Fund also may invest from time to time in privately placed notes, credit linked notes, structured notes or other instruments with credit and pricing terms which are, in the opinion of the Investment Advisor, consistent with investments in senior loan obligations.

The senior loans in which the Fund invests typically have stated maturities ranging from five to nine years, though such stated maturities could vary from this range and the Fund is not subject to any restrictions with respect to the maturity of senior loans held in its portfolio. 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. Because of prepayments, the Investment Advisor expects the average life of the senior loans in which the Fund invests to be shorter than the stated maturity.

The senior loans in which the Fund invests generally hold a senior position in the capital structure of the borrower. Such loans may include loans that hold the most senior position, loans that hold an equal ranking with other senior debt, or loans that are, in the judgment of the Investment Advisor, in the category of senior debt. A senior position in

the borrower's capital structure generally gives the holder of the senior loan a claim on some or all of the borrower's assets that is senior to that of subordinated debt, preferred stock and common stock in the event the borrower defaults or becomes bankrupt. The senior loans in which the Fund invests may be wholly or partially secured by collateral, or may be unsecured. In the event of a default, the ability of an investor to have access to any collateral may be limited by bankruptcy and other insolvency laws. The value of the collateral also may decline subsequent to the Fund's investment in the senior loan. Under certain circumstances, the collateral may be released with the

Table of Contents

consent of the Agent Bank and Co-Lenders (each as defined below), or pursuant to the terms of the underlying credit agreement with the borrower. There is no assurance that the liquidation of the collateral will satisfy the borrower's obligation in the event of nonpayment of scheduled interest or principal, or that the collateral could be readily liquidated. As a result, the Fund might not receive payments to which it is entitled and thereby may experience a decline in the value of the investment, and possibly, its NAV.

In the case of highly leveraged senior loans, a borrower is often required to pledge collateral that may include (i) working capital assets, such as accounts receivable and inventory, (ii) tangible fixed assets, such as real property, buildings and equipment, (iii) intangible assets, such as trademarks, copyrights and patent rights and/or (iv) security interests in securities of subsidiaries or affiliates. Collateral also may include guarantees or other credit support by subsidiaries or affiliates. In some cases the only collateral for the senior loan is the stock of the borrower and/or its subsidiaries and affiliates. To the extent a senior loan is secured by stock of the borrower and/or its subsidiaries and affiliates, such stock may lose all of its value in the event of a bankruptcy or insolvency of the borrower. In the case of senior loans to privately held companies, the companies' owners may provide additional credit support in the form of guarantees and/or pledges of other securities that they own.

In the case of project finance loans, the borrower is generally a special purpose entity that pledges undeveloped land and other non-income producing assets as collateral and obtains construction completion guaranties from third parties, such as the project sponsor. Project finance credit facilities typically provide for payment of interest from escrowed funds during a scheduled construction period, and for the pledge of current and fixed assets after the project is constructed and becomes operational. During the construction period, however, the lenders bear the risk that the project will not be constructed in a timely manner, or will exhaust project funds prior to completion. In such an event, the lenders may need to take legal action to enforce the completion guaranties, or may need to lend more money to the project on less favorable financing terms, or may need to liquidate the undeveloped project assets. There can be no assurance in any of such cases that the lenders will recover all of their invested capital.

The rate of interest payable on senior floating rate loans is established as the sum of a base lending rate plus a specified margin. These base lending rates generally are the prime rate (Prime Rate) of a designated U.S. bank, London Interbank Offered Rate (LIBOR), the Certificate of Deposit (CD) rate or another base lending rate used by commercial lenders. The interest rate on Prime Rate-based senior loans floats daily as the Prime Rate changes, while the interest rate on LIBOR-based and CD-based senior loans is reset periodically, typically every one, two, three or six months. Certain of the senior floating rate loans in which the Fund invests permit the borrower to select an interest rate reset period of up to one year. A portion of the Fund's portfolio may be invested in senior loans with interest rates that are fixed for the term of the loan. Investment in senior loans with longer interest rate reset periods or fixed interest rates may increase fluctuations in the Fund's NAV, and potentially the market price of the Fund's shares of common stock, as a result of changes in interest rates.

The Fund may receive and/or pay certain fees in connection with its lending activities. These fees are in addition to interest payments received and may include facility fees, commitment fees, amendment and waiver fees, commissions and prepayment fees. In certain circumstances, the Fund may receive a prepayment fee on the prepayment of a senior loan by a borrower. In connection with the acquisition of senior loans or other debt securities, the Fund also may acquire warrants and other debt and equity securities of the borrower or issuer or its affiliates. The Fund may also acquire other debt and equity securities of the borrower or issuer in connection with an amendment, waiver, conversion or exchange of a senior loan or in connection with a bankruptcy or workout of the borrower or issuer.

In making an investment in a senior loan, the Investment Advisor will consider factors deemed by it to be appropriate to the analysis of the borrower and the senior loan. The Investment Advisor performs its own independent credit analysis of the borrower in addition to utilizing information prepared and supplied by the Agent Bank, Co-Lender or

Participant (each defined below) from whom the Fund purchases its interest in a senior loan. Such factors include, but are not limited to, the legal/protective features associated with the securities (such as their position in the borrower's capital structure and any security through collateral), financial ratios of the borrower such as pre-tax interest coverage, leverage ratios, and the ratios of cash flows to total debts and the ratio of tangible assets to debt. In its analysis of these factors, the Investment Advisor also will be influenced by the nature of the industry in which the borrower is engaged, the nature of the borrower's assets and the Investment Advisor's assessments of the general quality of the borrower. The Investment Advisor's analysis continues on an ongoing basis for any senior loans in which the Fund has invested. Although the Investment Advisor uses due care in making such analysis, there can be no assurance that such analysis will disclose factors that may impair the value of the senior loan.

Table of Contents

Senior loans made in connection with highly leveraged transactions are subject to greater credit risks than other senior loans in which each Fund may invest. These credit risks include a greater possibility of default or bankruptcy of the borrower and the assertion that the pledging of collateral to secure the loan constituted a fraudulent conveyance or preferential transfer which can be nullified or subordinated to the rights of other creditors of the borrower under applicable law.

Many senior loans in which the Fund invests may not be rated by a rating agency, are not registered with the SEC, or any state securities commission, and are not listed on any national securities exchange. Borrowers may have outstanding debt obligations that are rated below investment grade by a rating agency. Many of the senior loans in which the Fund invests will have been assigned below investment grade ratings by independent rating agencies. In the event senior loans are not rated, they are likely to be the equivalent of below investment grade quality. The Investment Advisor does not view ratings as the determinative factor in its investment decisions and relies more upon its credit analysis abilities than upon ratings.

The Fund has no policy with regard to minimum ratings for senior loans in which it may invest. The Fund may purchase and retain in its portfolio senior loans where the borrower has experienced, or may be perceived to be likely to experience, credit problems, including involvement in or recent emergence from bankruptcy reorganization proceedings or other forms of debt restructuring. Such investments may provide opportunities for enhanced income as well as capital appreciation, although they also will be subject to greater risk of loss. 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 fixed income securities in exchange for all or a portion of a senior loan.

The secondary market for trading of senior loans continues to develop and mature. One of the effects of a more active and liquid secondary market, however, is that a senior loan may trade at a premium or discount to the principal amount, or par value, of the loan. There are many factors that influence the market value of a senior loan, including technical factors relating to the operation of the loan market, supply and demand conditions, market perceptions about the credit quality or financial condition of the borrower or more general concerns about the industry in which the borrower operates. The Fund participates in this secondary market for senior loans, purchasing and selling loans that may trade at a premium or discount to the par value of the loan. However, no active trading market may exist for some senior loans and some loans may be subject to restrictions on resale. A secondary market may be subject to irregular trading activity, wide bid/ask spreads and extended trade settlement periods, which may impair the ability to realize full value and thus cause a material decline in the Fund's NAV. In addition, the Fund may not be able to readily dispose of its senior loans at prices that approximate those at which the Fund could sell such loans if they were more widely-traded and, as a result of such illiquidity, the Fund may have to sell other investments or engage in borrowing transactions if necessary to raise cash to meet its obligations. During periods of limited supply and liquidity of senior loans, the Fund's yield may be lower.

When interest rates decline, the value of a fund invested in fixed rate obligations can be expected to rise. Conversely, when interest rates rise, the value of a fund invested in fixed rate obligations can be expected to decline. Although changes in prevailing interest rates can be expected to cause some fluctuations in the value of floating rate senior loans (due to the fact that floating rates on senior loans only reset periodically), the value of floating rate senior loans is substantially less sensitive to changes in market interest rates than fixed rate instruments. As a result, to the extent the Fund invests in floating rate senior loans, the Fund's portfolio may be less volatile and less sensitive to changes in market interest rates than if the Fund invested in fixed rate obligations. Similarly, a sudden and significant increase in market interest rates may cause a decline in the value of these investments and in the Fund's NAV. Other factors (including, but not limited to, rating downgrades, credit deterioration, a large downward movement in stock prices, a disparity in supply and demand of certain securities or market conditions that reduce liquidity) can reduce the value of

senior loans and other debt obligations, impairing the Fund's NAV.

A borrower must comply with various restrictive covenants contained in any credit agreement between the borrower and the lending syndicate. Such covenants, in addition to requiring the scheduled payment of interest and principal, may include restrictions on dividend payments and other distributions to stockholders, provisions requiring the borrower to maintain specific financial ratios or relationships, limits on total debt and restrictions on the borrower's

II-5

Table of Contents

ability to pledge its assets. In addition, the loan agreement may contain a covenant requiring the borrower to prepay the senior loan with any excess cash flow. Excess cash flow generally includes net cash flow after scheduled debt service payments and permitted capital expenditures, among other things, as well as the proceeds from asset dispositions or sales of securities. A breach of a covenant (after giving effect to any cure period) which is not waived by the Agent Bank and the lending syndicate normally is an event of default (i.e., the Agent Bank has the right to call the outstanding senior loan).

Senior loans usually require, in addition to scheduled payments of interest and principal, the prepayment of the senior loan from excess cash flow, as discussed above, and typically permit the borrower to prepay at its election. The degree to which borrowers prepay senior loans, whether as a contractual requirement or at their election, may be affected by general business conditions, the financial condition of the borrower and competitive conditions among lenders, among other factors. Accordingly, prepayments cannot be predicted with accuracy. Upon a prepayment, the Fund may receive both a prepayment fee from the prepaying borrower and a facility fee on the purchase of a new senior loan with the proceeds from the prepayment of the former. Such fees may mitigate any adverse impact on the yield on the Fund's portfolio which may arise as a result of prepayments and the reinvestment of such proceeds in senior loans bearing lower interest rates.

A senior loan in which the Fund may invest typically is originated, negotiated and structured by a syndicate of lenders (Co-Lenders) consisting of commercial banks, thrift institutions, insurance companies, finance companies, investment banking firms, securities brokerage houses or other financial institutions or institutional investors, one or more of which administers the loan on behalf of the syndicate (the Agent Bank). Co-Lenders may sell senior loans to third parties (Participants). The Fund invests in a senior loan either by participating in the primary distribution as a Co-Lender at the time the loan is originated or by buying an assignment or participation interest in the senior loan in the secondary market from a Co-Lender or a Participant.

The Fund may invest in a senior loan at origination as a Co-Lender or by acquiring an assignment or participation interest in the secondary market from a Co-Lender or Participant. If the Fund purchases an assignment, the Fund typically accepts all of the rights of the assigning lender in a senior loan, including the right to receive payments of principal and interest and other amounts directly from the borrower and to enforce its rights as a lender directly against the borrower and assumes all of the obligations of the assigning lender, including any obligations to make future advances to the borrower. As a result, therefore, the Fund has the status of a Co-Lender. In some cases, the rights and obligations acquired by a purchaser of an assignment may differ from, and may be more limited than, the rights and obligations of the assigning lender. The Fund also may purchase a participation in a portion of the rights of a Co-Lender or Participant in a senior loan by means of a participation agreement. A participation is similar to an assignment in that the Co-Lender or Participant transfers to the Fund all or a portion of an interest in a senior loan. Unlike an assignment, however, a participation does not establish any direct relationship between the Fund and the borrower. In such a case, the Fund is required to rely on the Co-Lender or Participant that sold the participation not only for the enforcement of the Fund's rights against the borrower but also for the receipt and processing of payments due to the Fund under the senior loans.

Because it may be necessary to assert through a Co-Lender or Participant such rights as may exist against the borrower, in the event the borrower fails to pay principal and interest when due, the Fund may be subject to delays, expenses and risks that are greater than those that would be involved if the Fund could enforce its rights directly against the borrower. Moreover, under the terms of a participation, the Fund may be regarded as a creditor of the Co-Lender or Participant that sold the participation (rather than of the borrower), so that the Fund may also be subject to the risk that the Co-Lender or Participant may become insolvent. Similar risks may arise with respect to the Agent Bank, as described below. Further, in the event of the bankruptcy or insolvency of the borrower, the obligation of the borrower to repay the senior loan may be subject to certain defenses that can be asserted by such borrower as a result

of improper conduct by the Agent Bank, Co-Lender or Participant.

In a typical senior loan, the Agent Bank administers the terms of the credit agreement and is responsible for the collection of principal and interest and fee payments from the borrower and the apportionment of these payments to the credit of all lenders which are parties to the credit agreement. The Fund generally relies on the Agent Bank (or the Co-Lender or Participant that sold the Fund a participation interest) to collect its portion of the payments on the senior loan. Furthermore, the Fund generally relies on the Agent Bank to use appropriate creditor remedies against the borrower. Typically, under credit agreements, the Agent Bank is given broad discretion in enforcing the credit agreement, and is obligated to use only the same care it would use in the management of its own property. The borrower compensates the Agent Bank for these services. Such compensation may include special fees paid on structuring and funding the senior loan and other fees paid on a continuing basis.

Table of Contents

In the event that an Agent Bank becomes insolvent, or has a receiver, conservator, or similar official appointed for it by the appropriate bank regulatory authority or becomes a debtor in a bankruptcy proceeding, assets held by the Agent Bank under the credit agreement should remain available to holders of senior loans.

If, however, assets held by the Agent Bank for the benefit of the Fund were determined by an appropriate regulatory authority or court to be subject to the claims of the Agent Bank's general or secured creditors, the Fund might incur certain costs and delays in realizing payment on a senior loan or suffer a loss of principal and/or interest. In situations involving a Co-Lender or Participant that sold the Fund a participation interest, similar risks may arise, as described above.

The Fund may have certain obligations pursuant to a credit agreement, which may include the obligation to make future advances to the borrower in connection with revolving credit facilities in certain circumstances. These commitments may have the effect of requiring the Fund to increase its investment in a borrower at a time it might not be desirable to do so (including at a time when the borrower's financial condition makes it unlikely that such amounts will be repaid). The Fund currently intends to reserve against such contingent obligations by designating sufficient investments in liquid assets on its books and records.

The Fund may obtain exposure to senior loans through the use of derivative instruments, which have recently become increasingly available. The Investment Advisor may utilize these instruments and similar instruments that may be available in the future. The Fund may invest in a derivative instrument known as a Select Aggregate Market Index (SAMI), which provides investors with exposure to a reference basket of senior loans. SAMIs are structured as floating rate instruments. SAMIs consist of a basket of credit default swaps whose underlying reference securities are senior secured loans. While investing in SAMIs will increase the universe of floating rate fixed income securities to which the Fund is exposed, such investments entail risks that are not typically associated with investments in other floating rate fixed income securities. The liquidity of the market for SAMIs will be subject to liquidity in the secured loan and credit derivatives markets. Investment in SAMIs involves many of the risks associated with investments in derivative instruments discussed generally herein.

Second Lien Loans. The Fund may invest in second lien or other subordinated or unsecured floating rate and fixed rate loans or debt. Second lien loans have the same characteristics as senior loans except that such loans are second in lien property rather than first. Second lien loans typically have adjustable floating rate interest payments. Accordingly, the risks associated with second lien loans are higher than the risk of loans with first priority over the collateral. In the event of default on a second lien loan, the first priority lien holder has first claim to the underlying collateral of the loan. It is possible that no collateral value would remain for the second priority lien holder, which may result in a loss of investment to the Fund.

Mezzanine Loans. The Fund may invest in mezzanine loans. Structurally, mezzanine loans usually rank subordinate in priority of payment to senior debt, such as senior bank debt, and are often unsecured. However, mezzanine loans rank senior to common and preferred equity in a borrower's capital structure. Mezzanine debt is often used in leveraged buyout and real estate finance transactions. Typically, mezzanine loans have elements of both debt and equity instruments, offering the fixed returns in the form of interest payments associated with senior debt, while providing lenders an opportunity to participate in the capital appreciation of a borrower, if any, through an equity interest. This equity interest typically takes the form of warrants. Due to their higher risk profile and often less restrictive covenants as compared to senior loans, mezzanine loans generally earn a higher return than senior secured loans. The warrants associated with mezzanine loans are typically detachable, which allows lenders to receive repayment of their principal on an agreed amortization schedule while retaining their equity interest in the borrower. Mezzanine loans also may include a put feature, which permits the holder to sell its equity interest back to the borrower at a price determined through an agreed-upon formula. Mezzanine investments may be issued with or without registration rights. Similar to

other high yield securities, maturities of mezzanine investments are typically seven to ten years, but the expected average life is significantly shorter at three to five years; however, maturities and expected average lives could vary from these ranges and the Fund is not subject to any restrictions with respect to the maturities or expected average lives of mezzanine loans held in its portfolio. Mezzanine investments are usually unsecured and subordinate to other obligations of the issuer.

II-7

Table of Contents

Debtor-In-Possession Financings. The Fund may invest in debtor-in-possession or DIP financings newly issued in connection with special situation restructuring and refinancing transactions. DIP financings are loans to a debtor-in-possession in a proceeding under the U.S. Bankruptcy Code that has been approved by the bankruptcy court. These financings allow the entity to continue its business operations while reorganizing under Chapter 11 of the U.S. Bankruptcy Code. DIP financings are typically fully secured by a lien on the debtor's otherwise unencumbered assets or secured by a junior lien on the debtor's encumbered assets (so long as the loan is fully secured based on the most recent current valuation or appraisal report of the debtor). DIP financings are often required to close with certainty and in a rapid manner in order to satisfy existing creditors and to enable the issuer to emerge from bankruptcy or to avoid a bankruptcy proceeding.

Mortgage Related Securities. Mortgage-backed securities (MBS) include structured debt obligations collateralized by pools of commercial (CMBS) or residential (RMBS) mortgages. Pools of mortgage loans and mortgage-backed loans, such as mezzanine loans, are assembled as securities for sale to investors by various governmental, government-related and private organizations. MBS include complex instruments such as collateralized mortgage obligations (CMOs), stripped MBS, mortgage pass-through securities and interests in Real Estate Mortgage Investment Conduits (REMICs). The MBS in which the Fund may invest include those with fixed, floating or variable interest rates, those with interest rates that change based on multiples of changes in a specified reference interest rate or index of interest rates and those with interest rates that change inversely to changes in interest rates, as well as those that do not bear interest. The Fund may invest in RMBS and CMBS issued by governmental entities and private issuers, including subordinated MBS and residual interests. The Fund may invest in sub-prime mortgages or MBS that are backed by sub-prime mortgages.

In general, losses on a mortgaged property securing a mortgage loan included in a securitization will be borne first by the equity holder of the property, then by a cash reserve fund or letter of credit, if any, then by the holder of a mezzanine loan or B-Note, if any, then by the first loss subordinated security holder (generally, the B-Piece buyer) and then by the holder of a higher rated security. The Fund may invest in any class of security included in a securitization. In the event of default and the exhaustion of any equity support, reserve fund, letter of credit, mezzanine loans or B-Notes, and any classes of securities junior to those in which the Fund invests, the Fund will not be able to recover all of its investment in the MBS it purchases. MBS in which the Fund invests may not contain reserve funds, letters of credit, mezzanine loans and/or junior classes of securities. The prices of lower credit quality securities are generally less sensitive to interest rate changes than more highly rated investments, but more sensitive to adverse economic downturns or individual issuer developments.

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

RMBS. RMBS are securities the payments on which depend primarily on the cash flow from residential mortgage loans made to borrowers that are secured, on a first priority basis or second priority basis, subject to permitted liens, easements and other encumbrances, by residential real estate (one- to four-family properties), the proceeds of which

are used to purchase real estate and purchase or construct dwellings thereon or to refinance indebtedness previously used for such purposes. Residential mortgage loans are obligations of the borrowers thereunder only and are not typically insured or guaranteed by any other person or entity. The ability of a borrower to repay a loan secured by residential property is dependent upon the income or assets of the borrower. A number of factors, including a general economic downturn, acts of God, terrorism, social unrest and civil disturbances, may impair a borrower's ability to repay its loans.

II-8

Table of Contents

Agency RMBS. The principal U.S. governmental guarantor of mortgage related securities is GNMA, which is a wholly owned U.S. government corporation. GNMA is authorized to guarantee, with the full faith and credit of the U.S. government, the timely payment of principal and interest on securities issued by institutions approved by GNMA (such as savings and loan institutions, commercial banks and mortgage bankers) and backed by pools of mortgages insured by the Federal Housing Administration (the FHA) or guaranteed by the Department of Veterans Affairs (the VA). MBS issued by GNMA include GNMA Mortgage Pass-Through Certificates (also known as Ginnie Maes) which are guaranteed as to the timely payment of principal and interest by GNMA and such guarantees are backed by the full faith and credit of the United States. GNMA certificates also are supported by the authority of GNMA to borrow funds from the U.S. Treasury to make payments under its guarantee.

Government-related guarantors (i.e., not backed by the full faith and credit of the U.S. government) include the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). FNMA is a government-sponsored corporation the common stock of which is owned entirely by private stockholders. FNMA purchases conventional (i.e., not insured or guaranteed by any government agency) residential mortgages from a list of approved seller/servicers which include state and federally chartered savings and loan associations, mutual savings banks, commercial banks and credit unions and mortgage bankers. Pass-through securities issued by FNMA (also known as Fannie Maes) are guaranteed as to timely payment of principal and interest by FNMA, but are not backed by the full faith and credit of the U.S. government. FHLMC was created by Congress in 1970 for the purpose of increasing the availability of mortgage credit for residential housing. It is a government-sponsored corporation that issues FHLMC Guaranteed Mortgage Pass-Through Certificates (also known as Freddie Macs or PCs), which are pass-through securities, each representing an undivided interest in a pool of residential mortgages. FHLMC guarantees the timely payment of interest and ultimate collection of principal, but PCs are not backed by the full faith and credit of the U.S. government.

In 2008, the Federal Housing Finance Agency (FHFA) placed FNMA and FHLMC into conservatorship. FNMA and FHLMC are continuing to operate as going concerns while in conservatorship and each remains liable for all of its obligations, including its guaranty obligations, associated with its MBS.

As the conservator, FHFA succeeded to all rights, titles, powers and privileges of FNMA and FHLMC and of any stockholder, officer or director of FNMA and FHLMC with respect to FNMA and FHLMC and the assets of FNMA and FHLMC. In connection with the conservatorship, the U.S. Treasury entered into a Senior Preferred Stock Purchase Agreement with each of FNMA and FHLMC pursuant to which the U.S. Treasury would purchase up to an aggregate of \$100 billion of each of FNMA and FHLMC to maintain a positive net worth in each enterprise. This agreement contains various covenants that severely limit each enterprise's operations. In exchange for entering into these agreements, the U.S. Treasury received \$1 billion of each enterprise's senior preferred stock and warrants to purchase 79.9% of each enterprise's common stock. In February 2009, the U.S. Treasury doubled the size of its commitment to each enterprise under the Senior Preferred Stock Program to \$200 billion. The U.S. Treasury's obligations under the Senior Preferred Stock Program are for an indefinite period of time for a maximum amount of \$200 billion per enterprise. In December 2009, the U.S. Treasury announced further amendments to the Senior Preferred Stock Purchase Agreements which included additional financial support to certain governmentally supported entities, including the Federal Home Loan Banks (FHLBs), FNMA and FHLMC. It is difficult, if not impossible, to predict the future political, regulatory or economic changes that could impact FNMA, FHLMC and the FHLBs, and the values of their related securities or obligations. There is no assurance that the obligations of such entities will be satisfied in full, or that such obligations will not decrease in value or default.

Under the Federal Housing Finance Regulatory Reform Act of 2008 (the Reform Act), which was included as part of the Housing and Economic Recovery Act of 2008, FHFA, as conservator or receiver, has the power to repudiate any contract entered into by FNMA or FHLMC prior to FHFA's appointment as conservator or receiver, as applicable, if

FHFA determines, in its sole discretion, that performance of the contract is burdensome and that repudiation of the contract promotes the orderly administration of FNMA's or FHLMC's affairs. The Reform Act requires FHFA to exercise its right to repudiate any contract within a reasonable period of time after its appointment as conservator or receiver. FHFA, in its capacity as conservator, has indicated that it has no intention to repudiate the guaranty obligations of FNMA or FHLMC because FHFA views repudiation as incompatible with the goals of the conservatorship. However, in the event that FHFA, as conservator or if it is later appointed as receiver for FNMA or FHLMC, were to repudiate any such guaranty obligation, the conservatorship or receivership estate, as applicable, would be liable for actual direct compensatory damages in accordance with the provisions of the Reform Act. Any such liability could be satisfied only to the extent of FNMA's or FHLMC's assets available therefor. In the event of repudiation, the payments of interest to holders of FNMA or FHLMC MBS would be reduced if payments

Table of Contents

on the mortgage loans represented in the mortgage loan groups related to such MBS are not made by the borrowers or advanced by the servicer. Any actual direct compensatory damages for repudiating these guaranty obligations may not be sufficient to offset any shortfalls experienced by such MBS holders. Further, in its capacity as conservator or receiver, FHFA has the right to transfer or sell any asset or liability of FNMA or FHLMC without any approval, assignment or consent. Although FHFA has stated that it has no present intention to do so, if FHFA, as conservator or receiver, were to transfer any such guaranty obligation to another party, holders of FNMA or FHLMC MBS would have to rely on that party for satisfaction of the guaranty obligation and would be exposed to the credit risk of that party. In addition, certain rights provided to holders of MBS issued by FNMA and FHLMC under the operative documents related to such securities may not be enforced against FHFA, or enforcement of such rights may be delayed, during the conservatorship or any future receivership. The operative documents for FNMA and FHLMC MBS may provide (or with respect to securities issued prior to the date of the appointment of the conservator may have provided) that upon the occurrence of an event of default on the part of FNMA or FHLMC, in its capacity as guarantor, which includes the appointment of a conservator or receiver, holders of such MBS have the right to replace FNMA or FHLMC as trustee if the requisite percentage of MBS holders consent. The Reform Act prevents MBS holders from enforcing such rights if the event of default arises solely because a conservator or receiver has been appointed.

A 2011 report to Congress from the Treasury Department and the Department of Housing and Urban Development set forth a plan to reform America's housing finance market, which would reduce the role of and eventually eliminate FNMA and FHLMC. Notably, the plan did not propose similar significant changes to GNMA, which guarantees payments on mortgage related securities backed by federally insured or guaranteed loans. The report also identified three proposals for Congress and the administration to consider for the long-term structure of the housing finance markets after the elimination of FNMA and FHLMC, including implementing: (i) a privatized system of housing finance that limits government insurance to very limited groups of creditworthy low- and moderate-income borrowers; (ii) a privatized system with a government backstop mechanism that would allow the government to insure a larger share of the housing finance market during a future housing crisis; and (iii) a privatized system where the government would offer reinsurance to holders of certain highly rated mortgage related securities insured by private insurers and would pay out under the reinsurance arrangements only if the private mortgage insurers were insolvent.

Non-Agency RMBS. Non-agency RMBS are issued by commercial banks, savings and loan institutions, mortgage bankers, private mortgage insurance companies and other non-governmental issuers. Timely payment of principal and interest on RMBS backed by pools created by non-governmental issuers often is supported partially by various forms of insurance or guarantees, including individual loan, title, pool and hazard insurance. The insurance and guarantees are issued by government entities, private insurers and the mortgage poolers. There can be no assurance that the private insurers or mortgage poolers can meet their obligations under the policies, so that if the issuers default on their obligations, the holders of the security could sustain a loss. No insurance or guarantee covers the Fund or the price of the Fund's shares. RMBS issued by non-governmental issuers generally offer a higher rate of interest than government agency and government-related securities because there are no direct or indirect government guarantees of payment.

CMBS. CMBS generally are multi-class debt or pass-through certificates secured or backed by mortgage loans on commercial properties. CMBS generally are structured to provide protection to the senior class investors against potential losses on the underlying mortgage loans. This protection generally is provided by having the holders of subordinated classes of securities (Subordinated CMBS) take the first loss if there are defaults on the underlying commercial mortgage loans. Other protection, which may benefit all of the classes or particular classes, may include issuer guarantees, reserve funds, additional Subordinated CMBS, cross-collateralization and over-collateralization.

The Fund may invest in Subordinated CMBS, which are subordinated in some manner as to the payment of principal and/or interest to the holders of more senior CMBS arising out of the same pool of mortgages and which are often

referred to as B-Pieces. The holders of Subordinated CMBS typically are compensated with a higher stated yield than are the holders of more senior CMBS. On the other hand, Subordinated CMBS typically subject the holder to greater risk than senior CMBS and tend to be rated in a lower rating category (frequently a substantially lower rating category) than the senior CMBS issued in respect of the same mortgage pool. Subordinated CMBS generally are likely to be more sensitive to changes in prepayment and interest rates and the market for such securities may be less liquid than is the case for traditional income securities and senior CMBS.

II-10

Table of Contents

CMOs. A CMO is a multi-class bond backed by a pool of mortgage pass-through certificates or mortgage loans. CMOs may be collateralized by (i) GNMA, FNMA or FHLMC pass-through certificates, (ii) unsecuritized mortgage loans insured by the FHA or guaranteed by the VA, (iii) unsecuritized conventional mortgages, (iv) other MBS or (v) any combination thereof. Each class of a CMO, often referred to as a tranche, is issued at a specific coupon rate and has a stated maturity or final distribution date. Principal prepayments on collateral underlying a CMO may cause it to be retired substantially earlier than its stated maturity or final distribution date. The principal and interest on the underlying mortgages may be allocated among the several classes of a series of a CMO in many ways. One or more tranches of a CMO may have coupon rates which reset periodically at a specified increment over an index, such as LIBOR (or sometimes more than one index). These floating rate CMOs typically are issued with lifetime caps on the coupon rate thereon. CMO residuals represent the interest in any excess cash flow remaining after making the payments of interest and principal on the tranches issued by the CMO and the payment of administrative expenses and management fees.

The Fund may invest in inverse floating rate CMOs. Inverse floating rate CMOs constitute a tranche of a CMO with a coupon rate that moves in the reverse direction relative to an applicable index such as LIBOR. Accordingly, the coupon rate thereon will increase as interest rates decrease. Inverse floating rate CMOs are typically more volatile than fixed or floating rate tranches of CMOs. Many inverse floating rate CMOs have coupons that move inversely to a multiple of an index. The effect of the coupon varying inversely to a multiple of an applicable index creates a leverage factor.. The market for inverse floating rate CMOs with highly leveraged characteristics at times may be very thin. The Fund's ability to dispose of its positions in such securities will depend on the degree of liquidity in the markets for such securities. It is impossible to predict the amount of trading interest that may exist in such securities, and therefore the future degree of liquidity.

Stripped MBS. Stripped MBS are created by segregating the cash flows from underlying mortgage loans or mortgage securities to create two or more new securities, each receiving a specified percentage of the underlying security's principal or interest payments. Mortgage securities may be partially stripped so that each investor class receives some interest and some principal. When securities are completely stripped, however, all of the interest is distributed to holders of one type of security, known as an interest-only security (or IO), and all of the principal is distributed to holders of another type of security, known as a principal-only security (or PO). Strips can be created in a pass-through structure or as tranches of a CMO. The yields to maturity on IOs and POs are very sensitive to the rate of principal payments (including prepayments) on the related underlying mortgage assets. If the underlying mortgage assets experience greater than anticipated prepayments of principal, the Fund may not fully recoup its initial investment in IOs. Conversely, if the underlying mortgage assets experience less than anticipated prepayments of principal, the yield on POs could be materially and adversely affected.

Adjustable Rate Mortgage Securities. Adjustable rate mortgages (ARMs) have interest rates that reset at periodic intervals. Acquiring ARMs permits the Fund to participate in increases in prevailing current interest rates through periodic adjustments in the coupons of mortgages underlying the pool on which ARMs are based. Such ARMs generally have higher current yield and lower price fluctuations than is the case with more traditional fixed income securities of comparable rating and maturity. In addition, when prepayments of principal are made on the underlying mortgages during periods of rising interest rates, the Fund may potentially reinvest the proceeds of such prepayments at rates higher than those at which they were previously invested. Mortgages underlying most ARMs, however, have limits on the allowable annual or lifetime increases that can be made in the interest rate that the mortgagor pays. Therefore, if current interest rates rise above such limits over the period of the limitation, the Fund, when holding an ARM, does not benefit from further increases in interest rates. Moreover, when interest rates are in excess of the coupon rates (i.e., the rates being paid by mortgagors) of the mortgages, ARMs behave more like fixed income securities and less like adjustable-rate securities and are subject to the risks associated with fixed income securities. In addition, during periods of rising interest rates, increases in the coupon rate of ARMs generally lag current market

interest rates slightly, thereby creating the potential for capital depreciation on such securities.

Sub-Prime Mortgages. Sub-prime mortgages are mortgages rated below A by S&P or Moody s. Historically, sub-prime mortgage loans have been made to borrowers with blemished (or non-existent) credit records, and the borrower is charged a higher interest rate to compensate for the greater risk of delinquency and the higher costs of loan servicing and collection. Sub-prime mortgages are subject to both state and federal anti-predatory lending statutes that carry potential liability to secondary market purchasers such as the Fund. Sub-prime mortgages have certain characteristics and associated risks similar to below investment grade securities, including a higher degree of credit risk, and certain characteristics and associated risks similar to MBS, including prepayment risk.

Table of Contents

Mortgage Related ABS. Asset-backed securities (ABS) are bonds backed by pools of loans or other receivables. ABS are created from many types of assets, including in some cases mortgage related asset classes, such as home equity loan ABS. Home equity loan ABS are subject to many of the same risks as RMBS, including interest rate risk and prepayment risk.

Mortgage REITs: The Fund may invest in equity interests and debt securities issued by real estate investment trusts (REITs). REITs possess certain risks which differ from an investment in common stocks. REITs are financial vehicles that pool investor s capital to purchase or finance real estate. REITs may concentrate their investments in specific geographic areas or in specific property types (i.e., hotels, shopping malls, residential complexes and office buildings). The market value of REIT shares and the ability of REITs to distribute income may be adversely affected by several factors, including rising interest rates, changes in the national, state and local economic climate and real estate conditions, perceptions of prospective tenants of the safety, convenience and attractiveness of the properties, the ability of the owners to provide adequate management, maintenance and insurance, the cost of complying with the Americans with Disabilities Act, increased competition from new properties, the impact of present or future environmental legislation and compliance with environmental laws, changes in real estate taxes and other operating expenses, adverse changes in governmental rules and fiscal policies, adverse changes in zoning laws and other factors beyond the control of the REIT issuers. In addition, distributions received by the Fund from REITs may consist of dividends, capital gains and/or return of capital. As REITs generally pay a higher rate of dividends (on a pre-tax basis) than operating companies, to the extent application of the Fund s investment strategy results in the Fund investing in REIT shares, the percentage of the Fund s dividend income received from REIT shares will likely exceed the percentage of the Fund s portfolio which is comprised of REIT shares. There are three general categories of REITs: equity REITs, mortgage REITs and hybrid REITs. Equity REITs invest primarily in direct fee ownership or leasehold ownership of real property; they derive most of their income from rents. Mortgage REITs invest mostly in mortgages on real estate, which may secure construction, development or long-term loans, and the main source of their income is mortgage interest payments. Hybrid REITs hold both ownership and mortgage interests in real estate.

Mortgage Related Derivative Instruments. The Fund may invest in MBS credit default swaps. MBS credit default swaps include swaps the reference obligation for which is an MBS or related index, such as the CMBX Index (a tradeable index referencing a basket of CMBS), the TRX Index (a tradeable index referencing total return swaps based on CMBS) or the ABX Index (a tradeable index referencing a basket of sub-prime MBS). The Fund may engage in other derivative transactions related to MBS, including purchasing and selling exchange-listed and over-the-counter put and call options, futures and forwards on mortgages and MBS. The Fund may invest in newly developed mortgage related derivatives that may hereafter become available.

Net Interest Margin (NIM) Securities. The Fund may invest in net interest margin (NIM) securities. These securities are derivative interest-only mortgage securities structured off home equity loan transactions. NIM securities receive any excess interest computed after paying coupon costs, servicing costs and fees and any credit losses associated with the underlying pool of home equity loans. Like traditional stripped MBS, the yield to maturity on a NIM security is sensitive not only to changes in prevailing interest rates but also to the rate of principal payments (including prepayments) on the underlying home equity loans. NIM securities are highly sensitive to credit losses on the underlying collateral and the timing in which those losses are taken.

Tiered Index Bonds. Tiered index bonds are relatively new forms of mortgage-related securities. The interest rate on a tiered index bond is tied to a specified index or market rate. So long as this index or market rate is below a predetermined strike rate, the interest rate on the tiered index bond remains fixed. If, however, the specified index or market rate rises above the strike rate, the interest rate of the tiered index bond will decrease. Thus, under these circumstances, the interest rate on a tiered index bond, like an inverse floater, will move in the opposite direction of prevailing interest rates, with the result that the price of the tiered index bond may be considerably more volatile than

that of a fixed-rate bond.

II-12

Table of Contents

TBA Commitments. The Fund may enter into to be announced or TBA commitments. TBA commitments are forward agreements for the purchase or sale of securities, including MBS, for a fixed price, with payment and delivery on an agreed upon future settlement date. The specific securities to be delivered are not identified at the trade date. However, delivered securities must meet specified terms, including issuer, rate and mortgage terms. See *When-Issued, Delayed Delivery and Forward Commitment Securities.*

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

Asset-Backed Securities. ABS are a form of structured debt obligation. The securitization techniques used for ABS are similar to those used for MBS. ABS are bonds backed by pools of loans or other receivables. The collateral for these securities may include home equity loans, automobile and credit card receivables, boat loans, computer leases, airplane leases, mobile home loans, recreational vehicle loans and hospital account receivables. The Fund may invest in these and other types of ABS that may be developed in the future. ABS present certain risks that are not presented by mortgage related securities. Primarily, these securities may provide the Fund with a less effective security interest in the related collateral than do mortgage related securities. Therefore, there is the possibility that recoveries on the underlying collateral may not, in some cases, be available to support payments on these securities.

Collateralized Debt Obligations. The Fund may invest in collateralized debt obligations (CDOs), which include collateralized bond obligations (CBOs), collateralized loan obligations (CLOs) and other similarly structured securities. CDOs are types of asset-backed securities. A CBO is ordinarily issued by a fund or other special purpose entity (SPE) and is typically backed by a diversified pool of fixed income securities (which may include high risk, below investment grade securities) held by such issuer. A CLO is ordinarily issued by a trust or other SPE and is typically collateralized by a pool of loans, which may include, among others, domestic and non-U.S. senior secured loans, senior unsecured loans, and subordinate corporate loans, including loans that may be rated below investment grade or equivalent unrated loans, held by such issuer. Although certain CDOs may benefit from credit enhancement in the form of a senior-subordinate structure, over-collateralization or bond insurance, such enhancement may not always be present, and may fail to protect the Fund against the risk of loss on default of the collateral. Certain CDO issuers may use derivatives contracts to create synthetic exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments described elsewhere in this Prospectus. CDOs may charge management fees and administrative expenses, which are in addition to those of the Fund.

For both CBOs and CLOs, the cash flows from the SPE are split into two or more portions, called tranches, varying in risk and yield. The riskiest portion is the equity tranche, which bears the first loss from defaults from the bonds or loans in the SPE and serves to protect the other, more senior tranches from default (though such protection is not complete). Since it is partially protected from defaults, a senior tranche from a CBO or CLO typically has higher ratings and lower yields than its underlying securities, and may be rated investment grade. Despite the protection from the equity tranche, CBO or CLO tranches can experience substantial losses due to actual defaults, downgrades of the underlying collateral by rating agencies, forced liquidation of the collateral pool due to a failure of coverage tests, increased sensitivity to defaults due to collateral default and disappearance of protecting tranches, market anticipation of defaults as well as investor aversion to CBO or CLO securities as a class. Interest on certain tranches of a CDO may be paid in kind or deferred and capitalized (paid in the form of obligations of the same type rather than cash), which involves continued exposure to default risk with respect to such payments.

In addition to the general risks associated with fixed income securities discussed in this prospectus, CDOs carry additional risks, including: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the quality of the collateral may decline in value or default; (iii) the possibility that the CDO securities are subordinate to other classes; and (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer or unexpected investment results.

The credit quality of CDOs depends primarily upon the quality of the underlying assets and the level of credit support and/or enhancement provided. The underlying assets (e.g., securities or loans) of CDOs may be subject to prepayments, which would shorten the weighted average maturity and may lower the return of the CDO. If a credit support or enhancement is exhausted, losses or delays in payment may result if the required payments of principal and interest are not made. The transaction documents relating to the issuance of CDOs may impose eligibility

Table of Contents

criteria on the assets of the issuing SPE, restrict the ability of the investment manager to trade investments and impose certain portfolio-wide asset quality requirements. These criteria, restrictions and requirements may limit the ability of the SPE's investment manager to maximize returns on the CDOs. In addition, other parties involved in structured products, such as third party credit enhancers and investors in the rated tranches, may impose requirements that have an adverse effect on the returns of the various tranches of CDOs. Furthermore, CDO transaction documents generally contain provisions that, in the event that certain tests are not met (generally interest coverage and over-collateralization tests at varying levels in the capital structure), require that proceeds that would otherwise be distributed to holders of a junior tranche must be diverted to pay down the senior tranches until such tests are satisfied. Failure (or increased likelihood of failure) of a CDO to make timely payments on a particular tranche will have an adverse effect on the liquidity and market value of such tranche.

Payments to holders of CDOs may be subject to deferral. If cash flows generated by the underlying assets are insufficient to make all current and, if applicable, deferred payments on the CDOs, no other assets will be available for payment of the deficiency and, following realization of the underlying assets, the obligations of the issuer to pay such deficiency will be extinguished. The value of CDO securities also may change because of changes in the market's perception of the creditworthiness of the servicing agent for the pool, the originator of the pool, or the financial institution or fund providing the credit support or enhancement. Furthermore, the leveraged nature of each subordinated class may magnify the adverse impact on such class of changes in the value of the assets, changes in the distributions on the assets, defaults and recoveries on the assets, capital gains and losses on the assets, prepayment on the assets and availability, price and interest rates of the assets. CDOs are limited recourse, may not be paid in full and may be subject to up to 100% loss.

CDOs are typically privately offered and sold, and thus are not registered under the securities laws. As a result, investments in CDOs may be characterized as illiquid securities; however, an active dealer market may exist which would allow such securities to be considered liquid in some circumstances

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

Zero-Coupon Bonds, Step-Ups and Pay-In-Kind Securities. Zero-coupon bonds pay interest only at maturity rather than at intervals during the life of the security. Like zero-coupon bonds, step up bonds pay no interest initially but eventually begin to pay a coupon rate prior to maturity, which rate may increase at stated intervals during the life of the security. Pay-in-kind securities (PIKs) are debt obligations that pay interest in the form of other debt obligations, instead of in cash. Each of these instruments is normally issued and traded at a deep discount from face value. Zero-coupon bonds, step-ups and PIKs allow an issuer to avoid or delay the need to generate cash to meet current interest payments and, as a result, may involve greater credit risk than bonds that pay interest currently or in cash. The Fund would be required to distribute the income on these instruments as it accrues, even though the Fund will not receive the income on a current basis or in cash. Thus, the Fund may have to sell other investments, including when it may not be advisable to do so, to make income distributions to its shareholders.

U.S. Government Debt Securities. The Fund may invest in debt securities issued or guaranteed by the U.S. government, its agencies or instrumentalities, including U.S. Treasury obligations, which differ in their interest rates, maturities and times of issuance. Such obligations include U.S. Treasury bills (maturity of one year or less), U.S. Treasury notes (maturity of one to ten years) and U.S. Treasury bonds (generally maturities of greater than ten years),

including the principal components or the interest components issued by the U.S. government under the separate trading of registered interest and principal securities program (i.e., STRIPS), all of which are backed by the full faith and credit of the United States.

Municipal Securities: The Fund may invest in municipal securities, which include debt obligations issued to obtain funds for various public purposes, including the construction of a wide range of public facilities, refunding of outstanding obligations and obtaining funds for general operating expenses and loans to other public institutions and facilities. In addition, certain types of private activity bonds (PABs) (or industrial development bonds, under

Table of Contents

pre-1986 law) are issued by or on behalf of public authorities to finance various privately owned or operated facilities, including among other things, airports, public ports, mass commuting facilities, multi-family housing projects, as well as facilities for water supply, gas, electricity, sewage or solid waste disposal and other specialized facilities. Other types of PABs, the proceeds of which are used for the construction, equipment or improvement of privately operated industrial or commercial facilities, may constitute municipal securities. The interest on municipal securities may bear a fixed rate or be payable at a variable or floating rate. The two principal classifications of municipal securities are general obligation bonds and revenue bonds, which latter category includes PABs. Municipal securities typically are issued to finance public projects, such as roads or public buildings, to pay general operating expenses or to refinance outstanding debt. Municipal securities may also be issued for private activities, such as housing, medical and educational facility construction, or for privately owned industrial development and pollution control projects. General obligation bonds are backed by the full faith and credit, or taxing authority, of the issuer and may be repaid from any revenue source. Revenue bonds may be repaid only from the revenues of a specific facility or source. Municipal securities may be issued on a long term basis to provide permanent financing. The repayment of such debt may be secured generally by a pledge of the full faith and credit taxing power of the issuer, a limited or special tax, or any other revenue source, including project revenues, which may include tolls, fees and other user charges, lease payments and mortgage payments. Municipal securities may also be issued to finance projects on a short-term interim basis, anticipating repayment with the proceeds of the later issuance of long-term debt. Obligations are included within the term municipal securities if the interest paid thereon is excluded from gross income for U.S. federal income tax purposes in the opinion of bond counsel to the issuer.

General Obligation Bonds. General obligation bonds are secured by the issuer's pledge of its faith, credit and taxing power for the payment of principal and interest. The taxing power of any governmental entity may be limited, however, by provisions of its state constitution or laws, and an entity's creditworthiness will depend on many factors, including potential erosion of its tax base due to population declines, natural disasters, declines in the state's industrial base or inability to attract new industries, economic limits on the ability to tax without eroding the tax base, state legislative proposals or voter initiatives to limit ad valorem real property taxes and the extent to which the entity relies on federal or state aid, access to capital markets or other factors beyond the state's or entity's control. Accordingly, the capacity of the issuer of a general obligation bond as to the timely payment of interest and the repayment of principal when due is affected by the issuer's maintenance of its tax base.

Revenue Bonds. Revenue bonds are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise tax or other specific revenue sources such as payments from the user of the facility being financed. Accordingly, the timely payment of interest and the repayment of principal in accordance with the terms of the revenue or special obligation bond is a function of the economic viability of such facility or such revenue source. Revenue bonds issued by state or local agencies to finance the development of low-income, multi-family housing involve special risks in addition to those associated with municipal securities generally, including that the underlying properties may not generate sufficient income to pay expenses and interest costs. Such bonds are generally non-recourse against the property owner, may be junior to the rights of others with an interest in the properties, may pay interest that changes based in part on the financial performance of the property, may be prepayable without penalty and may be used to finance the construction of housing developments which, until completed and rented, do not generate income to pay interest. Increases in interest rates payable on senior obligations may make it more difficult for issuers to meet payment obligations on subordinated bonds.

Moral Obligation Bonds. The Fund also may invest in moral obligation bonds, which are normally issued by special purpose public authorities. If an issuer of moral obligation bonds is unable to meet its obligations, the repayment of such bonds becomes a moral commitment but not a legal obligation of the state or municipality in question.

Municipal Lease Obligations. The Fund may invest in participations in lease obligations or installment purchase contract obligations (hereinafter collectively called Municipal Lease Obligations) of municipal authorities or entities. Although a Municipal Lease Obligation does not constitute a general obligation of the municipality for which the municipality's taxing power is pledged, a Municipal Lease Obligation is ordinarily backed by the municipality's covenant to budget for, appropriate and make the payments due under the Municipal Lease Obligation. However, certain Municipal Lease Obligations contain non-appropriation clauses, which provide that the municipality has no obligation to make lease or installment purchase payments in future years unless money is

Table of Contents

appropriated for such purpose on a yearly basis. In the case of a non-appropriation lease, the Fund's ability to recover under the lease in the event of non-appropriation or default will be limited solely to the repossession of the leased property, without recourse to the general credit of the lessee, and the disposition or re-leasing of the property might prove difficult.

Certificates of Participation. A certificate of participation represents an undivided interest in an unmanaged pool of municipal leases, installment purchase agreements or other instruments. The certificates are typically issued by a municipal agency, a trust or other entity that has received an assignment of the payments to be made by the state or political subdivision under such leases or installment purchase agreements. Such certificates provide the Fund with the right to a pro rata undivided interest in the underlying municipal securities. In addition, such participations generally provide the Fund with the right to demand payment, on not more than seven days' notice, of all or any part of the Fund's participation interest in the underlying municipal securities, plus accrued interest.

Pre-Refunded Municipal Securities. The principal of, and interest on, pre-refunded municipal securities are no longer paid from the original revenue source for the securities. Instead, the source of such payments is typically an escrow fund consisting of U.S. government securities. The assets in the escrow fund are derived from the proceeds of refunding bonds issued by the same issuer as the pre-refunded municipal securities. Issuers of municipal securities use this advance refunding technique to obtain more favorable terms with respect to securities that are not yet subject to call or redemption by the issuer. For example, advance refunding enables an issuer to refinance debt at lower market interest rates, restructure debt to improve cash flow or eliminate restrictive covenants in the indenture or other governing instrument for the pre-refunded municipal securities. However, except for a change in the revenue source from which principal and interest payments are made, the pre-refunded municipal securities remain outstanding on their original terms until they mature or are redeemed by the issuer.

Private Activity Bonds. Private activity bonds, formerly referred to as industrial development bonds, are issued by or on behalf of public authorities to obtain funds to provide privately operated housing facilities, airports, mass transit or port facilities, sewage disposal, solid waste disposal or hazardous waste treatment or disposal facilities, and certain local facilities for water supply, gas or electricity. Other types of private activity bonds, the proceeds of which are used for the construction, equipment, repair or improvement of privately operated industrial or commercial facilities, may constitute municipal securities, although the current federal tax laws place substantial limitations on the size of such issues. Such bonds are secured primarily by revenues derived from loan repayments or lease payments due from the entity, which may or may not be guaranteed by a parent company or otherwise secured. Private activity bonds generally are not secured by a pledge of the taxing power of the issuer of such bonds. Therefore, an investor should be aware that repayment of such bonds generally depends on the revenues of a private entity and be aware of the risks that such an investment may entail. Continued ability of an entity to generate sufficient revenues for the payment of principal and interest on such bonds will be affected by many factors, including the size of the entity, capital structure, demand for its products or services, competition, general economic conditions, government regulation and the entity's dependence on revenues for the operation of the particular facility being financed.

Special Taxing Districts. Special taxing districts are organized to plan and finance infrastructure developments to induce residential, commercial and industrial growth and redevelopment. Bonds issued pursuant to financing methods such as tax increment finance, tax assessment, special services district and Mello-Roos bonds (a type of municipal security established by the Mello-Roos Community Facilities District Act of 1982), are generally payable solely from taxes or other revenues attributable to the specific projects financed by the bonds without recourse to the credit or taxing power of related or overlapping municipalities. They often are exposed to real estate development-related risks and can have more taxpayer concentration risk than general tax-supported bonds, such as general obligation bonds. Further, the fees, special taxes, or tax allocations and other revenues that are established to secure such financings are generally limited as to the rate or amount that may be levied or assessed and are not subject to increase pursuant to

rate covenants or municipal or corporate guarantees. The bonds could default if development failed to progress as anticipated or if larger taxpayers failed to pay the assessments, fees and taxes as provided in the financing plans of the districts.

VRDOs. Variable rate demand obligations (VRDOs) are tax-exempt obligations that contain a floating or variable interest rate adjustment formula and right of demand on the part of the holder thereof to receive payment of the unpaid principal balance plus accrued interest upon a short notice period not to exceed seven days. There is,

Table of Contents

however, the possibility that because of default or insolvency the demand feature of VRDOs may not be honored. The interest rates are adjustable at intervals (ranging from daily to up to one year) to some prevailing market rate for similar investments, such adjustment formula being calculated to maintain the market value of the VRDOs, at approximately the par value of the VRDOs on the adjustment date. The adjustments typically are based upon SIFMA or some other appropriate interest rate adjustment index. The Fund may invest in all types of tax-exempt instruments currently outstanding or to be issued in the future. VRDOs that contain an unconditional right of demand to receive payment of the unpaid principal balance plus accrued interest on a notice period exceeding seven days may be deemed to be illiquid securities.

Taxable Municipal Securities. The Fund may invest in taxable municipal securities, which include obligations issued pursuant to the American Recovery and Reinvestment Act of 2009 (the ARRA) or other legislation providing for the issuance of taxable municipal debt on which the issuer receives federal support (any bonds so issued are considered Build America Bonds). If the Fund invests in Build America Bonds, it expects to invest in direct pay Build America Bonds and principal only strips of tax credit Build America Bonds. Provisions of the ARRA relevant to the issuance of Build America Bonds expired on December 31, 2010 and, as such, issuance has ceased.

Preferred Securities. The Fund may invest in preferred securities. There are two basic types of preferred securities. The first type, sometimes referred to as traditional preferred securities, consists of preferred stock issued by an entity taxable as a corporation. The second type, sometimes referred to as trust preferred securities, are usually issued by a trust or limited partnership and represent preferred interests in deeply subordinated debt instruments issued by the corporation for whose benefit the trust or partnership was established.

Traditional Preferred Securities. Traditional preferred securities generally pay fixed or adjustable rate dividends (or a combination thereof e.g., a fixed rate that moves to an adjustable rate after some period of time) to investors and generally have a preference over common stock in the payment of dividends and the liquidation of a company's assets. This means that a company must pay dividends on preferred stock before paying any dividends on its common stock. In order to be payable, distributions on such preferred securities must be declared by the issuer's board of directors. Income payments on typical preferred securities currently outstanding are cumulative, causing dividends and distributions to accumulate even if not declared by the board of directors or otherwise made payable. In such a case all accumulated dividends must be paid before any dividend on the common stock can be paid. However, some traditional preferred stocks are non-cumulative, in which case dividends do not accumulate and need not ever be paid. A portion of the portfolio may include investments in non-cumulative preferred securities, whereby the issuer does not have an obligation to make up any arrearages to its shareholders. Should an issuer of a non-cumulative preferred stock held by the Fund determine not to pay dividends on such stock, the amount of dividends the Fund pays may be adversely affected. There is no assurance that dividends or distributions on the preferred securities in which the Fund invests will be declared or otherwise made payable.

Preferred stockholders usually have no right to vote for corporate directors or on other matters. Shares of preferred stock have a liquidation value that generally equals the original purchase price at the date of issuance. The market value of preferred securities may be affected by favorable and unfavorable changes impacting companies in the utilities and financial services sectors, which are prominent issuers of preferred securities, and by actual and anticipated changes in tax laws, such as changes in corporate income tax rates or the Dividends Received Deduction. Because the claim on an issuer's earnings represented by preferred securities may become onerous when interest rates fall below the rate payable on such securities, the issuer may redeem the securities. Thus, in declining interest rate environments in particular, the Fund's holdings, if any, of higher rate-paying fixed rate preferred securities may be reduced and the Fund may be unable to acquire securities of comparable credit quality paying comparable rates with the redemption proceeds.

Trust Preferred Securities. Trust preferred securities are typically issued by corporations, generally in the form of interest-bearing notes with preferred security characteristics, or by an affiliated business trust of a corporation, generally in the form of beneficial interests in subordinated debentures or similarly structured securities. The trust preferred securities market consists of both fixed and adjustable coupon rate securities that are either perpetual in nature or have stated maturity dates.

Trust preferred securities are typically junior and fully subordinated liabilities of an issuer or the beneficiary of a guarantee that is junior and fully subordinated to the other liabilities of the guarantor. In addition, trust preferred securities typically permit an issuer to defer the payment of income for eighteen months or more without triggering

Table of Contents

an event of default. Generally, the deferral period is five years or more. Because of their subordinated position in the capital structure of an issuer, the ability to defer payments for extended periods of time without default consequences to the issuer, and certain other features (such as restrictions on common dividend payments by the issuer or ultimate guarantor when full cumulative payments on the trust preferred securities have not been made), these trust preferred securities are often treated as close substitutes for traditional preferred securities, both by issuers and investors. Trust preferred securities have many of the key characteristics of equity due to their subordinated position in an issuer's capital structure and because their quality and value are heavily dependent on the profitability of the issuer rather than on any legal claims to specific assets or cash flows.

Convertible Securities. A convertible security is a bond, debenture, note, preferred stock or other security that may be converted into or exchanged for a prescribed amount of common stock or other equity security of the same or a different issuer within a particular period of time at a specified price or formula. A convertible security entitles the holder to receive interest paid or accrued on debt or the dividend paid on preferred stock until the convertible security matures or is redeemed, converted or exchanged. Before conversion, convertible securities have characteristics similar to nonconvertible income securities in that they ordinarily provide a stable stream of income with generally higher yields than those of common stocks of the same or similar issuers, but lower yields than comparable nonconvertible securities. The value of a convertible security is influenced by changes in interest rates, with investment value declining as interest rates increase and increasing as interest rates decline. The credit standing of the issuer and other factors also may have an effect on the convertible security's investment value. Convertible securities rank senior to common stock in a corporation's capital structure but are usually subordinated to comparable nonconvertible securities. Convertible securities may be subject to redemption at the option of the issuer at a price established in the convertible security's governing instrument.

A synthetic or manufactured convertible security may be created by the Fund or by a third party by combining separate securities that possess the two principal characteristics of a traditional convertible security: an income producing component and a convertible component. The income-producing component is achieved by investing in non-convertible, income-producing securities such as bonds, preferred stocks and money market instruments. The convertible component is achieved by investing in securities or instruments such as warrants or options to buy common stock at a certain exercise price, or options on a stock index. Unlike a traditional convertible security, which is a single security having a single market value, a synthetic convertible comprises two or more separate securities, each with its own market value. Because the market value of a synthetic convertible security is the sum of the values of its income-producing component and its convertible component, the value of a synthetic convertible security may respond differently to market fluctuations than a traditional convertible security. The Fund also may purchase synthetic convertible securities created by other parties, including convertible structured notes. Convertible structured notes are income-producing debentures linked to equity. Convertible structured notes have the attributes of a convertible security; however, the issuer of the convertible note (typically an investment bank), rather than the issuer of the underlying common stock into which the note is convertible, assumes credit risk associated with the underlying investment and the Fund in turn assumes credit risk associated with the issuer of the convertible note.

Restricted and Illiquid Securities. The Fund may invest in restricted, illiquid or less liquid securities or securities in which no secondary trading market is readily available or which are otherwise illiquid, including private placement securities.

The liquidity of a security relates to the ability to dispose easily of the security and the price to be obtained upon disposition of the security, which may be less than would be obtained for a comparable more liquid security. Illiquid securities are securities which cannot be sold within seven days in the ordinary course of business at approximately the value used by the Fund in determining its NAV. Illiquid securities may trade at a discount from comparable, more liquid investments. Investment of the Fund's assets in illiquid securities may restrict the ability of the Fund to dispose

of its investments in a timely fashion and for a fair price as well as its ability to take advantage of market opportunities. The risks associated with illiquidity will be particularly acute where the Fund's operations require cash, such as when the Fund pays dividends, and could result in the Fund borrowing to meet short-term cash requirements or incurring capital losses on the sale of illiquid investments.

Restricted securities are securities that are not registered under the Securities Act. Restricted securities may be sold in private placement transactions between issuers and their purchasers and may be neither listed on an exchange nor traded in other established markets. In many cases, privately placed securities may not be freely transferable under the laws of the applicable jurisdiction or due to contractual restrictions on resale. As a result of the absence of

Table of Contents

a public trading market, privately placed securities may be less liquid and more difficult to value than publicly traded securities. To the extent that privately placed securities may be resold in privately negotiated transactions, the prices realized from the sales, due to restrictions on resale, could be less than those originally paid by the Fund or less than their fair market value. In addition, issuers whose securities are not publicly traded may not be subject to the disclosure and other investor protection requirements that may be applicable if their securities were publicly traded. If any privately placed securities held by the Fund are required to be registered under the securities laws of one or more jurisdictions before being resold, the Fund may be required to bear the expenses of registration. Certain of the Fund's investments in private placements may consist of direct investments and may include investments in smaller, less seasoned issuers, which may involve greater risks. These issuers may have limited product lines, markets or financial resources, or they may be dependent on a limited management group. In making investments in such securities, the Fund may obtain access to material nonpublic information, which may restrict the Fund's ability to conduct portfolio transactions in such securities.

Some of these securities are new and complex, and trade only among institutions; the markets for these securities are still developing, and may not function as efficiently as established markets. Also, because there may not be an established market price for these securities, the Fund may have to estimate their value, which means that their valuation (and thus the valuation of the Fund) may have a subjective element.

Transactions in restricted or illiquid securities may entail registration expense and other transaction costs that are higher than those for transactions in unrestricted or liquid securities eligible for trading on national securities exchanges or in the over-the-counter markets. Where registration is required for restricted or illiquid securities a considerable time period may elapse between the time the Fund decides to sell the security and the time it is actually permitted to sell the security under an effective registration statement. If during such period, adverse market conditions were to develop, the Fund may obtain less favorable pricing terms than when it decided to sell the security.

Non-U.S. Securities. The Fund may invest in securities of non-U.S. issuers (Non-U.S. Securities). Subject to the Fund's investment policies, these securities may be U.S. dollar-denominated or non-U.S. dollar-denominated. Some Non-U.S. Securities may be less liquid and more volatile than securities of comparable U.S. issuers. Similarly, there is less volume and liquidity in most foreign securities markets than in the United States and, at times, greater price volatility than in the United States. Because evidence of ownership of such securities usually is held outside the United States, the Fund will be subject to additional risks if it invests in Non-U.S. Securities, which include adverse political and economic developments, seizure or nationalization of foreign deposits and adoption of governmental restrictions which might adversely affect or restrict the payment of principal and interest on the foreign securities to investors located outside the country of the issuer, whether from currency blockage or otherwise. Non-U.S. Securities may trade on days when the common stock is not priced or traded.

Emerging Markets Investments. The Fund may invest in securities of issuers located in emerging market countries, including securities denominated in currencies of emerging market countries. Emerging market countries generally include every nation in the world except the United States, Canada, Japan, Australia, New Zealand and most countries located in Western Europe. These issuers may be subject to risks that do not apply to issuers in larger, more developed countries. These risks are more pronounced to the extent the Fund invests significantly in one country. Less information about non-U.S. issuers or markets may be available due to less rigorous disclosure and accounting standards or regulatory practices. Many non-U.S. markets are smaller, less liquid and more volatile than U.S. markets. In a changing market, the Investment Advisor may not be able to sell the Fund's portfolio securities in amounts and at prices it considers reasonable. The U.S. dollar may appreciate against non-U.S. currencies or an emerging market government may impose restrictions on currency conversion or trading. The economies of non-U.S. countries may grow at a slower rate than expected or may experience a downturn or recession. Economic, political and social developments may adversely affect non-U.S. securities markets.

Equity Securities. The Fund may invest in equity securities, including common stocks and warrants. Common stock represents an equity ownership interest in a company. The Fund may hold or have exposure to common stocks of issuers of any size, including small and medium capitalization stocks. Warrants are privileges issued by corporations enabling the owners to subscribe to and purchase a specified number of shares of the corporation at a specified price during a specified period of time. Subscription rights normally have a short life span to expiration. The purchase of warrants involves the risk that the Fund could lose the purchase value of a right or warrant if the right to subscribe to additional shares is not exercised prior to the warrants' expiration. Also, the purchase of warrants involves the risk

Table of Contents

that the effective price paid for the warrant added to the subscription price of the related security may exceed the value of the subscribed security's market price such as when there is no movement in the level of the underlying security. Buying a warrant does not make the Fund a shareholder of the underlying stock.

Sovereign Governmental and Supranational Debt. The Fund may invest in all types of debt securities of governmental issuers in all countries, including emerging market countries. These sovereign debt securities may include without limitation : debt securities issued or guaranteed by governments, governmental agencies or instrumentalities and political subdivisions; debt securities issued by government owned, controlled or sponsored entities; interests in entities organized and operated for the purpose of restructuring the investment characteristics of instruments issued by any of the above issuers; Brady Bonds, which are debt securities issued under the framework of the Brady Plan as a means for debtor nations to restructure their outstanding external indebtedness; participations in loans between governments and financial institutions; or debt securities issued by supranational entities such as the World Bank. A supranational entity is a bank, commission or company established or financially supported by the national governments of one or more countries to promote reconstruction or development. Sovereign government and supranational debt involve all the risks described herein regarding foreign and emerging markets investments as well as the risk of debt moratorium, repudiation or renegotiation.

Brady Bonds are debt securities, generally denominated in U.S. dollars, issued under the framework of the Brady Plan as a means for debtor nations to restructure their outstanding external indebtedness. In restructuring its external debt under the Brady Plan framework, a debtor nation negotiates with its existing bank lenders as well as multilateral institutions such as the World Bank and the International Monetary Fund (the IMF). The Brady Plan framework, as it has developed, contemplates the exchange of external commercial bank debt for newly issued bonds known as Brady Bonds. Brady Bonds may also be issued in respect of new money being advanced by existing lenders in connection with the debt restructuring. The World Bank and/or the IMF support the restructuring by providing funds pursuant to loan agreements or other arrangements which enable the debtor nation to collateralize the new Brady Bonds or to repurchase outstanding bank debt at a discount. Under these arrangements with the World Bank and/or the IMF, debtor nations have been required to agree to the implementation of certain domestic monetary and fiscal reforms. Such reforms have included the liberalization of trade and foreign investment, the privatization of state-owned enterprises and the setting of targets for public spending and borrowing. These policies and programs seek to promote the debtor country's economic growth and development. Investors should also recognize that the Brady Plan only sets forth general guiding principles for economic reform and debt reduction, emphasizing that solutions must be negotiated on a case-by-case basis between debtor nations and their creditors.

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

Inflation-Indexed Bonds. Inflation-indexed bonds (other than municipal inflation-indexed bonds and certain corporate inflation-indexed bonds) are fixed income securities the principal value of which is periodically adjusted according to the rate of inflation. If the index measuring inflation falls, the principal value of inflation-indexed bonds (other than municipal inflation-indexed bonds and certain corporate inflation-indexed bonds) will be adjusted downward, and consequently the interest payable on these securities (calculated with respect to a smaller principal amount) will be reduced. Repayment of the original bond principal upon maturity (as adjusted for inflation) is guaranteed in the case of U.S. Treasury inflation-indexed bonds (TIPS). For bonds that do not provide a similar guarantee, the adjusted principal value of the bond repaid at maturity may be less than the original principal. With regard to municipal

inflation-indexed bonds and certain corporate inflation-indexed bonds, the inflation adjustment is typically reflected in the semi-annual coupon payment. As a result, the principal value of municipal inflation-indexed bonds and such corporate inflation-indexed bonds does not adjust according to the rate of inflation.

Variable and Floating Rate Instruments. Variable and floating rate securities provide for a periodic adjustment in the interest rate paid on the obligations. The terms of such obligations provide that interest rates are adjusted periodically based upon an interest rate adjustment index as provided in the respective obligations. The adjustment intervals may be regular, and range from daily up to annually, or may be event-based, such as based on a change in the prime rate.

Table of Contents

The interest rate on a floating rate security is a variable rate which is tied to another interest rate, such as a money-market index or Treasury bill rate. The interest rate on a floating rate security resets periodically, typically every six months. Because of the interest rate reset feature, floating rate securities provide the Fund with a certain degree of protection against rises in interest rates, although the Fund will participate in any declines in interest rates as well.

Inverse Floating Rate Securities. An inverse floating rate security (or inverse floater) is a type of debt instrument that bears a floating or variable interest rate that moves in the opposite direction to interest rates generally or the interest rate on another security or index. Changes in interest rates generally, or the interest rate of the other security or index, inversely affect the interest rate paid on the inverse floater, with the result that the inverse floater's price will be considerably more volatile than that of a fixed rate bond. The Fund may invest in inverse floaters, which brokers typically create by depositing an income-producing instrument, including a mortgage related security, in a trust. The trust in turn issues a variable rate security and inverse floaters. The interest rate for the variable rate security is typically determined by an index or an auction process, while the inverse floater holder receives the balance of the income from the underlying income-producing instrument less an auction fee. The market prices of inverse floaters may be highly sensitive to changes in interest rates and prepayment rates on the underlying securities, and may decrease significantly when interest rates increase or prepayment rates change. In a transaction in which the Fund purchases an inverse floater from a trust, and the underlying security was held by the Fund prior to being deposited into the trust, the Fund typically treats the transaction as a secured borrowing for financial reporting purposes. As a result, for financial reporting purposes, the Fund will generally incur a non-cash interest expense with respect to interest paid by the trust on the variable rate securities and will recognize additional interest income in an amount directly corresponding to the non-cash interest expense. Therefore, the Fund's NAV per common share and performance are not affected by the non-cash interest expense. This accounting treatment does not apply to inverse floaters acquired by the Fund when the Fund did not previously own the underlying bond.

Strategic Transactions and Other Management Techniques. The Fund may use a variety of other investment management techniques and instruments. The Fund may purchase and sell futures contracts, enter into various interest rate transactions such as swaps, caps, floors or collars, currency transactions such as currency forward contracts, currency futures contracts, currency swaps or options on currency or currency futures and swap contracts (including, but not limited to, credit default swaps) and may purchase and sell exchange-listed and over-the-counter put and call options on securities and swap contracts, financial indices and futures contracts and use other derivative instruments or management techniques, including derivative instruments that combine features of these instruments (collectively, Strategic Transactions). These Strategic Transactions may be used for duration management and other risk management purposes, including to attempt to protect against possible changes in the market value of the Fund's portfolio resulting from trends in the securities markets and changes in interest rates or to protect the Fund's unrealized gains in the value of its portfolio securities, to facilitate the sale of portfolio securities for investment purposes, to establish a position in the securities markets as a temporary substitute for purchasing particular securities or, to the extent applicable, to enhance income or gain. There is no particular strategy that requires use of one technique rather than another as the decision to use any particular strategy or instrument is a function of market conditions and the composition of the portfolio. The use of Strategic Transactions to enhance current income may be particularly speculative. The ability of the Fund to use Strategic Transactions successfully will depend on the Investment Advisor's ability to predict pertinent market movements as well as sufficient correlation among the instruments, which cannot be assured. The use of Strategic Transactions may result in losses greater than if they had not been used, may require the Fund to sell or purchase portfolio securities at inopportune times or for prices other than current market values, may limit the amount of appreciation the Fund can realize on an investment or may cause the Fund to hold a security that it might otherwise sell. Inasmuch as any obligations of the Fund that arise from the use of Strategic Transactions will be covered by segregated or earmarked liquid assets or offsetting transactions, the Fund and the Investment Advisor believe such obligations do not constitute senior securities and, accordingly, will not treat such transactions as being

subject to its borrowing restrictions or policies regarding economic leverage. See **Leverage** under Item 8. Additionally, segregated or earmarked liquid assets, amounts paid by the Fund as premiums and cash or other assets held in margin accounts with respect to Strategic Transactions are not otherwise available to the Fund for investment purposes. Certain provisions of the Code may restrict or affect the ability of the Fund to engage in Strategic Transactions. In addition, the use of certain Strategic Transactions may give rise to taxable income and have certain other consequences. See **Risk Factors Strategic Transactions and Derivatives Risk** under Item 8.

II-21

Table of Contents

Swaps. The Fund may enter into swap agreements, including interest rate and index swap agreements. Swap agreements are two party contracts entered into primarily by institutional investors for periods ranging from a few weeks to more than one year. In a standard swap transaction, two parties agree to exchange the returns (or differentials in rates of return) earned or realized on particular predetermined investments or instruments. The gross returns to be exchanged or swapped between the parties are calculated with respect to a notional amount, i.e., the dollar amount invested at a particular interest rate, in a particular foreign currency, or in a basket of securities representing a particular index. The notional amount of the swap agreement is only a fictive basis on which to calculate the obligations that the parties to a swap agreement have agreed to exchange. The Fund's obligations (or rights) under a swap agreement will generally be equal only to the net amount to be paid or received under the agreement based on the relative values of the positions held by each party to the agreement (the net amount). The Fund's obligations under a swap agreement will be accrued daily (offset against any amounts owing to the Fund) and the Fund will segregate with a custodian or earmark on its books and records an amount of cash or liquid assets having an aggregate NAV at all times at least equal to any accrued but unpaid net amounts owed to a swap counterparty.

Whether the Fund's use of swap agreements will be successful in furthering its investment objective will depend on the Investment Advisor's ability to correctly predict whether certain types of investments are likely to produce greater returns than other investments. Moreover, the Fund bears the risk of loss of the amount expected to be received under a swap agreement in the event of the default or bankruptcy of a swap agreement counterparty. Swap agreements also bear the risk that the Fund will not be able to meet its payment obligations to the counterparty. As noted, however, the Fund will deposit in a segregated account, or earmark on its books and records, liquid assets permitted to be so segregated or earmarked by the SEC in an amount equal to or greater than the market value of the Fund's liabilities under the swap agreement or the amount it would cost the Fund initially to make an equivalent direct investment plus or minus any amount the Fund is obligated to pay or is to receive under the swap agreement. Restrictions imposed by the tax rules applicable to regulated investment companies may limit the Fund's ability to use swap agreements. The regulation of the swap market is undergoing significant change as a result of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). See Risk Factors Strategic Transactions and Derivatives Risk Dodd-Frank Act Risk under Item 8. It is possible that developments in the swap market, including government regulation, could adversely affect the Fund's ability to terminate existing swap agreements or to realize amounts to be received under such agreements.

Swaptions. A swaption is a contract that gives a counterparty the right (but not the obligation) to enter into a new swap agreement or to shorten, extend, cancel or otherwise modify an existing swap agreement, at some designated future time on specified terms. The Fund may write (sell) and purchase put and call swaptions. Depending on the terms of the particular option agreement, the Fund will generally incur a greater degree of risk when it writes a swaption than it will incur when it purchases a swaption. When the Fund purchases a swaption, it risks losing only the amount of the premium it has paid should it decide to let the option expire unexercised. However, when the Fund writes a swaption, upon exercise of the option the Fund will become obligated according to the terms of the underlying agreement.

Credit Default Swaps. The Fund may enter into credit default swap agreements. The credit default swap agreement may have as reference obligations one or more securities that are not currently held by the Fund. The protection buyer in a credit default contract may be obligated to pay the protection seller an upfront or a periodic stream of payments over the term of the contract, provided that no credit event on the reference obligation occurs. If a credit event occurs, the seller generally must pay the buyer the par value (full notional amount) of the swap in exchange for an equal face amount of deliverable obligations of the reference entity described in the swap, or if the swap is cash settled the seller may be required to deliver the related net cash amount (the difference between the market value of the reference obligation and its par value). The Fund may be either the buyer or seller in the transaction. If the Fund is a buyer and no credit event occurs, the Fund will generally receive no payments from its counterparty under the swap if the swap is held through its termination date. However, if a credit event occurs, the buyer generally may elect to receive the full

notional amount of the swap in exchange for an equal face amount of deliverable obligations of the reference entity, the value of which may have significantly decreased. As a seller, the Fund generally receives an upfront payment or a fixed rate of income throughout the term of the swap, which

Table of Contents

typically is between six months and three years, provided that there is no credit event. If a credit event occurs, generally the seller must pay the buyer the full notional amount of the swap in exchange for an equal face amount of deliverable obligations of the reference entity, the value of which may have significantly decreased. As the seller, the Fund would effectively add leverage to its portfolio because, in addition to its Managed Assets, the Fund would be subject to investment exposure on the notional amount of the swap.

Credit default swap agreements involve greater risks than if the Fund had taken a position in the reference obligation directly (either by purchasing or selling) since, in addition to general market risks, credit default swaps are subject to illiquidity risk, counterparty risk and credit risks. A buyer generally will also lose its upfront payment or any periodic payments it makes to the seller counterparty and receive no payments from its counterparty should no credit event occur and the swap is held to its termination date. If a credit event were to occur, the value of any deliverable obligation received by the seller, coupled with the upfront or periodic payments previously received, may be less than the full notional amount it pays to the buyer, resulting in a loss of value to the seller. A seller of a credit default swap or similar instrument is exposed to many of the same risks of leverage since, if a credit event occurs, the seller generally will be required to pay the buyer the full notional amount of the contract net of any amounts owed by the buyer related to its delivery of deliverable obligations. The Fund's obligations under a credit default swap agreement will be accrued daily (offset against any amounts owed to the Fund). The Fund will at all times segregate or designate on its books and records in connection with each such transaction liquid assets or cash with a value at least equal to the Fund's exposure (any accrued but unpaid net amounts owed by the Fund to any counterparty) on a marked-to-market basis (as required by the clearing organization with respect to cleared swaps or as calculated pursuant to requirements of the SEC). If the Fund is a seller of protection in a credit default swap transaction, it will designate on its books and records in connection with such transaction liquid assets or cash with a value at least equal to the full notional amount of the contract. Such designation will ensure that the Fund has assets available to satisfy its obligations with respect to the transaction and will avoid any potential leveraging of the Fund's portfolio. Such designation will not limit the Fund's exposure to loss.

In addition, the credit derivatives market is subject to a changing regulatory environment. It is possible that regulatory or other developments in the credit derivatives market could adversely affect the Fund's ability to successfully use credit derivatives.

Total Return Swaps. Total return swap agreements are contracts in which one party agrees to make periodic payments to another party based on the change in market value of the assets underlying the contract, which may include a specified security, basket of securities or securities indices during the specified period, in return for periodic payments based on a fixed or variable interest rate or the total return from other underlying assets. Total return swap agreements may be used to obtain exposure to a security or market without owning or taking physical custody of such security or investing directly in such market. Total return swap agreements may effectively add leverage to the Fund's portfolio because, in addition to its Managed Assets, the Fund would be subject to investment exposure on the notional amount of the swap.

Total return swap agreements are subject to the risk that a counterparty will default on its payment obligations to the Fund thereunder. Swap agreements also bear the risk that the Fund will not be able to meet its obligation to the counterparty. Generally, the Fund will enter into total return swaps on a net basis (i.e., the two payment streams are netted against one another 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 total return swap will be accrued on a daily basis, and an amount of liquid assets having an aggregate NAV at least equal to the accrued excess will be segregated by the Fund or earmarked on its books and records. If the total return swap transaction is entered into on other than a net basis, the full amount of the Fund's obligations will be accrued on a daily basis, and the full amount of the Fund's obligations will be segregated or earmarked by the Fund in an amount

equal to or greater than the market value of the liabilities under the total return swap agreement or the amount it would have cost the Fund initially to make an equivalent direct investment, plus or minus any amount the Fund is obligated to pay or is to receive under the total return swap agreement.

Interest Rate Transactions. The Fund may enter into interest rate swaps and purchase or sell interest rate caps, floors and collars. The Fund may enter into these transactions to seek to preserve a return or spread on a particular investment or portion of its portfolio, as a duration management technique to protect against any increase in the price of securities the Fund anticipates purchasing at a later date or, to the extent applicable, to seek to enhance its return or to seek to increase the Fund's yield. Interest rate swaps involve the exchange by the Fund with another

Table of Contents

party of their respective commitments to pay or receive interest (e.g., an exchange of floating rate payments for fixed rate payments with respect to a notional amount of principal). The purchase of an interest rate cap entitles the purchaser, to the extent that the level of a specified interest rate exceeds a predetermined interest rate (i.e., the strike price), to receive payments of interest on a notional principal amount from the party selling such interest rate cap. The purchase of an interest rate floor entitles the purchaser, to the extent that the level of a specified interest rate falls below a predetermined interest rate (i.e., the strike price), to receive payments of interest on a notional principal amount from the party selling such interest rate floor.

For example, if the Fund holds a debt instrument with an interest rate that is reset only once each year, it may swap the right to receive interest at this fixed rate for the right to receive interest at a rate that is reset every week. This would enable the Fund to offset a decline in the value of the debt instrument due to rising interest rates but would also limit its ability to benefit from falling interest rates. Conversely, if the Fund holds a debt instrument with an interest rate that is reset every week and it would like to lock in what it believes to be a high interest rate for one year, it may swap the right to receive interest at this variable weekly rate for the right to receive interest at a rate that is fixed for one year. Such a swap would protect the Fund from a reduction in yield due to falling interest rates and may permit the Fund to enhance its income through the positive differential between one week and one year interest rates, but would preclude it from taking full advantage of rising interest rates.

The Fund may hedge both its assets and liabilities through interest rate swaps, caps and floors. Usually payments with respect to interest rate swaps will be made on a net basis (i.e., the two payment streams are netted out) with the Fund receiving or paying, as the case may be, only the net amount of the two payments on the payment dates. The Fund will accrue the net amount of the excess, if any, of the Fund's obligations over its entitlements with respect to each interest rate swap on a daily basis and will segregate with a custodian or designate on its books and records an amount of cash or liquid assets having an aggregate NAV at all times at least equal to the accrued excess. If there is a default by the other party to an uncleared interest rate swap transaction, gener