

**FLAHERTY & CRUMRINE INVESTMENT GRADE
FIXED INCOME FUND**

INITIAL ANNUAL INFORMATION FORM

May 19, 2005

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GLOSSARY OF TERMS

In this Annual Information Form, the following terms shall have the meanings set forth below, unless otherwise indicated.

“Annual Redemption Date” means the second last Business Day of November of each year.

“Annual Redemption Payment Date” means the date on or before the tenth Business Day of December, being the day on which payment of the redemption price for Units redeemed pursuant to an annual redemption in that year is to be made.

“BCAF” means Brompton Capital Advisors Inc.

“Book-Entry Only System” means the book-based system administered by CDS.

“Brompton” means the Brompton Group of companies operating out of its offices in Toronto.

“Business Day” means any day except Saturday, Sunday, a statutory holiday in Toronto, Ontario or any other day on which the TSX is not open for trading.

“Cash and Cash Equivalents” means (i) obligations issued or guaranteed by the Government of Canada or any province of Canada or the Government of the United States or any U.S. State or any agency or instrumentality thereof with less than twelve months to maturity; (ii) term deposits, guaranteed investment certificates, certificates of deposit or bankers’ acceptances of or guaranteed by any chartered bank or other financial institution, the short-term debt or deposits of which have been rated at least Investment Grade; and (iii) commercial paper rated at least Investment Grade, in each case either maturing within 365 days after the date of acquisition or for which the Manager or the Portfolio Manager believes that there will be a liquid market for the resale thereof within such 365-day period.

“CDS” means The Canadian Depository for Securities Limited.

“CDS Participant” means a participant in CDS.

“Closing Market Price” means the closing price of the Units on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX) or, if there was no trade on the relevant Monthly Redemption Date, the average of the last bid and the last asking prices of the Units on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX).

“CRA” means the Canada Revenue Agency .

“Custodian” means The Royal Trust Company, in its capacity as custodian under the Custodian Agreement.

“Custodian Agreement” means the custodian agreement entered into as of December 3, 2004 between the Manager, on behalf of the Fund, and the Custodian, as it may be amended from time to time.

“debt securities” include bonds, debentures, notes and other debt securities of corporate and other issuers, including convertible securities, asset-backed securities, structured notes, commercial paper, zero coupon bonds and Cash and Cash Equivalents.

“Declaration of Trust” means the declaration of trust governing the Fund dated as of November 25, 2004, as it may be amended from time to time.

“Distribution Payment Date” means the date on which cash distributions are paid by the Fund, such date to be no later than the date which is the tenth Business Day after the applicable Record Date.

“Distribution Reinvestment Plan” means the Fund’s distribution reinvestment plan, as it may be amended from time to time as described in section 3.16 of this Annual Information Form.

“Distribution Reinvestment Plan Agency Agreement” means the distribution reinvestment plan agency agreement dated as of December 15, 2004 among the Fund, the Manager and Computershare Trust Company of Canada, in its capacity as the Plan Agent, establishing the Distribution Reinvestment Plan, as it may be amended from time to time.

“Extraordinary Resolution” means a resolution passed by the affirmative vote of at least 66 2/3% of the votes cast, either in person or by proxy, at a meeting of Unitholders called for the purpose of approving such resolution.

“Fund” means the Flaherty & Crumrine Investment Grade Fixed Income Fund, an investment trust established under the laws of the Province of Alberta pursuant to the Declaration of Trust.

“Investment Grade” in respect of a security means a security, and in respect of an issuer means an issuer, which has at least one of the following ratings: (i) at least BBB- by S&P; (ii) at least Baa3 by Moody’s Investor Services, Inc.; (iii) at least BBB- by Fitch Ratings; or (iv) the equivalent rating by another nationally recognized credit rating organization.

“Investment Grade Portfolio” means the portfolio of fixed income securities acquired by the Fund with the net proceeds of the offering of Units together with proceeds from borrowings or other forms of leverage.

“Investment Objectives” means the investment objectives of the Fund set forth in the Declaration of Trust and as described in section 3.3 of this Annual Information Form.

“Investment Restrictions” means the investment restrictions of the Fund set forth in the Declaration of Trust restricting the investment activities of the Fund, as described in section 3.5 of this Annual Information Form.

“Investment Strategy” means the investment strategy to be followed by the Portfolio Manager in respect of the Fund set forth in the Declaration of Trust and as described in section 3.4.1 of this Annual Information Form.

“Lender” means a Canadian chartered bank or other lending institution.

“Loan Facility” means the loan facility entered into between the Manager, on behalf of the Fund, and the Lender or other lending institution as more fully described in section 3.14 of this Annual Information Form.

“Management Agreement” means the management agreement dated November 25, 2004, between the Trustee and the Manager as described in section 3.10.2.

“Management Fee” means the management fee payable to the Manager as described in section 3.12.1 of this Annual Information Form.

“Manager” means the manager of the Fund, Brompton FFI Management Limited.

“Market Price” means the weighted average trading price of the Units on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX) for the 10 trading days immediately preceding the relevant Distribution Date or Monthly Redemption Date, as applicable.

“Monthly Redemption Date” means the second last Business Day of each month, except for the month of November.

“Monthly Redemption Payment Date” means the date on or before the tenth Business Day of the month subsequent to the relevant Monthly Redemption Date, being the day on which payment of the monthly redemption price for Units redeemed in the previous month shall be made.

“Net Asset Value” means the net asset value of the Fund, as determined by subtracting the aggregate liabilities of the Fund from its Total Assets, in each case on the date on which the calculation is being made.

“Net Asset Value per Unit” means the Net Asset Value divided by the total number of Units outstanding on the Valuation Date.

“NI 81-102” means National Instrument 81-102 of the Canadian Securities Administrators (or any successor policy, rule or national instrument), as it may be amended from time to time.

“Ordinary Resolution” means a resolution passed by the affirmative vote of at least 50% of the votes cast, either in person or by proxy, at a meeting of Unitholders called for the purpose of approving such resolution.

“Plan Agent” means Computershare Trust Company of Canada, in its capacity as agent under the Distribution Reinvestment Plan.

“Plan Participants” means Unitholders who are participants in the Distribution Reinvestment Plan.

“Portfolio Management Agreement” means the portfolio management agreement dated as of December 15, 2004 among BCAI, the Fund, the Portfolio Manager and the Manager, as it may be amended from time to time as described in section 3.11.2 of this Annual Information Form.

“Portfolio Manager” means the investment advisor and portfolio manager of the Fund, Flaherty & Crumrine Incorporated.

“Record Date” means the last Business Day of each calendar month prior to the Termination Date commencing with the last Business Day of the month.

“Safety Net Hedge” means a hedging strategy to be employed by the Portfolio Manager in the Investment Grade Portfolio as described in section 3.4.3 of this Annual Information Form.

“Service Fee” means the fee that the Fund will pay to the Manager, who in turn pays an equivalent amount to dealers as described in section 3.12.2 of this Annual Information Form.

“**S& P**” means Standard & Poor’s, a division of The McGraw-Hill Group of Companies, Inc.

“**Tax Act**” means the *Income Tax Act* (Canada), as now or hereafter amended, or successor statutes.

“**Termination Date**” means the date the Fund is terminated as described in section 3.9.2 of this Annual Information Form.

“**Total Assets**” means the aggregate value of the assets of the Fund.

“**Trustee**” means Computershare Trust Company of Canada.

“**TSX**” means the Toronto Stock Exchange.

“**Unitholders**” means, unless the context otherwise requires, the owners of the beneficial interest in the Units.

“**Units**” means the transferable, redeemable trust units of the Fund, each of which represents an equal undivided beneficial interest in the net assets of the Fund.

“**Valuation Date**” means, at a minimum, Friday of each week, or if any Friday is not a Business Day, the immediately preceding Business Day, and the last Business Day of each month, and includes any other date on which the Manager elects, in its discretion, to calculate the Net Asset Value and the Net Asset Value per Unit.

1.0 CORPORATE STRUCTURE

1.1 Name and Incorporation

Flaherty & Crumrine Investment Grade Fixed Income Fund is an investment trust established under the laws of the Province of Alberta pursuant to the Declaration of Trust. Brompton FFI Management Limited is the manager of the Fund. Flaherty & Crumrine Incorporated is the Portfolio Manager. The Fund's principal office is Suite 2930, BCE Place, Bay Wellington Tower, 181 Bay Street, Toronto, ON M5J 2T3. The fiscal year-end of the Fund is December 31.

2.0 GENERAL DEVELOPMENT OF THE BUSINESS

The Fund closed its initial public offering on December 15, 2004 with the placement of 14,400,000 transferable, redeemable units of the Fund at \$25.00 per Trust Unit. On December 30, 2004, a further 480,000 Trust Units were issued pursuant to the over-allotment option granted to the agents of the offering resulting in gross and net proceeds of the offering of \$372 million and \$352.5 million respectively.

The Fund invests in an actively managed portfolio of investment grade fixed income securities consisting primarily of various corporate debt securities and hybrid preferred securities of North American issuers. The debt securities market is a primary source of capital for US corporations and other issuers. The corporate debt securities market is significantly larger than the preferred securities market with approximately US\$6.4 trillion in debt outstanding in late 2004. The hybrid preferred securities market has grown rapidly since it began to develop in the mid-1990s. The US dollar preferred securities market as at December 31, 2003 was approximately US\$240 billion comprised of US\$49 billion of traditional preferred shares and US\$191 billion of hybrid preferred securities. By the fourth quarter of 2004, the US dollar preferred securities market had grown to US\$260 billion comprised of US\$209 billion of hybrid preferred securities and US\$51 billion of traditional preferred shares.

The size of the preferred securities market and the corporate debt securities market provides significant investment and trading opportunities for the Fund.

3.0 NARRATIVE DESCRIPTION OF THE BUSINESS

3.1 Description of the Trust Units

The Fund is authorized to issue an unlimited number of transferable, redeemable Units of beneficial interest, each of which represents an equal, undivided beneficial interest in the net assets of the Fund. Each Unit entitles the holder to the same rights and obligations as a holder of any other Unit and no holder of Units is entitled to any privilege, priority or preference in relation to any other holder of Units. Each holder of Units is entitled to one vote for each Unit held and is entitled to participate equally with respect to any and all distributions made by the Fund. On termination or liquidation of the Fund, the holders of outstanding Units of record are entitled to receive on a pro rata basis all of the assets of the Fund remaining after payment of all debts, liabilities and liquidation expenses of the Fund.

3.2 Investments

3.2.1 Hybrid Preferred Securities

The Fund invests, in part, in hybrid preferred securities. Hybrid preferred securities are typically issued by corporations, generally in the form of interest-bearing notes or preferred securities, or by an affiliated business trust of a corporation, generally in the form of beneficial interests in subordinated debentures or similarly structured securities. The hybrid preferred securities market consists of both fixed and adjustable coupon rate securities that are either perpetual in nature or have stated maturity dates. The hybrid preferred securities market is divided into the "\$25 par" and the "institutional" segments. The \$25 par

segment is typified by securities that are listed on the New York Stock Exchange, which trade and are quoted “flat”, i.e., without accrued dividend income, and which are typically callable at par value five years after their original issuance date. The institutional segment is typified by \$1,000 par value securities that are not exchange-listed, which trade and are quoted on an “accrued income” basis, and which typically have a minimum of 10 years of call protection (at premium prices) from the date of their original issuance.

Hybrid preferred securities are typically junior and fully subordinated obligations of an issuer or the beneficiary of a guarantee that is junior and fully subordinated to the other obligations of the guarantor. In addition, hybrid preferred securities typically permit an issuer to defer payments for eighteen months or more without triggering an event of default. Generally, the deferral period is five years but may be longer. Because of their subordinated position in the capital structure of an issuer, the ability to defer payments for extended periods of time without adverse consequence to the issuer, and certain other features (such as restrictions on the payment of dividends on common shares by the issuer or ultimate guarantor when cumulative payments on the hybrid preferred securities have not been made), hybrid preferred securities are often treated as close substitutes for traditional preferred shares, both by issuers and investors. Typically, hybrid preferred securities are not redeemable by the issuer unless all cumulative payment obligations have been met, although issuers may be able to engage in open-market repurchases without regard to any cumulative dividends payable. A portion of the Investment Grade Portfolio may include investments in non-cumulative hybrid preferred securities, whereby the issuer does not have an obligation to make up any arrears to its shareholders. Hybrid 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.

Many hybrid preferred securities are issued by trusts or other special purpose entities established by operating companies and are not a direct obligation of an operating company. At the time a trust or special purpose entity sells its preferred securities to investors, the trust or special purpose entity purchases debt of the operating company (with terms comparable to those of the trust or special purpose entity securities), which enables the operating company to deduct for tax purposes the interest paid on the debt held by the trust or special purpose entity. The trust or special purpose entity in turn would be a holder of the operating company’s debt and would have priority with respect to the operating company’s earnings and profits over the operating company’s common shareholders, but would typically be subordinated to other classes of the operating company’s debt. Typically a trust preferred security has a rating that is slightly below that of its corresponding operating company’s senior debt securities.

3.2.3 Debt Securities

Debt securities typically pay either a fixed or variable rate of interest and carry original maturities from 1 to 100 years, although the vast majority of issues are 30 years or shorter. Issues may be either general obligations of the issuer (unsecured debt) or backed by specific assets of the issuer (secured or asset-backed debt). In a typical debt security, the issuer must pay the stated rate of interest for the life of the security and must repay the amount borrowed on its maturity date, or possibly earlier if the security has a put, call, sinking fund or some other early redemption or payment feature. In case of default, holders of debt securities have a claim to the assets of the issuer ahead of preferred securities and common stock. For this reason, corporate debt securities generally have a higher credit rating than preferred securities of the same issuer. They also typically yield less than preferred securities, reflecting the higher credit quality, although this yield differential can vary considerably over time.

These are numerous types of debt securities including straight fixed and variable-rate debt, convertible securities, asset-backed securities, commercial paper and zero-coupon bonds. Debt securities vary in

maturity and duration which is a measure of the expected life of a debt security used to determine the sensitivity of the security's price to interest rates.

3.3 Investment Objectives

The Fund's investment objectives are to:

- provide Unitholders with a stable stream of monthly distributions targeted to be \$0.1354 per Unit per annum (\$1.625 per annum to yield 6.5% on the original subscription price of \$25.00 per Unit);
- mitigate the impact of significant interest rate increases on the value of the Investment Grade Portfolio;
- preserve the Net Asset Value per Unit; and
- enhance the total return per Unit by actively managing the Investment Grade Portfolio.

3.4 Investment Strategy and Investment Approach

3.4.1 Investment Strategy

The Fund's investment strategies are (i) to invest in an actively managed portfolio that consists primarily of various corporate debt securities and hybrid preferred securities of North American issuers, (ii) under normal market conditions, to employ a hedging strategy which is intended to mitigate the impact of significant interest rate increases on the net asset value of the Fund's portfolio while permitting it to benefit from declines in interest rates, (iii) to hedge substantially all of the Fund's portfolio to the Canadian dollar and (iv) to invest in or use derivative instruments for hedging, investment or leverage purposes, including buying or selling credit derivatives, and to borrow or employ other forms of leverage, including securities lending and repurchase agreements, to enhance the returns of the Fund's portfolio.

3.4.2 Investment Approach

The Portfolio Manager seeks to achieve consistently superior results utilizing active management of the investment portfolio through a combination of:

- intensive credit analysis of current and potential portfolio holdings;
- thorough analysis of securities' terms and structure, with a preference for issues offering attractive, sustainable income over high current yield;
- exploiting pricing inefficiencies within the preferred and debt securities markets; and
- consistent use of hedging strategies to help manage the interest rate risk while avoiding strategies that require anticipating the direction of interest rates.

The Portfolio Manager will pursue a strategy of investing in Investment Grade preferred and debt securities to meet the Fund's Investment Objectives. It seeks to identify those preferred and debt securities that provide optimal return characteristics relative to risks. Supported by a highly experienced research and trading staff, the Portfolio Manager begins its investment process with a thorough assessment of the creditworthiness of each issuer. It considers the outlooks for different industries, sectors, and the economy as a whole in determining portfolio allocations. It weighs the position of each security in an issuer's capital structure relative to the issue's potential return. Using proprietary quantitative models, the Portfolio Manager also evaluates the specific terms of each issue and is generally

willing to forgo high current income over the short term to hold securities with more favourable call protection. The Portfolio Manager believes that this approach, which is a continuous process, will result in both attractive, sustainable income and long-term preservation of capital.

The Portfolio Manager also seeks to exploit pricing inefficiencies within the preferred and debt securities markets. There have been numerous instances in the past when, for periods of time, the various sectors of the preferred security or debt security asset classes have moved independently of one another, eventually restoring more traditional relationships. The Portfolio Manager believes that, based on its expertise, it is well positioned to take advantage of such inefficiencies and pricing anomalies in the preferred securities and debt securities markets in an attempt to enhance investment performance. The Portfolio Manager anticipates that it will actively reposition the Investment Grade Portfolio both horizontally between issuers and obligors as well as vertically among issuers' preferred and debt securities. The Portfolio Manager will employ proprietary models detailing duration, convexity and guideline compliance to provide real time analysis of the Investment Grade Portfolio.

Finally, the Portfolio Manager will pursue hedging strategies that are designed to mitigate the impact of significant interest rate increases on the Investment Grade Portfolio. Under normal market circumstances, all of the preferred and debt securities held by the Fund will be hedged against increases in the level of interest rates.

3.4.3 *Safety Net Hedge*

The Portfolio Manager will engage in hedging strategies in an attempt to protect the Investment Grade Portfolio against adverse changes in the level of interest rates. Under normal market conditions, the Portfolio Manager will employ a Safety Net Hedge, which is a hedging strategy that is intended to mitigate the impact of significant interest rate increases on the net asset value of the Investment Grade Portfolio, while permitting it to benefit from declines in interest rates. The strategy is intended to result in income generated by the Investment Grade Portfolio increasing over time in response to significant increases in interest rates, while being relatively resistant to the impact of declines in interest rates. The Portfolio Manager anticipates using various hedging instruments and techniques, including entering into futures contracts, options on futures contracts, interest rate swap positions and options thereon, known as "swaptions."

The Safety Net Hedge is designed to hedge against substantial rate increases that may occur over an investment horizon. Normally, the Safety Net Hedge is structured to reduce the duration of the Investment Grade Portfolio to approximately zero if the level of interest rates rises by 40-50 basis points over a one-to three-month horizon, while leaving the Investment Grade Portfolio duration unchanged if interest rates remain stable or decline, although the exact structure of the Safety Net Hedge will vary with market conditions. There is a cost to this hedging strategy that is borne by the Investment Grade Portfolio. While total return will be considerably higher with the hedge than without it when interest rates rise substantially, total return generally will be lower than it otherwise would be in a stable to falling interest rate environment. Given the long duration of the Investment Grade Portfolio, the Portfolio Manager believes that the Safety Net Hedge will help the Fund to achieve its Investment Objectives, and the Portfolio Manager will seek to balance the cost of the hedge over time with the risk-reduction benefit provided by it.

Under normal market conditions, 100% of the Investment Grade Portfolio will be hedged against increases in the level of interest rates using the Safety Net Hedge or, under certain circumstances, other hedging strategies. As with virtually all hedging strategies, there can be no assurance that the hedge will accomplish its objective. In addition to the Flaherty & Crumrine Investment Grade Preferred Fund, the Portfolio Manager has employed the Safety Net Hedge strategy in the closed-end funds it manages in the

U.S., including the Flaherty & Crumrine Preferred Income Fund and the Flaherty & Crumrine Preferred Income Opportunity Fund, and certain client accounts since 1992.

3.5 Investment Restrictions

The Portfolio Manager will actively manage the Investment Grade Portfolio, subject to certain investment restrictions as set out below.

- (i) **Purchasing Securities.** The Portfolio Manager will not purchase securities other than through normal market facilities unless the purchase price approximates the prevailing market price or is negotiated or established on an arm's length basis.
- (ii) **Concentration.** The Fund will not invest more than 10% of its Total Assets (determined at the time of purchase) in the securities of any one issuer (other than Cash and Cash Equivalents and securities issued by the U.S. Government, U.S. Government sponsored enterprises, or the Government of Canada).
- (iii) **Control.** The Portfolio Manager will not purchase securities if after such purchase the Fund would hold more than 10% of the outstanding voting securities of that issuer at the time of purchase.
- (iv) **Leverage.** The Fund may borrow or employ other forms of leverage for investment purposes in an aggregate amount not to exceed 35% of the Total Assets of the Fund at the time the borrowing or other transaction is entered into. With respect to other forms of leverage, any counterparty (or its guarantor) will be rated at least Investment Grade. In addition to leverage for investment purposes, the Fund may borrow up to 2.5% of its Total Assets determined at the time of borrowing for working capital purposes.
- (v) **Credit Quality.** The Fund will not invest in securities which do not have an Investment Grade rating at the time of purchase. With respect to securities purchased pursuant to the Safety Net Hedge, any counterparty (or its guarantor) will be rated at least Investment Grade.
- (vi) **Commodities.** The Fund will not purchase or sell commodities or commodity contracts except that the Fund may purchase and sell financial futures contracts, credit related derivatives and related options.
- (vii) **No Guarantee.** The Fund will not guarantee securities or obligations of another person or company.
- (viii) **Mutual Fund Trust.** The Fund will manage its investments and affairs to ensure that it will be a "mutual fund trust" for purposes of the Tax Act.
- (ix) **Foreign Investment Entities and Foreign Affiliates.** The Fund will not make any investment that could require the Fund to include in its income an amount pursuant to subsection 94.1(4), 94.2(4) or 94.3(4) of the Tax Act as proposed in draft legislation issued by the Department of Finance on October 30, 2003. The Fund will not make any investments in entities that would be "foreign affiliates" of the Fund for purposes of the Tax Act.

3.5.1 *Use of Derivative Instruments*

The Fund may invest in or use derivative instruments for hedging, investment or leverage purposes consistent with the Investment Strategies, Investment Objectives and Investment Restrictions of the Fund. A derivative is generally an instrument, agreement or security, the market price, value or payment obligations of which are derived from, referenced to or based on an underlying security, interest, benchmark or formula.

Risks to be hedged against include interest rate increases as described above under “Safety Net Hedge” and fluctuations in currency values. The Net Asset Value is measured in Canadian dollars and payments to Unitholders will be made in Canadian dollars. However, most of the investments in the Investment Grade Portfolio will consist of securities denominated in U.S. dollars. It is expected that substantially all of the Investment Grade Portfolio will be hedged back to the Canadian dollar at all times. BCAI will provide advice to the Fund with regard to currency hedging. While the Fund intends to purchase forward contracts for currency hedging, it is not precluded from using other derivatives, such as put and call options on foreign currencies to do so. The Fund may also buy and sell credit derivatives, including credit default swaps, total return swaps and market spread swaps, to manage credit risk and, in certain instances, to increase total return.

3.5.2 *Leverage*

In order to provide the Portfolio Manager with the ability to use leverage to enhance the return of the Investment Grade Portfolio, the Fund may borrow pursuant to loan facilities or otherwise. The Fund may also add leverage to the Investment Grade Portfolio by utilizing other strategies, including securities lending and repurchase agreements.

Leverage permits the Manager, on behalf of the Fund, to borrow monies or employ other forms of leverage to purchase additional securities in accordance with the Investment Strategies, Investment Objectives and Investment Restrictions and Investment Restrictions relating to the Fund. The Manager, on behalf of the Fund, intends to use such leverage, when it considers market conditions are appropriate, to attempt to increase the potential returns of the Fund by taking advantage of the spread between the potential return on additional investments in the Investment Grade Portfolio and the cost of borrowing the purchase price for such investments. The use of leverage to enhance returns on the Investment Grade Portfolio may result in losses or a decrease in net cash distributions to Unitholders. The Manager anticipates that the Fund will be required to provide a security interest in some or all of its assets in favour of the lenders or other parties to secure such borrowings or other leverage. Such securities lending and repurchase agreements must qualify as “securities lending arrangements” for purposes of the Tax Act.

The aggregate amount of leverage for investment purposes may not exceed 35% of the Total Assets of the Fund at the time the borrowing or other transaction is entered into. In the event that the total amounts borrowed (or otherwise subject to leverage) for investment purposes by the Fund exceeds 40% of the Total Assets of the Fund, BCAI will instruct the Portfolio Manager to reduce such indebtedness on an orderly basis as soon as practicable so that the amount borrowed or otherwise subject to leverage for investment purposes does not exceed such limit.

In addition to leverage for investment purposes, the Fund may borrow up to 2.5% of its Total Assets determined at the time of borrowing for working capital purposes.

The amount of borrowing and other leverage of the Fund will be monitored by BCAI.

3.5.3 *Securities Lending*

In order to generate additional returns, the Fund may lend securities in the Investment Grade Portfolio to borrowers acceptable to the Fund pursuant to the terms of a securities lending agreement between the

Fund and any such borrower. Under any securities lending arrangement: (i) the borrower will pay a negotiated securities lending fee and will make compensation payments equal to any distributions received by the borrower on the securities borrowed; (ii) the securities loans must qualify as “ securities lending arrangements” for the purposes of the Tax Act; and (iii) the Fund will receive appropriate collateral security. For greater certainty, any securities lending by the Fund will not be subject to the restrictions in NI 81-102.

3.5.4 Non-Resident Unitholders

At no time may (i) non-residents of Canada, (ii) partnerships that are not Canadian partnerships or (iii) a combination of non-residents of Canada and such partnerships (all as defined in the Tax Act) be the beneficial owners of a majority of the Units and the Trustee shall inform the transfer agent and registrar of this restriction. The Trustee may require declarations as to the jurisdictions in which beneficial owners of Units are resident and, if a partnership, its status as a Canadian partnership. If the Trustee becomes aware, as a result of requiring such declarations as to beneficial ownership or otherwise, that the beneficial owners of 40% of the Units then outstanding are, or may be, non-residents and/or partnerships that are not Canadian partnerships, or that such a situation is imminent, the Trustee may make a public announcement thereof. If the Trustee determines that a majority of the Units are beneficially held by non-residents and/or partnerships that are not Canadian partnerships, the Trustee may send a notice to such non-resident Unitholders and partnerships, chosen in inverse order to the order of acquisition or in such manner as the Trustee may consider equitable and practicable, requiring them to sell their Units or a portion thereof within a specified period of not less than 30 days. If the Unitholders receiving such notice have not sold the specified number of Units or provided the Trustee with satisfactory evidence that they are not non-residents and/or partnerships that are not Canadian partnerships within such period, the Trustee may on behalf of such Unitholders sell such Units and, in the interim, shall suspend the voting and distribution rights attached to such Units. Upon such sale, the affected holders shall cease to be beneficial holders of Units and their rights shall be limited to receiving the net proceeds of sale of such Units.

3.6 Monthly Distributions

Unitholders of record at the close of business on the last Business Day of each month are entitled to receive a monthly cash Distribution payable on or about the tenth Business Day of the subsequent month. Unitholders are entitled to participate equally in respect of each Trust Unit held with respect to any and all Distributions made by the Fund. There can be no assurance that the Fund will be able to achieve its monthly Distribution objective or make such payments on any Distribution Payment Date.

If, in any year after such Distributions, there would otherwise remain in the Fund additional net income or net realized capital gains, the Fund will make, on or before December 31 of that year, a special distribution of such portion of the remaining net income and net realized capital gains as is necessary to ensure that the Fund will not be liable for income tax thereon under the Tax Act. Unless the Manager otherwise determines, all special distributions will be paid in Units and then the Units will be automatically consolidated into that number of Units outstanding immediately prior to the Distribution.

The amount of Distributions in any particular calendar month are determined by the Manager, having regard to the Investment Objectives, the net realized capital gains and net income of the Fund, if any, during the calendar month and in the year to date, the net realized capital gains and net income of the Fund anticipated in the balance of the year and Distributions made in previous months.

Distributions will be payable to Unitholders of record on the Record Date. All Distributions will be paid to Unitholders proportionately based on their respective holdings of Units.

3.7 Valuation, Total Assets and Net Asset Value

The Net Asset Value per Unit on any Valuation Date shall be calculated by dividing the Net Asset Value on such Valuation Date by the total number of Units outstanding on such Valuation Date. The Valuation Date will, at a minimum, be Friday of each week, or if any Friday is not a Business Day, the immediately preceding Business Day, and the last Business Day of each month, and includes any other date on which the Manager elects, in its discretion, to calculate the Net Asset Value per Unit. The Fund will make available to the financial press for publication on a weekly basis the Net Asset Value per Unit.

The Net Asset Value per Trust Unit is calculated in Canadian dollars.

3.8 Fund Rating

The Units of the Fund have received a rating of P-2f from Standard and Poor's based on a review of the Manager, the Portfolio Manager, the prospective composition of the Investment Grade Portfolio and the Investment Objectives, Investment Strategies and Investment Restrictions of the Fund. S&P will continue to monitor and review the Fund, and in particular the creditworthiness of the securities comprising the Investment Grade Portfolio, and will be provided with information on the Fund's performance, financial profile, monthly distributions and the composition of the Investment Grade Portfolio on an ongoing basis for its review in respect of the rating of the Units. No assurance can be given that the rating will be maintained. It is not an objective of the Fund to maintain this rating. Accordingly, the rating assigned to Units of the Fund from time to time may be negatively impacted by the actions taken on behalf of the Fund and no remedial actions will be required to be taken on behalf of the Fund by reason only of a change in the rating.

The Manager has retained S&P to provide a rating for the Units. S&P is paid a fee for these services, but has no other relationship with, or economic interest in, either of the Fund or the Manager.

3.9 The Trustee

Computershare Trust Company of Canada acts as the Trustee of the Fund. The Trustee is responsible for certain aspects of the administration of the Fund as described in the Declaration of Trust. The Trustee or any successor Trustee may resign upon 120 days written notice to the Manager or may be removed by an Extraordinary Resolution passed at a meeting of Unitholders called for such purpose. Any such resignation or removal shall become effective only on the appointment of a successor Trustee by the Manager. If, after notice of resignation has been received from the Trustee, no successor has been appointed within 120 days of such notice, the Trustee, the Manager or any Unitholder may apply to a court of competent jurisdiction for the appointment of a successor Trustee.

The Declaration of Trust provides that the Trustee will not be liable in carrying out its duties under the Declaration of Trust except in cases where the Trustee fails to act honestly and in good faith with a view to the best interests of the Unitholders or to exercise the degree of care, diligence and skill that a reasonably prudent trustee would exercise in comparable circumstances. In addition, the Declaration of Trust contains other customary provisions limiting the liability of the Trustee and indemnifying the Trustee in respect of certain liabilities incurred by it in carrying out its duties.

The Trustee is entitled to receive fees from the Fund and to be reimbursed by the Fund for all expenses which it reasonably incurs in connection with the activities of the Fund.

3.9.1 *Modification of Declaration of Trust and Meetings of Unitholders*

Except as provided below, the Declaration of Trust may be amended by an Ordinary Resolution approved at a meeting of Unitholders duly convened and held in accordance with the provisions of the Declaration of Trust, or by the written consent in lieu of a meeting if there is only one Unitholder. Not less than 21 days' notice will be given for any meeting of Unitholders. The quorum for any meeting of Unitholders is

two or more Unitholders present in person or represented by proxy holding not less than 5% of the Units then outstanding. If no quorum is present at such meeting when called, the meeting, if convened upon the request of Unitholders, shall be dissolved, but in any other case shall be adjourned for not less than 14 days and the Unitholders present in person or represented by proxy at such adjourned meeting form the necessary quorum. At any such meetings, each Unitholder will be entitled to one vote for each whole Unit held.

The approval of Unitholders by an Ordinary Resolution passed at a meeting called for the purpose of considering such Ordinary Resolution (provided that Unitholders holding at least 10% of the Units outstanding on the record date of the meeting vote in favour of such Ordinary Resolution), is required for any termination of the Manager other than termination in circumstances where the Manager has been removed by the Trustee pursuant to the Declaration of Trust or the Manager has resigned.

The following may only be undertaken with the approval of Unitholders by an Extraordinary Resolution:

- (i) the liquidation, dissolution or termination of the Fund, except that the Manager may, in its discretion, terminate the Fund without the approval of Unitholders if, in the opinion of the independent directors of the Manager, the Net Asset Value of the Fund is reduced as the result of redemptions or otherwise so that it is no longer economically feasible to continue the Fund and it would be in the best interests of the Unitholders to terminate the Fund;
- (ii) an amendment to the Declaration of Trust to permit the redemption or retraction of Units at the option of the Unitholder or the Fund, other than as currently provided for in the Declaration of Trust;
- (iii) the sale of all or substantially all of the assets of the Fund other than in the ordinary course;
- (iv) the termination of the Trustee or any one of its affiliates as the trustee of the Fund;
- (v) any change in the Investment Objectives, Investment Strategies, and Investment Restrictions, unless such changes are necessary to ensure compliance with applicable laws, regulations or other requirements imposed by applicable regulatory authorities from time to time;
- (vi) any increase in the fees payable to the Manager, the Portfolio Manager or BCAI;
- (vii) any amendment, modification or variation in the provisions or rights attaching to the Units;
- (viii) any termination of the Portfolio Manager (other than in certain circumstances specified in the Portfolio Management Agreement such as the insolvency or wilful misconduct of the Portfolio Manager) provided that Unitholders holding at least 10% of the Units outstanding on the record date of the meeting vote in favour of such Extraordinary Resolution;
- (ix) any issue of Units for net proceeds per Unit less than the most recently calculated Net Asset Value per Unit prior to the date of the setting of the subscription price by the Fund;

- (x) any change in the frequency of calculating Net Asset Value per Unit to less often than weekly; and
- (xi) any amendment to i to x above except as outlined below.

The Trustee is entitled to amend the Declaration of Trust without the consent of, or notice to, the Unitholders, to:

- (i) ensure compliance with applicable laws, regulations or requirements of any governmental authority having jurisdiction over the Fund;
- (ii) maintain the status of the Fund as a “mutual fund trust”;
- (iii) make changes or corrections which counsel for the Fund advise are necessary or desirable for the correction of typographical mistakes or are required for the purpose of curing any ambiguity or defective or inconsistent provisions or omissions or manifest error; or
- (iv) provide added protection for Unitholders,

but only if such amendments do not in the opinion of the Manager adversely affect the pecuniary value of the interest of the Unitholders or restrict any protection for the Trustee or the Manager or increase their respective responsibilities without their consent.

The holders of not less than 10% of the then outstanding Units may requisition the Trustee to call a meeting of Unitholders for the purpose stated in the requisition. The Fund does not intend to hold annual meetings of Unitholders. However, the Fund has undertaken to the TSX to hold annual meetings of Unitholders if so instructed by the TSX. To date, the TSX has not instructed the Fund to hold annual meetings of Unitholders.

3.9.2 Termination of the Fund

The Fund will be terminated at any time upon not less than 90 days written notice to the Manager from the Trustee with the approval of Unitholders by an Extraordinary Resolution and passed at a duly convened meeting of Unitholders called for the purpose of considering such Extraordinary Resolution, provided that Unitholders holding at least 10% of the Units outstanding on the record date of the meeting vote in favour of such Extraordinary Resolution. The Manager may, in its discretion, terminate the Fund without the approval of Unitholders if, in the opinion of the independent directors of the Manager, the Net Asset Value of the Fund is reduced as the result of redemptions or otherwise so that it is no longer economically feasible to continue the Fund and it would be in the best interests of the Unitholders to terminate the Fund. Prior to the Termination Date, the Manager will convert the Investment Grade Portfolio to cash to the extent practicable and will satisfy or make appropriate provision for all liabilities of the Fund. The Manager may, in its discretion and upon not less than 30 days' notice to the Unitholders, extend the Termination Date by a period of up to 180 days if the Manager will be unable to convert all of the Investment Grade Portfolio to cash prior to the original Termination Date and the Manager determines that it would be in the best interests of the Unitholders to do so. The Fund will distribute to Unitholders their *pro rata* portions of the remaining assets of the Fund which will include cash and, to the extent liquidation of certain assets is not practicable or the Manager considers such liquidation not to be appropriate prior to the Termination Date, such unliquidated assets *in specie* rather than in cash, subject to compliance with any securities or other laws applicable to such distributions. Following such distribution, the Fund will be dissolved.

The Fund will also be terminated in the event of the resignation of the Manager if a replacement Manager has not been appointed within 120 days of the date upon which the Manager gives notice to the Trustee of its resignation. Such termination shall occur on the date which is 60 days following the last day of the aforementioned 120 day period.

3.10 The Manager and the Management Agreement

3.10.1 *The Manager*

Brompton FFI Management Limited was incorporated pursuant to the *Business Corporations Act* (Ontario) on October 21, 2004. Its head office is at Suite 2930, BCE Place, Bay Wellington Tower, 181 Bay Street, Toronto, ON M5J 2T3. The Manager was organized for the purpose of managing and administering closed-end investments including the Fund. The Manager is a wholly owned subsidiary of Brompton Management Limited and is a member of the Brompton Group of companies.

3.10.2 *Declaration of Trust and Management Agreement*

Pursuant to the Management Agreement, the Manager has exclusive authority to manage the business and affairs of the Fund and to make all decisions regarding the business of the Fund and has authority to bind the Fund. The Manager is required to exercise its powers and perform its duties honestly, in good faith and in the best interests of the Unitholders and to exercise the care, diligence and skill that a reasonably prudent manager would exercise in comparable circumstances. The Management Agreement provides that the Manager will not be liable in any way for any default, failure or defect in, or any loss or diminution of value of, any assets of the Fund if it has satisfied the duties and the standard of care, diligence and skill set forth above. The Manager will incur liability, however, in cases of wilful misconduct, bad faith, negligence or disregard of its duties or standard of care, diligence and skill or material breach or default of the Manager's obligations under the Management Agreement. Among other restrictions imposed on the Manager, it may not terminate the Fund or wind up the Fund's affairs except in accordance with the provisions of the Management Agreement.

Under the terms of the Management Agreement, the Manager is responsible for providing, or causing to be provided, management and administrative services and facilities to the Fund, including, without limitation:

- (a) monitoring the performance of persons, including BCAI, appointed to maintain the Investment Grade Portfolio in accordance with the Investment Objectives, Investment Strategies and Investment Restrictions;
- (b) managing relationships with the Trustee, the Custodian, registrar and transfer agent, auditors, legal counsel and other organizations or professionals serving the Fund;
- (c) monitoring the suitability of the Investment Objectives, Investment Strategies and Investment Restrictions and preparing for adoption by the Unitholders of any amendments to the Investment Objectives, Investment Strategies and Investment Restrictions which the Manager believes are in the best interests of the Fund and Unitholders;
- (d) the authorization and payment on behalf of the Fund of expenses incurred on behalf of the Fund and the negotiation of contracts with third party providers of services (including, but not limited to, custodians, transfer agents, legal counsel, auditors and printers);
- (e) the provision of office space, telephone service, office equipment, facilities, supplies and

executive, secretarial and clerical services;

- (f) the preparation of accounting, management and other reports, including periodic and annual reports to Unitholders, financial statements, tax reporting to Unitholders and income tax returns;
- (g) keeping and maintaining the books and records of the Fund and the supervision of compliance by the Fund with record keeping requirements under applicable regulatory regimes;
- (h) the calculation of the amount, and the determination of the frequency, of distributions by the Fund;
- (i) communications and correspondence with Unitholders and the preparation of notices of distributions to Unitholders;
- (j) establishing and monitoring the Distribution Reinvestment Plan, and amending, modifying, suspending or terminating the Distribution Reinvestment Plan in a manner which the Manager believes is in the best interests of Unitholders;
- (k) ensuring that the Net Asset Value per Unit is calculated and provided to the financial press;
- (l) general investor relations and responding to investors' inquiries in respect of the Fund;
- (m) dealing with banks and custodians, including the maintenance of bank records and the negotiation and securing of bank financing or refinancing;
- (n) obtaining such insurance as the Manager considers appropriate for the Fund;
- (o) arranging for the provision of services by CDS for the administration of the Book-Entry Only System with respect to the Units;
- (p) reviewing fees and expenses charged to the Fund and ensuring the timely payment thereof; and
- (q) ensuring:
 - (i) that the Fund complies with all regulatory requirements and applicable stock exchange listing requirements;
 - (ii) the preparation and delivery of the Fund's reports to, and dealing with, relevant securities regulatory authorities and any similar organization of any government or any stock exchange to which the Fund is obligated to report;
 - (iii) the organization of any meetings of Unitholders; and
 - (iv) the provision of such other managerial and administrative services as may be reasonably required for the ongoing business and administration of the Fund.

In consideration for these services, the Fund pays to the Manager the Management Fee and reimburses the

Manager for all reasonable costs and expenses incurred by the Manager on behalf of the Fund. The Manager, BCAI and each of their directors, officers, employees, consultants and agents are indemnified and will be reimbursed by the Fund to the fullest extent permitted by law against all liabilities and expenses (including judgments, fines, penalties, interest, amounts paid in settlement with the approval of the Fund and counsel fees and disbursements on a solicitor and client basis) reasonably incurred in connection with providing services to the Fund described herein or a director, officer, employee, consultant or agent thereof, including in connection with any civil, criminal, administrative, investigative or other action, suit or proceeding to which any such person may hereafter be made a party by reason of being or having been the Manager or a director, officer, employee, consultant or agent thereof, except for liabilities and expenses resulting from the person's wilful misconduct, bad faith, negligence, disregard of their duties or standard of care, diligence and skill or material breach or default of their obligations under the Management Agreement.

The Manager may be terminated at any time by the Fund on 90 days written notice with the approval of the Unitholders by an Ordinary Resolution passed at a duly convened meeting of Unitholders called for the purpose of considering such Ordinary Resolution provided that Unitholders holding at least 10% of the Units outstanding on the record date of the meeting vote in favour of such Ordinary Resolution. The Manager may be terminated by the Fund at any time on 30 days written notice to the Manager in the event of the persistent failure of the Manager to perform its duties and discharge its obligations under the Management Agreement, or the continuing malfeasance or misfeasance of the Manager in the performance of its duties under the Management Agreement. The Manager may be terminated immediately by the Fund in the event of the commission by the Manager of any fraudulent act and shall be automatically terminated if it becomes bankrupt, insolvent or makes a general assignment for the benefit of its creditors. The Manager may assign its rights, duties and obligations as Manager to an affiliate at any time. The Manager may resign upon 120 days notice to the Trustee. If no new manager is appointed within such 120-day period, the Fund will be terminated. The appointment of a new manager (other than an affiliate of the Manager) requires the approval of the Unitholders by Ordinary Resolution. Other than fees and expenses payable to the Manager pursuant to the Management Agreement up to and including the date of termination, no additional payments will be required to be made to the Manager as a result of any termination. The services of the Manager and the officers, directors and employees of the Manager are not exclusive to the Fund. The Manager and its affiliates and associates (as defined in the *Securities Act* (Ontario) may, at any time, engage in any other activity including the administration of any other fund or trust.

3.11 The Portfolio Manager and the Portfolio Management Agreement

3.11.1 *The Portfolio Manager*

Flaherty & Crumrine Incorporated is the Portfolio Manager. It is headquartered in Pasadena, California and specializes in the active management of preferred shares, hybrid preferred securities and debt securities for institutional investors and publicly traded closed-end funds. The Portfolio Manager is registered as an investment adviser under the *Investment Advisers Act 1940*, as amended, with the U.S. Commodities Futures Trading Commission as a commodity trading adviser and is a member of the U.S. National Futures Association.

The Portfolio Manager will provide investment advisory and portfolio management services for the Fund and the provision of its services will be monitored by BCAI. Decisions as to the purchase and sale of Investment Grade Portfolio securities, as to borrowing and other forms of leverage by the Fund and as to the execution of all portfolio transactions, other than those pertaining to currency hedging, will be made by the Portfolio Manager, in accordance with and subject to the terms of the Portfolio Management Agreement. Subject to the terms of the Portfolio Management Agreement, the Portfolio Manager will determine security type and industry weighting for the Investment Grade Portfolio on an ongoing basis. In

making these determinations, the Portfolio Manager will use a review process that includes assessment and analysis of financial leverage, credit risk, business risk, industry risk, currency risk, issuer size, liquidity and volatility of the investment.

3.11.2 Portfolio Management Agreement

The Portfolio Management Agreement, unless terminated as described below, will continue until the Termination Date. The Fund or BCAI may terminate the Portfolio Management Agreement in the following circumstances: (i) with the approval of Unitholders of the Fund by an Extraordinary Resolution provided that Unitholders holding at least 10% of the Units outstanding on the record date of the meeting vote in favour of such Extraordinary Resolution; (ii) in the event that the Portfolio Manager is in material breach of the Portfolio Management Agreement and the material breach has not been cured within 30 days' written notice thereof to the Portfolio Manager; (iii) if there is a dissolution and commencement of winding-up of the Portfolio Manager; (iv) if the Portfolio Manager becomes bankrupt or insolvent or makes a general assignment for the benefit of its creditors or a receiver is appointed in respect of the Portfolio Manager or a substantial portion of its assets; (v) if the assets of the Portfolio Manager become subject to seizure or confiscation by any public or governmental organization; (vi) if the Portfolio Manager has lost any registration, license or other authorization required by it to perform its duties under the Portfolio Management Agreement or is otherwise deemed unable to perform the services delegated to it thereunder; or (vii) if the Portfolio Manager has acted with wilful misconduct, fraud or negligence and as a result of such action there has been a material adverse effect on the Investment Grade Portfolio.

The Portfolio Manager may terminate the Portfolio Management Agreement in the event the Fund or BCAI is in material breach of the provisions thereof and such material breach has not been cured within 30 days' notice of such breach to the Fund. The Portfolio Manager may resign upon 120 days' notice to the Fund and BCAI.

In the event that the Portfolio Management Agreement is terminated or the Portfolio Manager resigns as provided above, the Manager or BCAI shall promptly appoint a successor portfolio manager to carry out the activities of the Portfolio Manager until a meeting of the Fund's unitholders is held to confirm such appointment.

In the Portfolio Management Agreement, the Portfolio Manager covenants to act honestly and in good faith with a view to the best interests of the Fund and, in connection therewith, to exercise the degree of care, diligence and skill that a reasonably prudent portfolio manager would exercise in the circumstances. The Portfolio Management Agreement provides that the Portfolio Manager will not be liable in any way for any default, failure or defect in, or any loss or diminution of value of, any of the securities comprising the Investment Grade Portfolio if it has satisfied the duties and the standard of care, diligence and skill set forth above. The Portfolio Management Agreement also requires that the Portfolio Manager and its officers, directors and employees shall be indemnified, from the assets of the Fund, in respect of all losses (other than loss of profits), expenses, claims, actions, damages or liabilities whatsoever which they suffer or incur, unless such claim resulted from an act or omission involving wilful misconduct, fraud, negligence or reckless disregard of the Portfolio Manager's duties under the Portfolio Management Agreement or a material breach or default of the Portfolio Manager's obligations under the Portfolio Management Agreement.

The services of the Portfolio Manager and the officers, directors and employees of the Portfolio Manager are not exclusive for the Fund. The Portfolio Manager and its affiliates and associates (as defined in the *Securities Act* (Ontario)) may, at any time, engage in any other activity, including providing portfolio management and investment advisory services to any other partnership, fund or trust. The Portfolio Manager may acquire or dispose of the same investment for the Fund and for one or more of its other

clients. Under the Portfolio Management Agreement, the Portfolio Manager has agreed to allocate investment opportunities fairly among the Fund and its other clients.

3.12 Fees and Expenses Payable by the Fund

3.12.1 Management Fee

The Manager receives an annual management fee in an amount equal to 0.35% of the Net Asset Value calculated and payable monthly in arrears plus all applicable taxes and may for any month be paid in cash or Units at the option of the Manager. The Manager has been issued a right entitling the Manager to receive, upon exercise on or before the last Business Day of each month for so long as the Manager acts as manager to the Fund, payment of the Management Fee for such month in Units. To the extent that Units are issued for this purpose, Units will be issued at their Net Asset Value per Unit. Units that are distributed in this respect will be distributed in accordance with exemptions from applicable securities laws in a manner determined by the Manager. Such distributions will be made in accordance with any applicable securities laws including the *Securities Act* (Ontario) and the rules of the TSX. The distribution of Units to the Manager as payment of the Management Fee will have the effect of providing additional cash flow for distributions to Unitholders of the Fund and increasing the number of issued and outstanding Units once the distribution is made.

3.12.2 Service Fee

The Fund pays to the Manager a Service Fee (calculated quarterly and paid as soon as practicable after the end of each calendar quarter) equal to 0.30% per annum of the Net Asset Value of the Fund, plus any applicable taxes. The Service Fee is pro rated if payable in respect of a partial calendar quarter. The Service Fee is applied by the Manager to pay a service fee in an equivalent aggregate amount, plus any applicable taxes, to dealers based on the number of Units held by clients of such dealers at the end of the relevant quarter.

3.12.3 Portfolio Management Fee

As compensation for the services rendered for the Fund, BCAI and the Portfolio Manager are entitled to receive from the Fund an aggregate annual portfolio management fee in an amount equal to 0.70% of the Net Asset Value of the Fund calculated and payable monthly in arrears plus any applicable taxes. The Portfolio Management Fee for any month may be paid in cash or Units, or some combination thereof, at the option of the Portfolio Manager and BCAI. The issue of any such Units will be made in accordance with any applicable securities laws including the *Securities Act* (Ontario) and the rules of the TSX.

3.12.4 Ongoing Expenses

The Fund pays all expenses incurred in connection with its operation and administration, including, without limitation, fees payable to the Manager, the Portfolio Manager, BCAI, the Trustee, the Service Fee, custodial fees, legal, audit and valuation fees and expenses, fees and expenses of the directors of the Manager, premiums for directors' and officers' insurance coverage for the directors and officers of the Manager, costs of reporting to Unitholders, registrar, transfer and distribution agency costs, printing and mailing costs, listing fees and expenses and other administrative expenses and costs incurred in connection with the continuous public filing requirements of the Fund and investor relations, taxes, brokerage commissions, costs and expenses relating to the issue of Units, costs and expenses of preparing financial and other reports, costs and expenses arising as a result of complying with all applicable laws, regulations and policies and all amounts paid on account of indebtedness. Such expenses also include expenses of any action, suit or other proceedings in which or in relation to which the Manager, the Portfolio Manager, BCAI, the Custodian or the Trustee and/or any of their respective officers, directors, employees, consultants or agents is entitled to indemnity by the Fund.

The Fund is also responsible for its other costs of portfolio transactions and any extraordinary expenses that may be incurred from time to time. Any arrangements for additional services between the Fund and the Manager, or any affiliate thereof, that have not been described herein shall be on terms that are no less favourable to the Fund than those available from arm's length persons (within the meaning of the Tax Act) for comparable services and the Fund shall pay all expenses associated with such additional services.

3.13 Redemption of Trust Units

3.13.1 Annual Redemption

Units may be surrendered annually for redemption not more than 45 days and at least 20 Business Days prior to the second last Business Day in November each year. Unitholders whose Units are redeemed will receive a redemption price equal to 100% of Net Asset Value per Unit for each Unit so redeemed on the Annual Redemption Date minus any costs of funding the redemption including all brokerage fees, commissions and other costs incurred in liquidating securities held in the Investment Grade Portfolio. In calculating the Net Asset Value for these purposes, the value of any traded security shall be equal to the latest available bid price for such security. Unitholders will also receive any Distribution declared to Unitholders of record on or before the relevant Annual Redemption Date.

3.13.2 Monthly Redemption

In addition to the annual redemption right, Units may be surrendered for redemption at least ten Business Days prior to the second last Business Day of each month, except for the month of November, as Units may be surrendered for redemption pursuant to the annual redemption. Unitholders whose Units are redeemed in this manner will receive a redemption price per Unit equal to the lesser of (i) 96% of the Market Price of the Units, and (ii) 100% of the Closing Market Price of the Units on the applicable Monthly Redemption Date, minus any costs of funding the redemption including all brokerage fees, commissions and other costs incurred by the Fund in liquidating securities held in the Investment Grade Portfolio. Unitholders will also receive any Distribution payable to Unitholders of record on or before the relevant Monthly Redemption Date.

3.13.3 Redemption Procedure

A Unitholder who desires to exercise redemption privileges must do so by causing the CDS Participant through which he, she or it holds his, her or its Units to deliver to CDS at its office in the City of Toronto on behalf of the Unitholder, a written notice of the Unitholder's intention to redeem Units by no later than 5:00 p.m. (Toronto time) on the 20th Business Day prior to an Annual Redemption Date but no more than 45 days prior to the Annual Redemption Date in order to receive payment on the desired Annual Redemption Payment Date for an annual redemption and by no later than 5:00 p.m. (Toronto time) on the tenth Business Day prior to a Monthly Redemption Date in order to receive payment on the desired Monthly Redemption Payment Date for a monthly redemption. A Unitholder who desires to redeem Units should ensure that the CDS Participant is provided with notice of his, her or its intention to exercise his, her or its redemption right sufficiently in advance of the Annual Redemption Date or Monthly Redemption Date deadline, as applicable, so as to permit the CDS Participant to deliver a notice to CDS by 5:00 p.m. (Toronto time) on the 20th Business Day prior to the Annual Redemption Date but no more than 45 days prior to the Annual Redemption Date for an annual redemption or so as to permit the CDS Participant to deliver a notice to CDS by 5:00 p.m. (Toronto time) on the tenth Business Day prior to the Monthly Redemption Date for a monthly redemption.

By causing a CDS Participant to deliver to CDS a notice of the Unitholder's intention to redeem Units, the Unitholder shall be deemed to have irrevocably surrendered his or her Units for redemption and appointed such CDS Participant to act as his or her exclusive settlement agent with respect to the exercise of such redemption privilege and the receipt of payment in connection with the settlement of obligations arising from such exercise.

Any redemption notice that CDS determines to be incomplete, not in proper form or not duly executed shall, for all purposes, be void and of no effect and the redemption privilege to which it relates shall be considered, for all purposes, not to have been exercised thereby. A failure by a CDS Participant to exercise redemption privileges or to give effect to the settlement thereof in accordance with a Unitholder's instructions will not give rise to any obligations or liability on the part of the Fund or the Manager to the CDS Participant or the Unitholder.

The Manager may direct the Trustee to suspend the annual and monthly redemption of Units or payment of redemption proceeds (i) for the whole or any part of a period during which normal trading is suspended on a stock exchange, options exchange or futures exchange or other market within or outside Canada on which common shares, preferred or debt securities are listed and traded, or on which derivatives are traded, if those securities or derivatives represent more than 50% by value, or underlying market exposure, of the Total Assets of the Fund without allowance for liabilities and if those securities or derivatives are not traded on any other exchange or market that represents a reasonably practical alternative for the Fund; or (ii) with the permission of the Ontario Securities Commission for any period not exceeding 120 days during which the Manager determines that conditions exist which render impractical the sale of assets of the Fund which impair the ability to determine the value of the assets of the Fund. The suspension may, at the sole discretion of the Trustee, apply to all requests for redemption received prior to the suspension but as for which payment has not been made, as well as to all requests received while the suspension is in effect. All Unitholders making such requests shall be advised of the suspension and of their right to withdraw their request for redemption. Redemptions so suspended will be effected at a price determined on the first date that the Net Asset Value, Market Price and Closing Market Price, as applicable, is calculated following the termination of the suspension. The suspension shall terminate on the first day on which the condition giving rise to the suspension has ceased to exist provided that no other condition under which a suspension is authorized then exists. To the extent not inconsistent with official rules and regulations promulgated by any government body having jurisdiction over the Fund, any declaration of suspension made by the Manager shall be conclusive.

3.14 Loan Facility

In order to provide the Fund with a prudent level of leverage to enhance the Fund's total return, the Fund has entered into a Loan Facility with a Lender. The terms, conditions, interest rates, fees and expenses of and under the Loan Facility are typical for loans of this nature. The Lender is at arm's length to the Fund, the Trustee, the Manager and the Portfolio Manager and their respective affiliates and associates.

Pursuant to an agreement with a Canadian chartered bank, the Fund maintains a 364-day revolving credit facility. The revolving credit facility provides for maximum borrowings of \$13.9 million for working capital purposes under one tranche and US\$153.8 million under the second tranche for investment purposes. Both tranches can be availed at either the prime rate of interest, the bankers' acceptance rate plus a fixed percentage, at the LIBOR rate plus a fixed percentage or by US base rate borrowings. At December 31, 2004, the Fund had a US dollar loan equivalent to \$182.4 million (US\$152.3 million) outstanding under this facility. The credit facility is used by the Fund for the purchase of additional investments and for general Fund purposes.

3.15 Issuer Bid

The Fund implemented a normal course issuer bid program whereby the Fund may purchase up to 1,436,000 Units for cancellation for the period from December 22, 2004 to December 21, 2005. At the end of this period, the Fund plans to apply to the TSX to extend the issuer bid for another 12 months. Units can only be purchased by the Fund when the Net Asset Value per Unit exceeds the market price. During 2004, no Units were purchased for cancellation.

3.16 Distribution Reinvestment Plan

The Fund has adopted the Distribution Reinvestment Plan so that all Distributions shall be automatically reinvested on each Unitholder's behalf, at the election of each such Unitholder, pursuant to the Distribution Reinvestment Plan and in accordance with the provisions of the Distribution Reinvestment Plan Agency Agreement. Notwithstanding the Distribution Reinvestment Plan, all Distributions to non-resident Unitholders will be paid in cash and will not be reinvested.

Distributions due to the Plan Participants shall be applied, on behalf of Plan Participants, to purchase additional Units. Such purchases will either be made from the Fund or in the market. If the weighted average trading price on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX) for the 10 trading days immediately preceding the relevant Distribution Date (the "Market Price") is less than the Net Asset Value per Unit on the Distribution Date, the Plan Agent shall apply the Distributions either to purchase Units in the market or from treasury as follows. Purchases in the market will be made by the Plan Agent on an orderly basis during the six trading day period following the Distribution Date and the price paid for those Units will not exceed 115% of the Market Price of the Units on the relevant Distribution Date. On the expiry of that period, the unused part, if any, of the Distributions attributable to the Plan Participants will be used to purchase Units from the Fund at the Net Asset Value per Unit on the relevant Distribution Date.

If the Market Price is equal to or greater than the Net Asset Value per Unit on the Distribution Date, the Plan Agent shall apply the Distributions to purchase Units from the Fund through the issue of new Units at the higher of (i) the Net Asset Value per Unit on the relevant Distribution Date and (ii) 95% of the Market Price on the relevant Distribution Date.

If the Units are thinly traded, purchases in the market under the Distribution Reinvestment Plan may significantly affect the market price. Depending on market conditions, direct reinvestment of cash distributions by Unitholders in the market may be more, or less, advantageous than the reinvestment arrangements under the Distribution Reinvestment Plan. The Units purchased in the market or from the Fund will be allocated on a *pro rata* basis to the Plan Participants. The Plan Agent will furnish to each Plan Participant a report of the Units purchased for the Plan Participant's account in respect of each distribution and the cumulative total purchased for that account. The Plan Agent's charges for administering the Distribution Reinvestment Plan and all brokerage fees and commissions in connection with purchases in the market pursuant to the Distribution Reinvestment Plan will be paid by the Fund. The automatic reinvestment of distributions under the Distribution Reinvestment Plan will not relieve participants of any income tax applicable to those Distributions.

A Unitholder may elect to participate in the Distribution Reinvestment Plan by notifying CDS in writing via the applicable CDS Participant, which will then appropriately instruct the Plan Agent, no later than two Business Days prior to the Record Date in respect of each distribution in which the Unitholder intends to participate. That notice, if actually received by the Plan Agent no later than the close of business on the Business Day immediately preceding the Record Date, will have effect for the distribution to be made on the following Distribution Date. Unless the Plan Agent is provided written notice of a Unitholder's intention to participate in the Distribution Reinvestment Plan in such manner, distributions to Unitholders will be made in cash. The Manager may terminate the Distribution Reinvestment Plan in its sole discretion on not less than 30 days notice to the Plan Participants. The Manager may also amend, modify or suspend the Distribution Reinvestment Plan at any time in its sole discretion, provided that it gives notice of that amendment, modification or suspension to Unitholders. The Fund is not required to issue Units into any jurisdiction where that issuance would be illegal.

During 2004, no Units were issued pursuant to the Distribution Reinvestment Plan.

3.17 Auditors, Custodian, Registrar, Transfer Agent and Distribution Agent

The auditors of the Fund are PricewaterhouseCoopers LLP, Chartered Accountants, Suite 3000, Royal Trust Tower, Toronto-Dominion Centre, Toronto Ontario M5K 1G8.

The Royal Trust Company is the Custodian of the Fund's assets pursuant to the Custodian Agreement. The address of the Custodian is 77 King Street West, 11th Floor, Toronto, Ontario M5W 1P9.

Computershare Trust Company of Canada has been appointed the Transfer Agent and Registrar and distribution agent for the Units. The register and transfer ledger are kept by the Trustee at its principal stock and bond transfer office located in Toronto.

3.18 Risk Factors

There are many risks associated with an investment in the Trust Units, some of which are outlined below.

No Assurance of Achieving Investment Objectives and No Guaranteed Rate of Return

There is no assurance that the Fund will be able to achieve its monthly Distribution objective, its objective to mitigate the impact of significant interest rate increases on the value of the Investment Grade Portfolio, its objective to preserve the Net Asset Value per Unit, its objective to enhance the total return per Unit or that the Investment Grade Portfolio will earn any return. An investment in the Fund is appropriate only for investors who have the capacity to absorb a loss of some or all of their investment and who can withstand the effect of the target return not being met in any period.

Fluctuations in Net Asset Value

The Net Asset Value and the funds available for Distribution will vary according to, among other things, the value of the securities held in the Investment Grade Portfolio, which depend, in part, upon the performance of the issuers of such securities, the performance of the preferred securities and debt markets generally, interest rates, and foreign currency exposure. Additionally, external economic forces can affect the competitive strength and profitability of the businesses represented by these securities which could significantly affect the value of such securities. Fluctuations in the market values of the securities held in the Investment Grade Portfolio may occur for a number of reasons beyond the control of the Portfolio Manager. It is possible that, due to declines in the market values of such securities in the Investment Grade Portfolio, the Fund may not be able to achieve its monthly Distribution objective or its objective to preserve the Net Asset Value per Unit.

Units may trade in the market at a discount to the Net Asset Value per Unit.

Preferred Securities and Debt Securities

The Investment Grade Portfolio will hold investments in preferred and debt securities which involve risks of default or deferral on dividends, interest and principal and price changes due to factors such as general economic conditions and an issuer's creditworthiness. Preferred securities are typically subordinated to bonds and other debt instruments in a company's capital structure and, therefore, will be subject to greater credit risk than those debt instruments. In addition, the Investment Grade Portfolio may include preferred and debt securities which may entail greater potential price volatility and may be less liquid than higher rated instruments. They may also be more susceptible to real or perceived adverse economic and competitive industry conditions than higher rated securities. Although the Fund is prohibited from investing in securities which do not have an Investment Grade rating at the time of purchase, there can be no assurance that the securities held by the Fund will continue to have an Investment Grade rating.

Call risk is the risk that an issuer will exercise its right to pay principal on an obligation held by the Fund earlier than expected. This may happen when there is a decline in interest rates. Under these circumstances, the Fund may be unable to recoup all of its initial investment and will also suffer from

having to invest in lower yielding securities. Preferred securities frequently have call features that allow the issuer to repurchase the security prior to its stated maturity.

Extension risk is the risk that an issuer will exercise its right to pay principal on an obligation held by the Fund later than expected. This may happen when there is a rise in interest rates. Under these circumstances, the value of the obligation will decrease, and the Fund will also suffer from the inability to invest in higher yielding securities.

Generally, holders of preferred shares (such as the Fund) have no voting rights with respect to the issuing company unless preferred dividends have been in arrears for a specified number of periods, at which time the preferred shareholders may be granted voting rights which may entitle such holders to elect a number of directors to the issuer's board. Generally, once all the arrears have been paid, the preferred shareholders no longer have voting rights. In the case of certain hybrid preferred securities, holders generally have no voting rights except: (i) if the issuer fails to pay dividends for a specified period of time; or (ii) if a declaration of default occurs and is continuing. In such an event, rights of preferred security holders generally would include the right to appoint and authorize a trustee to enforce the trust or special purpose entity's rights as a creditor under the agreement with its operating company.

From time to time, preferred securities have been, and may in the future be, offered having features other than those described herein. The Fund reserves the right to invest in these securities if the Portfolio Manager believes that doing so would be consistent with the Fund's Investment Strategy and Investment Restrictions.

Because the market for these instruments would be new, the Fund may have difficulty disposing of them at a suitable price and time. In addition to limited liquidity, these instruments may present other risks, such as high price volatility.

Composition of the Investment Grade Portfolio

The composition of the Investment Grade Portfolio taken as a whole may vary widely from time to time and may be concentrated by type of security, industry or geography, resulting in the Investment Grade Portfolio being less diversified than anticipated. Overweighting investments in certain industries involves a risk that the Investment Grade Portfolio will suffer a loss because of general advances or declines in the prices of securities in those sectors or industries.

Securities Lending and Repurchase Agreements

The Fund may engage in securities lending and repurchase agreements. Although the Fund will receive collateral for the loans and such collateral is marked to market, the Fund will be exposed to the risk of loss should the borrower default on its obligation to return the borrowed securities and the collateral is insufficient to reconstitute the portfolio of loaned securities.

Leverage

One element of the Fund's investment strategy is the utilization of borrowings or the employment of other forms of leverage to make investments in additional instruments. The obligations under loan facilities or other forms of leverage may be secured by the assets of the Fund. By adding additional leverage, these strategies have the potential to enhance returns but also involve additional risks. There can be no assurance that the leveraging strategy employed for the Fund will enhance returns. The use of leverage may reduce returns (both Distributions and capital) to Unitholders. If the securities in the Investment Grade Portfolio suffer a decrease in value, the leverage component will cause a decrease in value of the Investment Grade Portfolio in excess of that which would otherwise be experienced. In addition, the cost of leverage may rise, potentially reducing income distributable to Unitholders. The aggregate amount of leverage for investment purposes may not exceed 35% of the Total Assets of the Fund at the time the

borrowing or other transaction is entered into. In the event that the total amount borrowed (or otherwise subject to leverage) for investment purposes by the Fund exceeds 40% of the Total Assets of the Fund, BCAI will instruct the Portfolio Manager to reduce such indebtedness or other leverage on an orderly basis as soon as practicable so that the amount borrowed or otherwise subject to leverage for investment purposes does not exceed such limit.

The interest expense and banking fees incurred in respect of loan facilities, or expenses and fees incurred in respect of other forms of leverage, may exceed the incremental capital gains/losses and income generated by the incremental investments for the Investment Grade Portfolio. In addition, the Fund may not be able to renew a loan facility or other form of leverage on acceptable terms. The Portfolio Manager expects that the Fund may be leveraged at the maximum amount permitted by the Investment Restrictions.

Nature of Units

While it is an investment objective of the Fund that the Net Asset Value per Unit be preserved, the Units are not debt securities and there is no obligation or guarantee to return the initial subscription price. The Units represent a fractional beneficial interest in the assets of the Fund. Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring “oppression” or “derivative” actions.

Changes in Legislation

There can be no assurance that income tax, securities, and other laws or the interpretation and application of such laws by courts or government authorities will not be changed in a manner which adversely affects the distributions received by the Fund or by the Unitholders.

Reliance on the Portfolio Manager and Key Personnel and on BCAI

Performance of the Investment Grade Portfolio will be dependent on the Portfolio Manager, which provides investment advisory and portfolio management services for the Fund pursuant to the Portfolio Management Agreement. Donald Crumrine, Robert Ettinger, Peter Stimes, Bradford Stone, Eric Chadwick and Christopher Ryan, employees of the Portfolio Manager, will be principally responsible for providing such investment advisory and portfolio management services and in the event that all or substantially all of the key personnel of the Portfolio Manager cease to be employed by the Portfolio Manager, or if the Portfolio Manager ceases to be the portfolio manager, the performance of the Investment Grade Portfolio may be adversely affected.

Performance of the Investment Grade Portfolio will also be dependent on BCAI, which provides advice to the Fund with regard to currency hedging and will monitor the amount of borrowing and other leverage of the Fund.

Foreign Currency Exposure

The Net Asset Value is measured in Canadian dollars and payments to Unitholders will be made in Canadian dollars. However, most of the investments in the Investment Grade Portfolio, at any time, will consist of securities denominated in U.S. dollars. Accordingly, the Net Asset Value and the Fund’s ability to make payments to Unitholders may be affected by fluctuations in the value of the Canadian dollar relative to the United States dollar. Although it is expected that substantially all of the Investment Grade Portfolio will be hedged to the Canadian dollar to address the foreign currency exposure of the Fund, there can be no assurance that such hedging strategies will be successful.

Foreign Issuers

The Investment Grade Portfolio may include securities of issuers established in jurisdictions outside Canada and the United States. Although most of such issuers will be subject to accounting, auditing and

financial reporting standards comparable to those applicable to Canadian and U.S. companies, some issuers may not be subject to such standards and, as a result, there may be less publicly available information about such issuers than a Canadian or U.S. company. The price of such securities may be affected by conditions in the market of the jurisdiction in which the issuer is located. Investments in foreign issuers carry the potential exposure to the risk of political upheaval, acts of terrorism and war, all of which could have an adverse impact on the value of such securities.

Interest Rate Changes and Sensitivity of Market Price of Units to Interest Rates

Interest rate risk is the risk that debt obligations and preferred securities will decline in value because of changes in interest rates. Generally, debt securities will decrease in value when interest rates rise and increase in value when interest rates decline. Net Asset Value may fluctuate with interest rate changes and the corresponding changes in the value of the securities in the Investment Grade Portfolio. The market price of Units may be affected by the level of interest rates prevailing from time to time.

Illiquid Securities

If the Portfolio Manager is unable to dispose of some or all of the Investment Grade Portfolio securities, the Fund may experience a delay in the receipt of the proceeds of disposition until such time as the Portfolio Manager is able to dispose of such Investment Grade Portfolio securities. If the Portfolio Manager determines that it is appropriate to acquire certain securities for the Fund, the Portfolio Manager may be unable to acquire the number of such securities, or to acquire such securities at a price acceptable to the Portfolio Manager, if the market for such securities is particularly illiquid.

Derivatives and Hedging Risk

The Investment Grade Portfolio may use derivatives for any purpose including, among other things, as a substitute for taking a position in the underlying asset or as part of a strategy designed to reduce or increase exposure to other risks, such as interest rate or currency risk. The Investment Grade Portfolio's use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks, such as liquidity risk, interest rate risk, market risk, credit risk, leveraging risk, counterparty risk and management risk. They also involve the risk of mispricing or improper valuation and the risk that changes in the value of a derivative may not correlate perfectly with the underlying asset, rate or index. If the Fund invests in a derivative instrument, it could lose more than the principal amount invested. Hedging with derivatives may not always work and it could restrict the Fund's ability to increase in value and adds to the risk of investing in Units. There is also no guarantee that the Fund will be able to obtain or close out a derivative contract when it needs to which could prevent the Fund from making a profit or limiting a loss. In addition, the Fund's success in using hedge instruments is subject to the Portfolio Manager's ability to predict correctly changes in the relationships of such hedge instruments to the Investment Grade Portfolio, and there can be no assurance that the Portfolio Manager's judgment in this respect will be accurate. Consequently, the use of hedging techniques might result in a poorer overall performance for the Fund, whether or not adjusted for risk, than if the Fund had not hedged its portfolio holdings.

Conflicts of Interest

The Manager, BCAI and the Portfolio Manager, their respective directors and officers and their respective affiliates and associates may engage in the promotion, management or investment management of other funds, including funds which invest primarily in securities to be held in the Investment Grade Portfolio. Investment decisions for the Investment Grade Portfolio will be made independently from those of other accounts advised by the Portfolio Manager. If such other accounts are prepared to invest in, or desire to dispose of, securities at the same time as the Investment Grade Portfolio, available investments or opportunities for sales will be allocated equitably to each entity. In some cases, this procedure may

adversely affect the size of the position obtained for or disposed of by the Investment Grade Portfolio or the price paid or received by it.

Although none of the directors or officers of the Manager will devote his or her full time to the business and affairs of the Fund or the Manager, each will devote as much time as is necessary to supervise the management of (in the case of the directors) or to manage (in the case of officers) the business and affairs of the Manager and the Fund. Although officers, directors and professional staff of the Portfolio Manager will devote as much time to the Fund as the Portfolio Manager deems appropriate to perform its duties in accordance with the Portfolio Management Agreement, the staff of the Portfolio Manager may have conflicts in allocating its time and services among the Fund and the other clients of the Portfolio Manager. In addition, the Portfolio Manager and/or its affiliates, in connection with their other business activities, may acquire material non-public confidential information that may restrict the Portfolio Manager from purchasing assets or selling assets for itself or its clients (including the Fund) or otherwise using such information for the benefit of its clients or itself.

Change or Withdrawal of Rating on the Units of the Fund

There can be no assurance that the rating on the Units of the Fund of P-2f by S&P will remain in effect or will not be revised. If the rating is withdrawn or revised, there may be an adverse effect on the market price of the Units.

Status of the Fund

The Fund is not a “mutual fund” for securities law purposes. As a result, some of the protections provided to investors in mutual funds under such laws will not be available to investors in the Units and certain restrictions imposed on mutual funds under Canadian securities laws do not apply to the Fund. The Fund has not adopted the standard investment restrictions and practices set forth in NI 81-102. Restrictions imposed on mutual funds under Canadian securities laws, including NI 81-102, do not apply to the Fund or the Investment Grade Portfolio.

Legal and Statutory Rights

The Portfolio Manager is a corporation formed under the laws of the State of Maryland. The foreign organization and offices of the Portfolio Manager and the fact that all or a substantial portion of its assets are situated outside of Canada may make it more difficult to enforce legal rights against the Portfolio Manager than if it were organized and resident in Canada. Although the custodian of the Investment Grade Portfolio is in Canada and some of the assets of the Fund may be held in Canada, the majority of the Fund’s assets may be held in accounts with sub-custodians in other jurisdictions. Accordingly, there may be additional defences available to any judgement obtained by the Fund in Canada that may affect enforcement in any such jurisdictions.

Liability of Unitholders

The Declaration of Trust provides that no Unitholder, in its capacity as such, will be subject to any personal liability whatsoever, in tort, contract or otherwise, to any person in connection with the Fund property or the obligations or the affairs of the Fund and all such persons shall look solely to the Fund property for satisfaction of claims of any nature arising out of or in connection therewith and the Fund’s property only shall be subject to levy or execution. Pursuant to the Declaration of Trust, the Fund will indemnify out of the Fund’s assets and hold harmless each Unitholder from any costs, damages, liabilities, expenses, charges and losses suffered by a Unitholder resulting from or arising out of such Unitholder not having limited liability.

The Declaration of Trust provides that the Trustee shall use reasonable means to cause the Fund’s operations to be conducted in such a way as to minimize any such risk and, in particular, where feasible, to cause every written contract or commitment of the Fund to contain an express disavowal of liability of

Unitholders. In any event, it is considered that the risk of any personal liability of Unitholders is minimal in view of the anticipated equity of the Fund, and the nature of its activities. In addition, the Alberta Legislature recently passed the *Income Trust Liability Act* to create a statutory limitation on the liability of Unitholders of Alberta income trusts such as the Fund. The legislation provides that notwithstanding any express or implied indemnity of a trustee by a unitholder, a unitholder will not be, as a beneficiary, liable for any act, default, obligation or liability of the trustee that arises after the legislation comes into force. In the event that a Unitholder should be required to satisfy any obligation of the Fund, such Unitholder will be entitled to reimbursement from any available assets of the Fund.

As a result of the foregoing, it is considered that there no longer is a risk of any personal liability to Unitholders of the Fund. In the event that a Unitholder should be required to satisfy any obligation of the Fund, such Unitholder will be entitled to reimbursement from any available assets of the Fund. Pursuant to the Declaration of Trust, the Fund will indemnify and hold harmless each Unitholder from any costs, damages, liabilities, expenses, charges and losses suffered by a Unitholder resulting from or arising out of such Unitholder not having limited liability. The Declaration of Trust provides that the Trustee and the Manager shall use reasonable means to cause to be inserted in each written agreement, undertaking and obligation signed by or on behalf of the Fund a provision to the effect that such agreement, undertaking or obligation will not be binding upon Unitholders personally. The Loan Facility and any other documents relating to the borrowing of money by the Fund contain such a provision.

Tax Proposals Respecting Deductions

On October 31, 2003 the federal Department of Finance announced a Tax Proposal relating to the deductibility of losses under the Tax Act. Under this Tax Proposal, a taxpayer will be considered to have a loss from a business or property for a taxation year only if, in that year, it is reasonable to expect that the taxpayer will realize a cumulative profit from the business or property during the time that the taxpayer has carried on, or can reasonably be expected to carry on, the business or has held, or can reasonably be expected to hold, the property. Profit, for this purpose, does not include capital gains or capital losses. If such Tax Proposal were to apply to the Fund, deductions that would otherwise reduce the Fund's taxable income could be denied, with after-tax returns to Unitholders reduced as a result. The Manager has advised counsel that it expects the Fund to realize cumulative profit from each of the securities in the Investment Grade Portfolio and, accordingly, this Tax Proposal, if enacted in the form proposed, should not adversely affect losses, if any, realized by the Fund. On February 23, 2005, the Minister of Finance (Canada) announced that a draft proposal to replace the Tax Proposal of October 31, 2003 would be released for comment at an early opportunity.

Treatment of Gains and Losses

In determining its income for tax purposes, the Fund intends to treat gains and losses on disposition of securities in the Investment Grade Portfolio on capital account. The CRA's practice is not to grant an advance income tax ruling on the characterization of items as capital gains or income and no advance ruling has been requested or obtained. If some or all of the transactions treated by the Fund as being on capital account were instead treated on income account, after-tax returns to Unitholders could be reduced.

Status as a Mutual Fund Trust for Tax Purposes

Currently, a trust will not be considered to be a mutual fund trust if it is established or maintained primarily for the benefit of non-residents unless all or substantially all of its property is property other than taxable Canadian property as defined in the Tax Act. On September 16, 2004, the Minister of Finance (Canada) released draft amendments to the Tax Act. Under the draft amendments, a trust would lose its status as a mutual fund trust if the aggregate fair market value of all units issued by the trust held by one or more non-resident persons or partnerships that are not Canadian partnerships (or any combination thereof) is more than 50% of the aggregate fair market value of all of the units issued by the trust where more than 10% (based on fair market value) of the trust's property is taxable Canadian

property or certain other types of property. If the draft amendments are enacted as proposed, and if, at any time, more than 50% of the aggregate fair market value of the Units of the Fund were held by non-residents and partnerships other than Canadian partnerships (or any combination thereof), the Fund would thereafter cease to be a mutual fund trust. The draft amendments do not currently provide any means of rectifying a loss of mutual fund trust status. On December 6, 2004, the Minister of Finance (Canada) tabled a Notice of Ways and Means Motion which did not include these draft amendments, and it is expected that further discussions will take place before a decision is made concerning whether the draft amendments will be enacted. On February 23, 2005, the Minister proposed that the limit in respect of foreign property that may be held by registered pension plans and other deferred plans be eliminated for 2005 and subsequent tax years.

4.0 SELECTED FINANCIAL INFORMATION

The following table sets forth selected financial information of the Fund for period from December 15, 2004 to December 31, 2004. The following summary of selected audited financial information is derived from, and should be read in conjunction with, and is qualified in its entirety by reference to the Fund's audited financial statements, including the notes thereto, for the period ended December 31, 2004:

4.1 Selected Annual and Quarterly Information

	2004*
Income:	
Total	\$ 993,055
Per Trust Unit	0.07
Net investment income	350,978
Net investment income per Trust Unit	0.02
Results of operations	(5,847,309)
Results of operations per Trust Unit	(0.40)
Net assets	345,726,142
Distributions paid to Unitholders	-
Distributions paid per Trust Unit	-

* for the period from December 15 to December 31

5.0 MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis for the period ended December 31, 2004 is contained in the 2004 Annual Report of the Fund and is herein incorporated by reference.

6.0 MARKET FOR SECURITIES

The Units are listed for trading on the TSX under the symbol FFI.UN.

7.0 DIRECTORS AND OFFICERS OF THE MANAGER

The Board of Directors of the Manager consists of a minimum of one and a maximum of nine directors. The Board of Directors of the Manager currently consists of five members. Directors are appointed to serve on the Board of Directors of the Manager until such time as they retire or are removed and their successors are appointed.

Name & Municipality of Residence	Position with the Manager	Principal Occupation	Trust Unit Holdings*	Trust Unit Holdings %
Peter A. Braaten Toronto, Ontario	Chairman of the Board	Chairman, Brompton Limited from November 2000; President, 2M Energy Corp. from July 1999 to November 2000; President, Morrison Middlefield Resources Limited from August 1993 to July 1999.	65,408	0.439%
James W. Davie ⁽¹⁾⁽²⁾⁽³⁾ Toronto, Ontario	Director	Corporate Director from June 2002; Managing Director, Investment Banking, RBC Dominion Securities Inc. from 1979 to June 2002.	-	-
P. Michael Nedham Toronto, Ontario	Director	Managing Director, Newport Partners Inc. from July 2002; President, Newport Securities Inc. from September 2001; President, Michael Nedham and Associates Ltd. from February 1998 to September 2001; Managing Director, TD Securities Inc. from 1995 to February 1998	-	-
Christopher S. L. Hoffman Toronto, Ontario	Executive Vice-President	Executive Vice President, Brompton Limited from October 2004; Legal Counsel, McCarthy Tétrault LLP from November 1989 to October 2004.	-	-
Ken S. Woolner ⁽¹⁾⁽²⁾⁽³⁾ Calgary, Alberta	Lead Director	Executive Chairman, White Fire Energy Ltd. since April 2005; President & Chief Executive Officer, Lightning Energy Ltd. from December 2001 to April 2005; President & CEO, Velvet Exploration Ltd. from April 1997 to July 2001.	-	-
Arthur R. A. Scace ⁽¹⁾⁽²⁾⁽³⁾ Toronto, Ontario	Director	Counsel, McCarthy Tétrault LLP from November 2003; Partner, McCarthy Tétrault from 1972 to November 2003.	-	-
Raymond R. Pether Toronto, Ontario	President & Chief Executive Officer	President, Brompton Limited from April 2001; President & CEO, Western Facilities Fund from June 1998 to April 2001; Chief Operating Officer, Morrison Middlefield Resources Limited from January 1994 to June 1998.	-	-
Christopher S.L. Hoffmann Toronto, Ontario	Executive Vice President	Executive Vice President, Brompton Limited from October 2004; Legal Counsel, McCarthy Tétrault LLP from November 1989 to October 2004.	-	-
Mark A. Caranci Toronto, Ontario	Chief Financial Officer	Chief Financial Officer, Brompton Limited from April 2001; CFO, Western Facilities Fund from December 2000 to April 2001; Vice President, Finance 2M Energy Corp. from August 1999 to November 2000; Vice President Finance, Morrison Middlefield Resources Limited from January 1997 to August 1999.	-	-

Moyra E. MacKay Toronto, Ontario	Vice President & Corporate Secretary	Vice President & Corporate Secretary, Brompton Limited from May 2000; Vice President, 2M Energy Corp. from August 1999 to May 2000; Vice President, Morrison Middlefield Resources Limited from August 1998 to August 1999; Vice President, Middlefield International Limited from June 1996 to August 1998.	-	-
David E. Roode Toronto, Ontario	Senior Vice President	Vice President, Brompton Limited from September 2002; Analyst, Middlefield Group from 1998 to 2001.	-	.
Craig T. Kikuchi Toronto, Ontario	Vice President, Finance	Vice President, Brompton Limited from August 2004; Controller, Brompton Limited from February 2002 to August 2004; PricewaterhouseCoopers LLP from September 1996 to January 2002.	-	-
Imran Pervaiz Oakville, Ontario	Controller	Controller, Brompton Limited from April 2004; Manager, PricewaterhouseCoopers LLP from October 2002 to April 2004; Accountant, Ontario Securities Commission from January 2001 to October 2002; Financial Analyst, Nortel Networks from June 2000 to January 2001; Senior Staff Accountant, KPMG LLP from September 1996 to June 2000.	-	-
Lorne Zeiler Toronto, Ontario	Vice President	Vice President, Brompton Limited from September 2004; Senior Financial Analyst, Assante Advisory Services from 2003 to 2004; Senior Relationship Manager, Scotiabank from 1998 to 2003.	845	0.006%
Jessica Leung Toronto, Ontario	Controller	Controller, Brompton Limited since February 2005; Manager, Ernst & Young LLP from October 2000 to January 2005.	-	-
Total			66,253	0.444%

* Includes Trust Units held directly, indirectly or over which control or direction is exercised at May 17, 2005.

- (1) Member of the Audit Committee
- (2) Member of the Corporate Governance Committee
- (3) Unrelated Director

7.1 *Remuneration of Directors and Officers*

The officers and directors of the Manager, other than the non-management directors of the Manager, receive their remuneration from the Manager. The fees of the non-management directors of the Manager, expenses of the directors of the Manager and the premiums for directors' and officers' insurance coverage for the directors and officers of the Manager are paid by the Fund.

8.0 FORWARD LOOKING INFORMATION

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks, may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may", "will" "should", "could", "anticipate", "believe", "expect",

"intend", "plan", "potential", "continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risk and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, we cannot assure that actual results will be consistent with these forward looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.

CERTAIN HISTORICAL INFORMATION CONTAINED IN THIS ANNUAL INFORMATION FORM HAS BEEN PROVIDED BY, OR DERIVED FROM INFORMATION PROVIDED BY, CERTAIN THIRD PARTIES. ALTHOUGH THE FUND HAS NO KNOWLEDGE THAT WOULD INDICATE THAT ANY SUCH INFORMATION IS UNTRUE OR INCOMPLETE, THE FUND ASSUMES NO RESPONSIBILITY FOR THE ACCURACY AND COMPLETENESS OF SUCH INFORMATION OR THE FAILURE BY SUCH THIRD PARTIES TO DISCLOSE EVENTS WHICH MAY HAVE OCCURRED OR MAY AFFECT THE COMPLETENESS OR ACCURACY OF SUCH INFORMATION BUT WHICH IS UNKNOWN TO THE FUND.

9.0 ADDITIONAL INFORMATION

Additional financial information is provided in the Fund's Financial Statements for the fiscal year ended December 31, 2004.

The Fund will provide to any person, upon request:

- (a) when the securities of the Fund are in the course of a distribution pursuant to a short form prospectus or a preliminary short form prospectus has been filed in respect of a distribution of its securities,
 - (i) one copy of the Annual Information Form of the Fund (the "AIF"), together with one copy of any document, or the pertinent pages of any document, incorporated by reference in the AIF,
 - (ii) one copy of the comparative financial statements of the Fund for its most recently completed financial year together with the accompanying report of the auditor and one copy of any interim financial statements of the Fund subsequent to the financial statements for its most recently completed financial year,
 - (iii) one copy of the information circular of the Fund in respect of its most recent annual meeting of shareholders that involved the election of directors or one copy of any annual filing prepared in lieu of that information circular, as appropriate, and
 - (iv) one copy of any other documents that are incorporated by reference into the shortform prospectus or the preliminary prospectus and are not required to be provided under (i) to (iii) above; or
- (b) at any other time, one copy of any other documents referred to in (1)(a)(i), (ii) and (iii) above, provided the Fund may require the payment of a reasonable charge if the request is made by a person who is not a unitholder of the Fund.

Requests should be addressed to the Corporate Secretary of the Manager at:

Brompton FFI Management Limited
Suite 2930, Box 793, BCE Place
Bay Wellington Tower, 181 Bay Street
Toronto, ON M5J 2T3