This offering circular contains important information about the collateralized exempt obligations. Please read it before investing and keep it for future reference.
The collateralized exempt obligations or “CEOs” are secured, short- and medium-term notes to be issued by the First Puerto Rico Tax-Exempt Fund, Inc. (the “Fund”) from time to time under its leverage program. The Fund is a continuously offered, non-diversified, open-end management investment company registered under the Puerto Rico Investment Companies Act.

The short-term notes will have stated maturities of up to 270 days after their date of issuance. The medium-term notes will have stated maturities of 270 days or more from the date they are originally issued.

Each series of notes will be secured separately in an amount equal to their outstanding principal amount by a pledge of eligible collateral allocated by the Fund to each series.

The Fund will offer notes from time to time and specify the terms and conditions of each issue of notes, including any applicable interest rates, maturity dates and redemption features, in a pricing supplement to this offering circular (each, a “pricing supplement”).

The notes may bear interest at fixed or floating rates or may not bear any interest as determined by the Fund at the time of issuance of the notes. If the notes bear interest at a floating rate, the floating rate may be based on or determined by reference to one or more indices or formulas plus or minus a fixed amount or multiplied by a factor.

The Fund will specify in the corresponding pricing supplement whether the notes can be redeemed or repaid before their maturity and whether they are subject to mandatory redemption, redemption at the option of the Fund or repayment at the option of the holder of the notes.

Fitch Ratings has rated the notes. The short-term notes of the Fund are rated “F1,” and the medium-term notes issued by the Fund are rated “A.” See “Ratings” on page 17 of this offering circular.

Investing in the notes involves certain risks. See “Risk Factors” on page 10 of this offering circular.

These securities have not been approved or disapproved by the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico. The Office of the Commissioner has not made any determination regarding the accuracy or adequacy of this offering circular or any pricing supplement. Any representation to the contrary is a criminal offense.

These securities have not been registered with the U.S. Securities and Exchange Commission under the Securities Act of 1933, or with any state securities commission. The Fund has not been registered under the U.S. Investment Company Act of 1940.

These securities are being offered exclusively to individuals having their principal residence within the Commonwealth of Puerto Rico and to persons, other than individuals, whose principal office and principal place of business are located within the Commonwealth of Puerto Rico.

The notes are not deposits, savings accounts or other obligations of, or guaranteed by, Banco Santander Puerto Rico, any of its affiliates or any other depository institution, and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. When considering an investment in the notes, you should read carefully this offering circular, the corresponding pricing supplement, the prospectus and most recent annual report for the Fund before making your investment decision. The notes are not a vehicle for trading purposes.

The Fund may sell notes to the agent named below (and to other agents appointed from time to time) as principal for resale at varying or fixed offering prices or through the agents using their reasonable efforts on behalf of the Fund. The offering of the notes by the agent named below will be conducted in accordance with NASD Rule 2720 of the Financial Industry Regulatory Authority, Inc. Please see “Plan of Distribution; Conflicts of Interest” on page 18 of this offering circular for further details. The Fund may also sell notes without the assistance of agents, whether acting as principal or as agent.

Santander Securities
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No person has been authorized to give any information or to make any representations in connection with this offering other than those contained in this offering circular and any corresponding supplement and, if given or made, such other information and representations must not be relied upon as having been authorized by the Fund, or the agents. Neither the delivery of this offering circular or any corresponding supplement thereto, nor any sale made hereunder, shall, under any circumstances, create any implication that there has been no change in the affairs of the Fund since the date hereof or that the information contained herein is correct as of any time subsequent to its date. Neither this offering circular nor any pricing supplement thereto constitutes an offer to sell, or a solicitation of an offer to buy, any securities other than the notes. Neither this offering circular nor any pricing supplement thereto constitutes an offer to sell, or a solicitation of an offer to buy, such securities in any circumstances in which such offer or solicitation is unlawful. *No offer of the notes may be made to a prospective investor without delivery of this offering circular and any corresponding supplement thereof, the most recent prospectus of the Fund and its latest annual report containing the audited financial statements as set forth herein under “Fund Prospectus and Annual Report.”*
SUMMARY

The following summary is qualified in its entirety by reference to the more detailed information included elsewhere in this offering circular and all other relevant documents referred to herein. This offering circular speaks only as of its date and the information contained herein is subject to change. No person is authorized to detach this Summary from this offering circular or otherwise use it without the entire offering circular.

The Fund

First Puerto Rico Tax-Exempt Fund, Inc. (the “Fund”) is a continuously offered, non-diversified, open-end management investment company. The Fund is a corporation organized under the laws of Puerto Rico and is registered as an investment company under the Puerto Rico Investment Companies Act. The Fund operates subject to ruling letters issued by the Office of the Commissioner of Financial Institutions of the Commonwealth of Puerto Rico. Investors in the notes are encouraged to read and carefully consider the most recent prospectus and annual report containing the financial information of the Fund before making an investment decision on the notes.

The Notes

Each note will be an obligation of the Fund only, and will not be an obligation of, or otherwise be guaranteed by, any other fund in the First Puerto Rico Family of Funds. The notes are also known as “CEOs” for marketing purposes. Each note will be issued as part of the Fund’s leverage program. See “Use of Proceeds.”

Maturities

The notes are being issued in two series: the short-term notes and the medium-term notes. The short-term notes will be offered with maturities of up to 270 days from their date of issuance, and may include notes payable on demand. The medium-term notes will be offered with maturities in excess of 270 days from their date of issuance. The maturity date and/or demand feature will be set forth on each note and corresponding pricing supplement delivered by the Fund in connection with the sale of the notes.

Minimum Denominations

The notes will be issued in minimum denominations of $25,000 and increments of $1,000 thereafter.

Ratings

Fitch Ratings has rated the notes. The short-term notes of the Fund are rated “F1,” and its medium-term notes are rated “A.” See “Ratings” below. The Fund has not been rated by Fitch Ratings.

Interest Rate

The notes may bear interest at a rate determined at the time of issuance of each note. If the notes bear interest, the interest rate will be set forth on each note and corresponding pricing supplement delivered in connection with the sale of the notes. The notes may bear interest at a fixed or floating rate. If the notes bear interest at a floating rate, the floating rate may be based on or determined by reference to one or more indices or formulas plus or minus a fixed amount or multiplied by a factor. The notes may also be issued at a discount without a stated rate of interest.

Redemption

The medium-term notes may be redeemed prior to their stated maturity at the option of the Fund as provided in the relevant note and corresponding pricing supplement. The short-term notes will not be subject to redemption prior to their stated maturity unless otherwise provided in the relevant note and corresponding pricing supplement.
Security for the Notes

Each series of notes issued by the Fund will be separately collateralized as to their full outstanding principal amount by a pledge of certain eligible portfolio securities of the Fund. These pledged securities include GNMA mortgage-backed securities, other U.S. government agency securities and Puerto Rico government securities, U.S. treasury securities, and municipal obligations. See “Security for the Notes” below.

Offering and Transfer Restrictions

The notes are being offered exclusively to individuals who maintain their principal residence in Puerto Rico and to entities that have their principal office and principal place of business in Puerto Rico. For purposes of this offering circular, entities having their principal office and principal place of business in Puerto Rico are considered to be residents of Puerto Rico.

Investors will be required to execute and deliver a Puerto Rico Residency Representation Letter in the form of Appendix C to this offering circular prior to purchasing the notes. The notes may be sold, pledged, hypothecated or otherwise transferred exclusively to residents of Puerto Rico. Noteholders who cease to be Puerto Rico Residents (as defined below) will not have available the tax benefits that make the notes an attractive investment, and such note holders have an obligation to notify Santander Securities Corporation (or any other dealer for the notes appointed by the Fund), the Collateral Agent and the Fund immediately upon ceasing to be Puerto Rico Residents, to redeem their notes as soon as it becomes economically feasible to do so, and to agree not to purchase any more notes. See “The Notes—Limitations on the Offering and Transfer of the Notes” and Appendix C—Puerto Rico Residency Representation Letter.”

In certain offerings of notes, the Fund may require other representation letters, such as accredited investor representation letters, from potential investors in connection with their purchases of notes. Forms of any such representation letters, to the extent required by the Fund, will be included in the corresponding pricing supplement.

Management of the Fund

Santander Asset Management Corporation (or “SAM”) is the investment adviser for the Fund. Santander Securities Corporation (or “Santander Securities”), the parent of the investment adviser, also acts as agent of the Fund for the offer and sale of the notes. SAM also acts as administrator to the Fund. You should be aware that certain conflicts of interest may exist among the Fund, Santander Securities and the investment adviser for the Fund as described in this offering circular and the prospectus of the Fund.

Collateral Agent

Banco Santander Puerto Rico (or “Banco Santander”) is the collateral agent for the note holders pursuant to the terms of a Security Agreement (as defined below). See “The Notes” below. Banco Santander also is the issuing, paying and transfer agent of the notes acting on behalf of the Fund. Banco Santander is an affiliate of Santander Securities and SAM.

Risk Factors

An investment in the notes involves certain risks, including risks associated with the operation of the Fund, the leverage activities of the Fund, the portfolio investments made by the Fund and the characteristics of the notes issued by the Fund and purchased by you. Prior to making any investment decision, investors are encouraged to read and carefully consider the information provided in the section entitled “Risk Factors,” which provides a description of certain risk factors relating to an investment in the notes, as well as the information contained in the prospectus for the Fund, particularly the information included under the caption “Risk Factors and Special Considerations,” which provides a more detailed description of the risks.
related to the Fund. Although the notes are secured by certain eligible collateral, the Fund cannot guarantee the creditworthiness of any particular security comprising such collateral or the issuer of such security.

**Transactions Involving Affiliates**

The Fund is not registered under the U.S. Investment Company Act of 1940 and therefore is not subject to the restrictions contained therein regarding, among others, transactions between the Fund, Santander Securities, and the investment adviser or its affiliates. Transactions among these affiliates will take place, including instances in which Santander Securities, the parent of the investment adviser, may be the only dealer in a particular security being purchased or sold by the Fund. In that event, independent sources for valuation or liquidity of the security may be limited or nonexistent. The Fund may invest a substantial portion of its assets in those securities.

All transactions with affiliates are subject to procedures adopted by the Board of Directors of the Fund, and, particularly the Fund’s independent directors, in an effort to address potential conflicts of interest. There is no assurance that the procedures will be effective.

The Fund’s Board of Directors also has adopted procedures in an effort to address potential conflicts of interest that may arise in the placement of the Fund’s notes, preferred stock, other debt securities, and other forms of leverage by Santander Securities.

**Plan of Distribution; Conflicts of Interest**

Santander Securities, the parent company of SAM and an affiliate of the Fund, will offer the notes on behalf of the Fund and may purchase the notes in a principal capacity and use its best efforts to sell the notes on behalf of the Fund. The Fund may appoint other dealers from time to time. Santander Securities and each such other dealers may be paid a fee to be negotiated from time to time equal to a percentage of the principal amount of notes sold by such agent or dealer and may be reimbursed for certain out-of-pocket expenses incurred. The Fund may also sell notes directly to investors from time to time. The Fund will also indemnify Santander Securities and any other dealer against certain liabilities, including liabilities under the U.S. Securities Act of 1933, as amended. The offering of the notes by Santander Securities will be conducted in accordance with NASD Rule 2720 of the Financial Industry Regulatory Authority, Inc. regarding a member firm’s distribution of the securities of an affiliate. Please see the section below entitled “Plan of Distribution; Conflicts of Interest” for further details.

**Puerto Rico Income Taxation**

In the opinion of Pietrantoni Méndez & Alvarez LLP, counsel to the Fund, based on Regulation 6925 (the “Regulation”) promulgated under the Puerto Rico Internal Revenue Code of 1994, as amended (the “PR Code”), by the Puerto Rico Treasury Department, interest on the notes issued by the Fund received by an individual that is a resident of Puerto Rico or a corporation organized in Puerto Rico will be exempt from regular Puerto Rico income taxes to the extent that the total exempt income received or accrued (as of the date of the interest payment) by the Fund that has not been previously paid as exempt interest or exempt dividends equals or exceeds such interest payments. The alternative minimum tax liability of Puerto Rico corporations is not affected by the receipt or accrual of interest income on the notes. While the Puerto Rico Treasury Department has not issued its formal position, in the opinion of our counsel, interest on the notes issued by the Fund that is exempt from regular income taxes should also be exempt from the alternative minimum tax in the case of Puerto Rico resident individuals. See “Taxation” below.
THE NOTES

General

The notes will be issued by the Fund from time to time pursuant to the terms of an Amended and Restated Custodial, Pledge and Security Agreement (as amended from time to time, the “Security Agreement”) between the Fund, the First Puerto Rico Target Maturity Funds, and Banco Santander, as issuing, paying and transfer agent on behalf of the Fund and as collateral agent on behalf of the holders of the notes (in such capacity, the “Collateral Agent”). The notes may be issued as short-term notes or medium-term notes. The notes will be issued in registered form without coupons and in minimum denominations of $25,000 and increments of $1,000 thereafter. The Fund will be obligated to fully repay the original principal amount of its notes when due, whether at their maturity, upon earlier redemption or otherwise. The notes will be fully collateralized by the issuing Fund in an amount equal to their full outstanding principal amount. This offering circular includes a summary of certain provisions of the Security Agreement and is qualified in its entirety by reference to the actual provisions of the agreement. The Security Agreement may be inspected by noteholders during business hours and upon reasonable prior notice at the office of the Collateral Agent specified in the section entitled “The Collateral Agent” herein.

The Offering

The notes are being offered exclusively to individuals who have their principal residence in Puerto Rico and to entities that have their principal office and principal place of business in Puerto Rico (collectively, “Puerto Rico Residents”). All investors in the notes will be required to represent to the Fund that the above conditions are satisfied. A Puerto Rico Residency Representation Letter in the form of Appendix C attached to this offering circular must be delivered to a dealer by each investor or transferee of a note prior to its purchase or transfer and delivery of notes.

Limitations on Offerings and Transfer of Notes

The notes have not been registered under the U.S. Securities Act of 1933, as amended (the “Securities Act”), and the Fund has not been registered under the U.S. Investment Company Act of 1940. Consequently, the notes may only be sold, pledged, hypothecated or otherwise transferred exclusively to Puerto Rico Residents. All investors and transferees of the notes must deliver to a dealer a Puerto Rico Residency Representation Letter in the form of Appendix C to this offering circular. The dealers are contractually obligated to the Fund to obtain a signed Puerto Rico Residency Representation Letter in proper form. Any sale of the notes to an initial investor or subsequent transfer of the notes to a transferee who has not so provided such a letter or otherwise complied with such procedures as may be required by Santander Securities to establish Puerto Rico residency will be null and void (other than transfers required to be made by operation of law). Holders of the notes who cease to be Puerto Rico Residents will no longer have available the tax benefits that make a note an attractive investment, and such holders have an obligation to notify Santander Securities (or any other dealer for the notes appointed by the Fund), the Collateral Agent and the Fund immediately upon ceasing to be Puerto Rico Residents, to liquidate their investment in the notes as soon as it becomes economically feasible to do so, and to agree not to purchase more notes. Any investor who is not a Puerto Rico Resident as described above will not be considered a noteholder for any purpose.

Upon due presentment for registration of transfer of any note at the Collateral Agent’s principal office, subject to the restrictions set forth in the preceding paragraph, the Collateral Agent must authenticate and deliver in the name of the transferee or transferees a new note or notes of like tenor, of authorized denominations, bearing the same interest rate (if any), and for a like aggregate principal amount, unless otherwise provided for in the notes and corresponding pricing supplement. All notes presented for registration of transfer must be (i) duly endorsed or accompanied by a written instrument or instruments of transfer in form satisfactory to the Collateral Agent, and duly executed by the registered holder thereof or by the registered holder’s duly authorized attorney-in-fact, and (ii) accompanied by a duly executed Puerto Rico Residency Representation Letter from the purported transferee of such notes or, in the case of purchases through Santander Securities, in accordance with such other procedures as may be required by Santander Securities to establish Puerto Rico residency. Any holder desiring to transfer a note shall be required to indemnify the Fund and the Collateral Agent against any liability that may result if the transfer is not made in accordance with the provisions of the note and of the Security Agreement. Any such registration of transfer shall be without charge, except that the Collateral
Agent may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in relation thereto.

These restrictions shall remain in effect until such time, if any, as the Fund or its investment adviser shall determine, based on an opinion of counsel, that the restrictions are no longer necessary in order to preserve an exemption for the notes from the registration requirements of the Securities Act and for the Fund from the registration requirements of the U.S. Investment Company Act of 1940.

In certain offerings of notes, the Fund may require other representation letters, such as accredited investor representation letters, from potential investors in connection with their purchases of notes. Forms of any such representation letters, to the extent required by the Fund, will be included in the corresponding pricing supplement.

**Maturities**

The short term notes will be offered with maturities of up to 270 days from the date of issuance, and may include notes payable on demand. The medium term notes will be offered with maturities in excess of 270 days from the date of issuance. The maturity date and/or demand feature will be set forth on each note and corresponding pricing supplement delivered by the Fund in connection with the sale of its notes.

**Ratings**

Fitch Ratings is the sole nationally recognized statistical rating organization (a “rating agency”) currently rating the notes. The short-term notes of the Fund are rated “F1,” and its medium-term notes are rated “A.” See “Ratings” below and Appendix A for a description of such ratings. Fitch Ratings, as well as any other rating agency which may rate the notes in the future, are herein referred to collectively as the “rating agency.” The Fund has not been rated by Fitch Ratings.

**Interest Rate**

The notes may bear interest, if any, at a rate determined at the time of issuance of each note. The interest rate will be set forth on each note and corresponding pricing supplement delivered by the Fund in connection with the sale of its notes. The notes may bear interest at a fixed or floating rate, or at a rate determined by reference to an index, as determined at the time of issuance. The notes may also be issued at a discount with no stated rate of interest. The interest rate payable with respect to notes issued at the same time and having the same maturity, or the discount at which such notes are issued, may vary depending on the principal amount of the notes being issued. Notes issued in a greater principal amount may bear a higher rate of interest or may be sold at a greater discount than notes that are otherwise identical but that are issued in a lesser principal amount.

**Payment of Principal and Interest**

The principal of the notes will be paid by the Fund on their corresponding maturity date upon presentation and surrender by the registered holder or its duly authorized representative at the principal office of the Collateral Agent prior to 12:00 noon (Puerto Rico time), or as otherwise provided in the corresponding pricing supplement. If presentation occurs after 12:00 noon, payment will be made on the next succeeding business day. Payment will be made by check mailed or delivered to such holder, or by wire transfer of immediately available funds to the account designated by the holder, in the case of holders of at least $1,000,000 in principal amount of notes which are part of the same series. The term “business day” for this purposes means any day of the year, other than a Saturday or Sunday, on which commercial banks are open for business in San Juan, Puerto Rico and in New York, New York, or as may otherwise be defined in the corresponding pricing supplement.

Interest on the notes shall be paid by the Fund periodically or at maturity, as specified in the pricing supplement for a series of notes. Interest payable prior to the maturity of a note shall be paid to the investor who is the registered holder of such note on the date specified in the relevant note and corresponding pricing supplement. Interest payable at the maturity of a note shall be paid together with the principal of such note upon presentation and surrender of such note. In the case of notes sold with a stated interest rate, such interest shall be computed on the basis of a 360-day year of
twelve 30-day months and the actual number of days elapsed in any period of less than one month, unless otherwise specified in the note or in the corresponding pricing supplement.

Except as may be otherwise specified in a pricing supplement, whenever any payment on the notes shall be stated to be due on a day that is not a business day, such payment shall be made on the next succeeding business day, and with respect to payments of principal (but not with respect to payments of interest), such extension of time shall in such case be included in computing interest in connection with such payment.

Redemption

The short-term notes will not be subject to redemption prior to their stated maturity unless otherwise provided in the notes and corresponding pricing supplement. The medium-term notes may be redeemed prior to their stated maturity at the option of the Fund at such times and at such prices as is provided in the notes and corresponding pricing supplement.

Certain Covenants

In the Security Agreement, the Fund has covenanted with the Collateral Agent for the benefit of note holders, among other things, as follows:

Negative Pledge. The Fund will not create any lien or encumbrance on any of the securities owned by it other than (i) the liens created pursuant to the Security Agreement for the benefit of the holders of each series of notes and (ii) liens on securities (other than securities pledged pursuant to the Security Agreement) created in connection with reverse repurchase agreements and other borrowings by the Fund and in connection with hedging transactions.

Maximum Amount of Notes. The Fund may not issue notes of a series on any day if, after giving effect to such issuance and to any payment of notes of such series to be made on that day, the sum of (i) the aggregate principal amount of outstanding notes of such series on such day, plus (ii) the aggregate principal amount of other borrowings by the Fund, including borrowings resulting from the issuance of any other series of notes, preferred stock, and other forms of leverage, borrowings for temporary or emergency purposes and borrowings in the form of reverse repurchase agreements (such an amount the “Aggregate Borrowing Base”) exceeds an amount equal to 55% of the fair market value of the assets of the Fund on such day. In the case of certain zero-coupon or indexed notes in connection with which the Fund hedges its exposure, only the principal amount of such notes may be required to be included in such calculation. Any such hedges would be described in the corresponding pricing supplement. Under its investment policies, which may be changed by the Fund’s shareholders without the consent of the holders of its notes, the Fund may not issue preferred stock, debt securities and other forms of leverage that exceed 50% of the Fund’s total assets immediately after the issuance of such securities, provided that the Fund may also borrow for temporary or emergency purposes (but not for leverage) an amount not exceeding 5% of its total assets.

Timing of Maturities of Short-Term Notes. The Fund may not issue short-term notes in an aggregate principal amount exceeding 20% of the Aggregate Borrowing Base maturing within any period of five consecutive business days.

In addition, the Fund may undertake to comply with other covenants established by Fitch Ratings from time to time in order to satisfy its requirements for purposes of issuing or maintaining a rating on the notes.

Events of Default; Remedies

If (i) on any Cure Date (as defined below) the sum of the Discounted Value (as defined below) of the pledged collateral securing any series of notes issued by the Fund plus cash on deposit in the Liquidity Account (as defined below) is less than the Collateral Maintenance Amount (as defined below); (ii) certain events of bankruptcy or insolvency with respect to the Fund shall occur; or (iii) the Fund shall fail to pay interest on or the principal of any note of such series as it becomes due (each an “Event of Default”), then (A) the Fund may not issue any additional notes and (B) the Collateral Agent may exercise in respect of the collateral pledged to secure such series all the rights and remedies of a secured party under applicable law, including selling the pledged collateral in accordance with Puerto Rico law to the extent required to pay notes as they become due. The maturity of the notes is not subject to acceleration upon the
occurrence of an Event of Default. Holders of a majority in aggregate principal amount of the issued and outstanding notes of the affected series may waive any Event of Default and its consequences, other than a failure to pay interest on or the principal of any note. As used herein, Liquidity Account shall mean any segregated account maintained by the Fund with the Collateral Agent in the name of the Collateral Agent for the benefit of the holders of any single series of notes.

Amendment of the Security Agreement

The Security Agreement may be amended through an agreement between the Fund and the Collateral Agent, provided that no amendment may adversely affect the rights of holders of outstanding notes except as described under “Security for the Notes—Maintenance of Minimum Amount of Collateral.” The covenants described above (except the limitation on debt imposed by the Fund’s investment policies) are rating requirements of Fitch Ratings and are subject to change or elimination through the agreement of the rating agency and the Fund without notice to or the consent of any noteholder.

The Fund has agreed to indemnify the Collateral Agent with respect to certain liabilities incurred by it in connection with the performance of its duties under the Security Agreement.

SECURITY FOR THE NOTES

Pursuant to the Security Agreement, as a condition to the issuance of notes, the Fund must pledge and grant a security interest over certain eligible portfolio securities (defined below as the “Eligible Collateral”) maintained by the Fund to secure the payment of each series of its notes. Each pool of pledged collateral will secure only each series of notes issued by the Fund pledging such collateral and will not secure any other series of notes issued by the same Fund or by any other fund in the First Puerto Rico Family of Funds. Under the Security Agreement, the pledged collateral for each series of notes secures the prompt payment in full when due, whether at stated maturity, upon earlier redemption, by acceleration or otherwise, of the notes and all the obligations of the issuing Fund with the holders of its notes.

The notes are not deposits, savings accounts or other obligations of, or guaranteed by, Banco Santander Puerto Rico, its affiliates or any other depository institution, and are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Liquidity Account

The Fund also must maintain a separate Liquidity Account with the Collateral Agent, and deposit in this account the pledged Eligible Collateral (as defined below). The Collateral Agent may contract a custodian or sub-custodian to safeguard the pledged Eligible Collateral. The Collateral Agent shall always maintain the Eligible Collateral separate from all other securities and cash held by the Collateral Agent. Once the Fund makes a deposit of pledged Eligible Collateral into the Liquidity Account, the Fund shall retain ownership of the deposited pledged Eligible Collateral, but the Fund shall not have any further control over the deposited Eligible Collateral until the collateral is returned to the Fund, free of any pledge, by the Collateral Agent.

The Collateral Agent has engaged Citibank, N.A as custodian of the pledged Eligible Collateral deposited by the Fund into the Liquidity Account. Although the Collateral Agent currently intends to continue to employ Citibank, N.A.’s services, the Collateral Agent may replace Citibank N.A. without any notice to the noteholders.
Eligible Collateral

The collateral pledged by the Fund to secure its notes generally will consist of one or more of the following types of securities (the “Eligible Collateral”):

- **Cash**;
- Direct obligations of, and obligations fully guaranteed by, the U.S. Government (“U.S. Treasury Securities”);
- Direct obligations of, and obligations fully guaranteed by, any agency or instrumentality of the U.S. Government the obligations of which are backed by the full faith and credit of the United States of America, including Puerto Rico GNMA Certificates, direct obligations of the Federal Home Loan Banks (“FHLB”), and securities issued by the Student Loan Marketing Association (“Sallie Mae”) (the “U.S. Government Agency Securities”) (this category does not include CMOs, which are described below);
- Securities issued by a state of the United States of America and its political subdivisions, agencies and instrumentalities (“U.S. Municipal Obligations”);
- Mortgage-backed securities issued by the Federal National Mortgage Association (“Fannie Mae”) or guaranteed by the Government National Mortgage Association (“GNMA”) or the Federal Home Loan Mortgage Corporation (“Freddie Mac”) (this category does not include CMOs, which are described below) (the “U.S. Taxable MBS”);
- Securities issued by the Commonwealth of Puerto Rico and its political subdivisions, agencies and instrumentalities (the “Puerto Rico Municipal Obligations”);
- Securities (other than Puerto Rico GNMA Certificates and other mortgage-backed securities and U.S. Taxable MBS) representing interests in or collateralized by mortgages on residential real estate (the “Collateralized Mortgage Obligations” or “CMOs”);
- U.S. non-agency mortgage pass-through certificates;
- Short-term money market instruments rated “F1” or higher by the rating agency and with a term to maturity of 90 days or less;
- Capital stock of a class that is preferred as to the payment of dividends or as to the distribution of assets upon liquidation or dissolution over any other class of capital stock (“Preferred Stock”); and
- Any other securities acceptable to the rating agency.

Maintenance of Minimum Amount of Collateral

Pursuant to the Security Agreement, the Fund has covenanted that, so long as any of its notes are outstanding, the Discounted Value of the collateral pledged to secure the notes of the same series issued by the Fund will not be less than the “Collateral Maintenance Amount.” The Collateral Maintenance Amount is defined as (i) in the case of the medium-term notes, the principal amount of all outstanding medium-term notes of such series plus the amount of interest, if any, accrued or to accrue during the 90-day period following the date on a weekly basis on which the pledged collateral is valued (a “Valuation Date”) and unpaid on all such outstanding medium-term notes of such series and (ii) in the case of the short-term notes, the principal amount of all outstanding short-term notes of such series plus the amount of interest, if any, accrued or to accrue and unpaid on all such outstanding short-term notes of such series (assuming for this purpose that short-term notes payable on demand have a fixed maturity determined in accordance with guidelines established by the rating agency). In the case of certain zero-coupon or indexed notes in connection with which the Fund hedges its exposure, only the principal amount of such notes may be required to be included in such calculation. As a result, the
Collateral Maintenance Amount may not include accrued interest on such zero-coupon or indexed notes and, therefore, such accrued interest may not be secured by pledged collateral.

The “Discounted Value” of any item of Eligible Collateral is equal to its fair market value, as determined by the Fund in accordance with its customary valuation procedures described below, divided by a series of “Discount Factors.” The Discount Factors are established independently by Fitch Ratings in its sole discretion, and may be changed by Fitch Ratings at any time without any notice to noteholders. The Discount Factors are designed to take into consideration the relative credit risk, market risk and diversification risk of each type of security included as Eligible Collateral.

The Discount Factors employ several specific components: (i) an issuer-specific discount factor, (ii) a minimum overall discount factor, and (iii) an overall diversification factor. For a more complete discussion of the Discount Factors and the Fitch Ratings methodology for rating the Notes, please refer to Appendix B to this offering circular.

Short-term notes issued by the Fund are rated “F1” by Fitch, and, consistent with Fitch’s rating methodology, will employ the Discount Factors set forth in Appendix B that are associated with a rating of “A” under Fitch’s criteria for Puerto Rico Funds. Medium-term notes issued by the Fund are rated “A” by Fitch, and will employ the Discount Factors set forth in Appendix B that are associated with a rating of “A” under Fitch’s criteria for Puerto Rico Funds.

The Discount Factors, the securities that may be included as Eligible Collateral, and any other covenant required by the rating agency then rating the notes as part of its requirement to issue or maintain a rating on the notes may be changed at any time by agreement between the Fund and the rating agency then rating the notes.

In order to ensure compliance with this Collateral Maintenance Amount covenant, the Collateral Agent is required to determine on each Valuation Date whether the Discounted Value of the pledged collateral securing each series of notes issued by the Fund equals or exceeds the Collateral Maintenance Amount. In the event that the Collateral Agent determines that the Discounted Value of such pledged collateral is less than the Collateral Maintenance Amount, the Fund will be required, on or before the fifth business day after such Valuation Date, to deliver additional Eligible Collateral to the Collateral Agent or direct the Collateral Agent to sell pledged collateral previously delivered by the Fund and deposit the proceeds or any portion thereof with the Collateral Agent so as to cause the Discounted Value of such pledged collateral as of a date not later than such fifth business day (the “Cure Date”) to be equal to or greater than the Collateral Maintenance Amount.

In the event that on any Cure Date the Discounted Value of the pledged collateral securing a particular series of notes issued by the Fund is less than the Collateral Maintenance Amount applicable to that series, the Fund shall be prohibited from issuing any additional notes (unless and until it shall have received a letter from the rating agency confirming that such notes are rated within one of the two highest rating categories in the case of the short-term notes, or within one of the four highest rating categories in the case of the medium-term notes, by the rating agency and shall be required to liquidate pledged collateral as necessary to pay all outstanding notes of the relevant series as they become due. The maturity of the notes is not subject to acceleration under these or any other circumstances.

The assets of the Fund are valued by SAM in good faith and under the supervision of the Fund’s Board of Directors based upon market quotations when such quotations are available. Primarily because it may be an administrative inconvenience for dealers other than Santander Securities to provide SAM with market quotations, independent sources of valuation may be unavailable for a substantial portion of the Fund’s assets. When market quotations for securities held by the Fund are not readily available from any such independent dealers, SAM will attempt to obtain quotations from Santander Securities. When market quotations for the Fund’s assets are not available from any sources, including Santander Securities, they will be valued at fair value by or under the direction of the Fund’s Board of Directors utilizing quotations and other information concerning similar securities derived from recognized dealers in those securities or information regarding the trade spreads quoted by recognized dealers between such securities and U.S. Treasury Securities whose maturities are determined to be most closely matched to the average life of the Fund’s securities for which fair value is to be determined.

In determining net asset value, the Fund also may utilize the valuations of portfolio securities furnished by a pricing service approved by such Fund’s Board of Directors. The pricing service typically values portfolio securities at the bid price or the yield equivalent when quotations are readily available. Portfolio securities for which quotations are
not readily available are valued at fair market value on a consistent basis as determined by the pricing service using a matrix system to determine valuations. The procedures of the pricing service and its valuations will be reviewed by the officers of the Fund under the general supervision of the Fund’s Board of Directors. Prior to using a pricing service, the Board of Directors will determine in good faith that the use of a pricing service is a fair method of determining the valuation of portfolio securities. There can be no assurance that the Fund could purchase or sell a portfolio security at the price used to calculate the Fund’s net asset value, and the fair values of one or more assets may not, in retrospect, be the prices at which those assets could have been purchased or sold during the period in which the particular fair values were used in determining the Fund’s net asset value.

Notwithstanding the above, assets with maturities of 60 days or less generally will be valued at amortized cost if their original term to maturity was 60 days or less, or by amortizing the difference between their fair value as of the 61st day prior to maturity and their maturity value if their original term to maturity exceeded 60 days, unless in either case the Board of Directors or an authorized committee thereof determines that this does not represent fair value. The valuation in either case is based on information concerning market transactions and quotations from dealers which reflect the bid of the overall market on the pricing date.

Certain Puerto Rico obligations have a limited number of participants in the market and might not have a readily ascertainable market value and may have periods of illiquidity. In such case, such securities will be valued in accordance with procedures established by the Board of Directors of the Fund.

The market value of the Fund’s investments will depend on a variety of factors, including general municipal and fixed income security market conditions, the financial condition of the issuer, the size of the particular offering, the maturity, credit quality and rating of the issue and changes in and expectations regarding changes in interest rates and income tax rates.

**Substitution and Sale of Collateral**

The Fund may substitute collateral pledged to secure its outstanding notes with other Eligible Collateral and to direct the Collateral Agent to sell pledged collateral and deliver the proceeds of such sale to the Fund free and clear of the lien created under the Security Agreement, so long as the Discounted Value of the pledged collateral securing the affected series as of the immediately preceding Valuation Date or Cure Date is at least equal to the Collateral Maintenance Amount, after giving effect to such substitution or sale and to other substitutions and sales since the immediately preceding Valuation Date or Cure Date.

**USE OF PROCEEDS**

The proceeds of the sale of the notes, net of annual expenses and net of commissions as described under the “Plan of Distribution” section below, will be used by the Fund to invest in securities (including, among others, the refinancing of reverse repurchase agreements and other debt incurred to finance the Fund’s investment in securities) in accordance with the Fund’s investment objectives.

**RISK FACTORS**

The principal risks related to an investment in the notes are discussed below. The investment portfolio of the Fund may be harmed by the performance of the financial markets in the United States, Puerto Rico and other foreign countries. A number of factors, such as interest rates, inflation trends, fiscal policy and political changes may impact the performance of these financial markets. Since the value of the investments made by the Fund may fluctuate due to market conditions, the Fund may be unable to pay, at any given point in time, the principal and accrued interest on its outstanding notes. Prior to making any investment decision, investors are also encouraged to read and carefully consider the information contained in the prospectus for the Fund, particularly the information included in any such prospectus under the caption “Risk Factors and Special Considerations,” which provides a more detailed description of the risks related to the Fund. The notes may not be suitable for all investors. *Any of the risks described below may cause you to lose money.*
Liquidity and Trading of the Notes

The notes have not been registered under the Securities Act, and the Fund has not been registered under the U.S. Investment Company Act of 1940. Consequently, the notes may only be sold, pledged, hypothecated or otherwise transferred exclusively to Puerto Rico Residents. All investors and transferees of the notes must deliver to a dealer a Puerto Rico Residency Representation Letter in the form of Appendix C herein. The dealers are contractually obligated to the Fund to obtain a signed Puerto Rico Residency Representation Letter in proper form. Any sale of the notes to an initial investor or subsequent transfer of the notes to a transferee who has not so provided such a letter or otherwise complied with such procedures as may be required by Santander Securities to establish Puerto Rico residency will be null and void (other than transfers required to be made by operation of law). Holders of the notes who cease to be Puerto Rico Residents will no longer have available the tax benefits that make a note an attractive investment, and such holders have an obligation to notify Santander Securities (or any other dealer for the notes appointed by the Fund), the Collateral Agent and the Fund immediately upon ceasing to be Puerto Rico Residents, to liquidate their investment in the notes as soon as it becomes economically feasible to do so, and to agree not to purchase more notes.

There is currently no secondary market for the notes, and there is no assurance that a secondary market for the notes will develop in the future. The agents do not have any obligation to make a market in the notes, and any such activities, if commenced, may be discontinued at any time. The market price of the notes will be determined by such factors as relative demand for and supply of the notes in the market, general market and economic conditions and other factors beyond the control of the Fund. The Fund cannot predict whether the notes will trade at, below or above their stated principal amount. Investors in the notes should not view the notes as a vehicle for trading purposes.

Pledged Collateral; Bankruptcy

Although the notes are secured by the pledged collateral and the Fund believes that such pledged collateral will provide adequate security for the repayment of the notes, the Fund cannot guarantee the creditworthiness of any particular security comprising the pledged collateral or of the issuer of such securities. The actual and perceived creditworthiness of the Fund or such issuers will depend on several factors, such as general and issuer-specific economic conditions, which may be beyond the control of the Fund and may negatively affect the market value of the pledged collateral or the notes. In the event the Fund is unable to meet its obligations under its notes, including, without limitation, because the Fund has become insolvent or the subject of bankruptcy proceedings, noteholders may be materially and adversely affected if the pledged collateral is insufficient to pay all accrued principal and interest on any then-outstanding notes. The payment of such amounts may also be delayed for the duration of any insolvency, bankruptcy or other similar proceedings. Each note will be an obligation of the Fund only, and will not be an obligation of, or otherwise be guaranteed by, any other fund in the First Puerto Rico Family of Funds.

Changes to Conditions for Favorable Income Tax Treatment of Interest on Notes

The exemption from Puerto Rico income taxes afforded to interest income derived from an investment in the notes is subject to certain conditions more fully set forth in the PR Code and the Regulation (as each such term is defined below), including, without limitation, the operation of the Fund as an investment company in accordance with the laws of Puerto Rico. The Fund must generate exempt income in the same or greater amount than the interest payments to be paid on the notes (reduced by prior exempt interest and exempt dividend payments made by the Fund). In the event of the failure to comply with any of such conditions, interest income derived from an investment in the notes may be treated as taxable income for Puerto Rico income tax purposes.

Changes in Applicable Law

Legislation affecting the Fund, its assets, investment companies, taxes, and other matters related to the business of the Fund is continually being considered by the Legislature of Puerto Rico and the U.S. Congress. Moreover, the Office of the Commissioner of Financial Institutions has granted certain waivers and rulings to the Fund that do not constitute a precedent binding on the Office. There can be no assurance that legislation enacted or regulations promulgated, or other governmental actions (including the amendment or repeal of regulations and circular letters issued by the Puerto Rico Treasury Department) after the date of the initial issuance of the notes, will not have an adverse effect
on the operations of the Fund, the economic value of the notes of the Fund, or the tax consequences of the acquisition or the disposition of the notes.

**Special Risks of Leverage**

The Fund may increase amounts available for investment through the issuance of preferred stock, debt securities (such as debt instruments of varying maturities, including commercial paper and short-term and medium-term notes; such securities collectively referred to herein as the “debt securities”), and other forms of leverage (including reverse repurchase agreements), representing not more than 50% of the Fund’s total assets immediately after the issuance of such securities. These offerings will be made solely to Puerto Rico Residents. The Office of the Commissioner of Financial Institutions has restricted the Fund’s leveraging activities under the rulings issued to the Fund.

The Fund, subject to the 50% limitation, may also engage in certain additional borrowings from banks or other financial institutions, through reverse repurchase agreements. The Fund will engage in borrowings from, and other forms of leverage with, Santander Securities and Banco Santander or their affiliates through reverse repurchase agreements, dollar rolls, or otherwise upon the approval of and subject to procedures as established by the Fund’s Board of Directors, in order to address, among other things, the potential conflict of interest in setting interest or dividend rates. There is no assurance that the procedures will be effective. In addition to leverage, the Fund may also borrow an amount up to 5% of its total assets for temporary or emergency purposes. Such borrowings would create leverage and would entail speculative factors similar to those applicable to the issuance of debt securities and other forms of leverage. Investors are urged to read the information contained in the prospectus for the Fund under the caption “Risk Factors and Special Considerations of Leverage.”

**Special Risk Factors Relating to Investments by the Fund**

In addition to the special risks of leverage, an investment in the notes involves risks associated with the operation of the Fund, including the portfolio investments made by the Fund. Investors in the notes should keep in mind that the Fund issues its own notes and does not guarantee the obligations of any other fund in the First Puerto Rico Family of Funds. Certain risks related to the operation of the Fund are described below. Prior to making any investment decision, investors are also encouraged to read and carefully consider the information contained in the prospectus for the Fund, particularly the information included in such prospectus under the caption “Risk Factors and Special Considerations,” which provides a more detailed description of the risks related to the Fund.

**Terms and Rate Differences Between the Fund's Assets and the Notes.** There may be differences between the term, interest rate, and other characteristics of the notes and the portfolio securities acquired or financed with the proceeds of the notes. In addition, the Fund may issue preferred stock with characteristics that differ from the portfolio securities acquired or financed with the proceeds of the preferred stock. These differences may expose the Fund to interest rate, market, and other risks that may have an adverse impact on the Fund and its noteholders.

**Issuer Concentration.** Under normal market conditions, the Fund intends to invest at least 67% of its total assets in Puerto Rico securities. Therefore, the Fund will be more susceptible to factors adversely affecting issuers of Puerto Rico securities than an investment company that is not concentrated in Puerto Rico securities to this degree. This makes the Fund more susceptible to economic, political, or regulatory occurrences in Puerto Rico than a geographically diversified fund. There presently are a limited number of participants in the market for certain Puerto Rico securities. In addition, certain Puerto Rico securities may have periods of illiquidity. These factors may affect the Fund’s ability to acquire or dispose of Puerto Rico securities, as well as the price paid or received upon acquisition or disposition. In addition, investment by the Fund in Puerto Rico securities is subject to their availability in the open market.

**Non-Diversification of Assets.** Pursuant to certain rulings issued by the Office of the Commissioner of Financial Institutions to the Fund, the Fund may invest more than 25% of its total assets in Puerto Rico securities and U.S. Government obligations, in each case in excess of the 25% limitation for an investment in a single issuer imposed by the Puerto Rico Investment Companies Act. The Fund may not hold more than 75% of the voting securities of any single issuer. To the extent that the Fund assumes large positions in the securities of a small number of issuers, the Fund’s net asset value and its yield may fluctuate to a greater extent than that of a diversified company as a result of changes in the financial condition or in the market’s assessment of the issuers. In addition, from time to time, the Fund may also invest...
in securities of issuers with which an investment adviser or the agent have a lending or other type of business relationship.

*Fixed-Income Securities Generally.* The yield on Puerto Rico securities and other fixed-income securities depends on a variety of factors, including general municipal and fixed-income security market conditions, the financial condition of the issuer, the size of the particular offering, the maturity, credit quality and rating of the issue and expectations regarding changes in income tax rates. Generally, the longer the maturity of a fixed income security, the higher the yield and the greater the volatility will be. The market value of fixed-income securities, and accordingly, the Fund’s net asset value, normally will vary inversely with changes in interest rates. Such changes in the values of Puerto Rico securities held by the Fund will not affect the interest income derived from them but will affect the Fund’s net asset value. The specific terms and conditions of certain types of securities may also make them more sensitive to changes in interest rates.

The obligations of certain issuers of Puerto Rico securities are subject to the provisions of bankruptcy, insolvency and other similar kinds of laws affecting the rights and remedies of creditors. In the event of a bankruptcy of such an issuer, the Fund could experience delays and limitations with respect to the collection of principal and interest on such Puerto Rico securities, and in some circumstances, the Fund might not be able to collect all principal and interest to which it is entitled. To enforce its rights in the event of a default in the payment of interest or repayment of principal, or both, the Fund might take possession of and manage the assets or have a receiver appointed to collect and disburse pledged revenues securing the issuer’s obligations on such securities; any such action could increase the Fund’s operating expenses and may adversely affect the Fund’s ability to make payment on the notes.

*Municipal Obligations.* The Fund may invest in municipal obligations that have their own risks. The value of certain municipal obligations, including derivative instruments, such as certain zero-coupon obligations and certain inverse floating rate obligations, may be subject to greater volatility than other municipal securities. Specifically, whether such instruments are used for derivative or income enhancement purposes, there can be no assurance that such transactions will be successful or will not result in losses (and those losses may exceed the percentage of the Fund’s assets actually invested in such instruments).

Certain municipal obligations held by the Fund may permit the issuer to call or redeem the municipal obligations, in whole or in part, at its option. If an issuer were to redeem municipal obligations held by the Fund during a time of declining interest rates, the Fund might realize capital gains or losses at a time that it would not otherwise do so, and the Fund might not be able to reinvest the proceeds of the redemption in municipal obligations providing as high a level of income as the municipal obligations that were redeemed. The Fund, however, may purchase an issuer’s right to call all or a portion of such municipal obligations for mandatory tender for purchase.

Opinions relating to the validity of municipal obligations and to the exemption of interest thereon from Puerto Rico income tax are rendered by bond counsel to the issuer at the time of issuance. Neither the Fund nor the investment adviser will review the proceedings relating to the issuance of municipal obligations or the basis for such opinions. Further, U.S. and Puerto Rico laws may be enacted that adversely affect the tax-exempt status of interest on municipal obligations or of the exempt-interest payable on the notes or that impose other constraints upon enforcement of such obligations. It is also possible that, as a result of litigation or other conditions, the power or ability of issuers to meet their obligations for the payment of principal of and interest on their municipal obligations may be materially and adversely affected.

*Mortgage-Backed Securities.* Mortgage-backed securities, in general, have many of the same risks of traditional fixed-income securities discussed above but also differ in that, among other things, principal may be prepaid at any time due to prepayments by the obligors on the underlying loans or other obligations. Prepayments might result in reinvestment of the proceeds of such prepayments at yields that are lower than the yield on prepaid securities. Prepayments are influenced by a variety of economic, geographic, demographic and other factors. Generally, however, prepayments will increase during periods of declining interest rates and decrease during periods of rising interest rates. Because a substantial portion of Puerto Rico securities available are mortgage-backed securities, the potential for increasing the Fund’s exposure to these and other risks related to such securities might cause the market value of the Fund’s securities to fluctuate more than otherwise would be the case. In case of private label mortgage-backed securities (as defined below), there is also, among other things, (i) credit risk exposure regarding the underlying obligations and,
depending on how the securitization has been structured, exposure to the bankruptcy or insolvency of the entity that originated or sold the underlying obligations, (ii) the risk that underlying obligations may be unenforceable or may expose the securitization vehicle to liability because it was not originated or serviced in accordance with applicable consumer protection laws, (iii) exposure to downturns in the real estate market, which will affect the amount of foreclosure proceeds that can be realized in respect of defaulted mortgage loans, and (iv) if the structure contains third-party credit enhancement or derivative instruments, credit exposure to the provider thereof. CMOs present certain special risks. CMO classes may be specially structured in a manner that provides any of a wide variety of investment characteristics, such as yield, effective maturity and interest rate sensitivity. As market conditions change, however, and particularly during periods of rapid or unanticipated changes in market interest rates, the attractiveness of the CMO classes and the ability of the structure to provide the anticipated investment characteristics may be significantly reduced. These changes can result in volatility in the market value, and in some instances reduced liquidity, of the CMO class.

The types of mortgage-backed securities in which the Fund may invest are described in Appendix A to the prospectus for the Fund. One such type of security is PAC Bonds. PAC Bonds are a particular type of mortgage-backed security designed to provide relatively predictable payments of principal provided that, among other things, the actual prepayment experience on the underlying mortgage loans falls within a contemplated range. If the actual prepayment experience on the underlying mortgage loans is at a rate faster or slower than the contemplated range, or if derivations from other assumptions occur, principal payments on a PAC Bond may be greater or smaller than predicted. The magnitude of the contemplated range varies from one PAC Bond to another; a narrower range increases the risk that prepayments will be greater or smaller than contemplated.

Value of Fund Assets; Illiquid Securities. The Fund’s assets are valued by SAM, as the Fund’s administrator, in good faith and under the supervision of the Board of Directors based upon market quotations when such quotations are available. Primarily because it may be an administrative inconvenience for dealers other than Santander Securities to provide market quotations, independent sources of valuation may be unavailable for a substantial majority of the Fund’s assets. When market quotations for securities held by the Fund are not readily available from any such independent dealers, SAM will attempt to obtain quotations from Santander Securities. When market quotations for the Fund’s assets are not available from any sources, including Santander Securities, they will be valued at fair value by or under the direction of its Board of Directors utilizing quotations and other information concerning similar securities derived from recognized dealers in those securities or information regarding the trade spreads quoted by recognized dealers between such securities and U.S. treasury securities whose maturities are determined to be most closely matched to the average life of the Fund’s securities for which fair value is to be determined.

There are no limitations on the Fund’s investments in illiquid Puerto Rico securities. The Fund may also continue to hold without limitation any securities that become illiquid subsequent to the Fund’s investment in them. Consequently, a majority of the Fund’s assets may consist of illiquid Puerto Rico securities. Illiquid Puerto Rico securities may include securities specifically structured by affiliates of the Fund or others as an investment for the Fund. The term “illiquid securities” means securities that cannot be disposed of within seven days in the ordinary course of business at approximately the amount at which the Fund has valued the securities and includes, among other things, securities subject to contractual restrictions on resale that hinder the marketability of the securities. To the extent the Fund invests in illiquid securities, it may not be able to liquidate readily such investments and would have to sell other investments if necessary to raise cash to meet its obligations, even when it may not be advantageous to do so. Moreover, depending on the level of the Fund’s investment in illiquid securities, the Fund may be unable to meet its obligations, which could have additional adverse consequences to the Fund and its shareholders. Illiquid securities may also include certain of the derivative instruments in which the Fund may invest. It may become difficult to dispose of such instruments particularly at a time when it is advisable to do so to minimize losses to the Fund. The Fund does not intend to invest in illiquid securities other than illiquid Puerto Rico securities.

Transactions with Affiliates; Conflicts of Interest. The Fund is not registered under the U.S. Investment Company Act of 1940 and is not subject to the restrictions contained therein regarding transactions between the Fund and its affiliates. The Fund is an affiliate of the investment adviser, Santander Securities Corporation, Banco Santander Puerto Rico and their respective affiliates. Furthermore, certain directors and officers of the Fund are also employees, officers or directors of the investment adviser, Santander Securities and/or their respective affiliates. The Fund may enter into various types of transactions with affiliated parties as described in their related prospectus. Although all transactions with affiliates are subject to procedures adopted by the Board of Directors of the Fund, including the independent
directors of the Board, there is no assurance that the procedures will be effective in addressing potential conflicts of interest. Please read the section “Portfolio Transactions—Transactions Involving Affiliates” in the prospectus of the Fund for a more detailed description of procedures adopted by the Fund related to transactions involving affiliates of the Fund.

**Derivatives: Hedging Strategies and Counterparties’ Risk.** The Fund may invest in derivatives on a limited basis. Derivatives may adversely affect the performance of the Fund because they are volatile investments. Even when such derivatives are used for hedging purposes, there can be no assurance that the hedging transactions will be successful or will not result in losses, including losses exceeding the percentage of the Fund’s assets actually invested in such instruments.

The Fund may use a variety of derivative instruments including securities options, financial future contracts, options on future contracts and engage in other interest rate protection transactions such as swap agreements, to attempt to hedge its portfolio of assets and enhance its returns. Successful use of most derivative instruments depends upon the investment adviser’s ability to predict movements of the overall securities and interest rate markets.

The Fund may engage in swap and other financial transactions directly with other counterparties. Transactions with counterparties, as opposed to transactions made through exchange markets, subject the Fund to the risk that the counterparty may default on its obligations to the Fund.

**THE FUND**

**General**

The Fund is a continuously offered, non-diversified, open-end management investment company. The Fund is a corporation incorporated and organized under the laws of Puerto Rico and operates as a registered investment company under the Puerto Rico Investment Companies Act, and the rulings issued by the Office of the Commissioner of Financial Institutions. The principal offices of the Fund is located at Santander Tower, Suite 1800, Tabonuco Street B-7, Guaynabo, Puerto Rico 00968-3028, and its telephone number is (787) 759-5340.

Please examine carefully the prospectus of the Fund for a description of the capital stock, investment objectives, principal investment strategies, investment restrictions and other investment policies and practices of each Fund. In addition, investors are also encouraged to review the information provided in such prospectus related to the management of the Fund.

**Investment Adviser**

Santander Asset Management Corporation is the investment adviser of the Fund. SAM is a wholly owned subsidiary of Santander Securities. SAM provides investment advisory services to the Fund under an investment advisory agreement with the Fund, subject to the control of the Board of Directors and the officers of the Fund. SAM is responsible for choosing the Fund’s investments and handling its business affairs. SAM offers a wide range of money management and investment services to individuals and institutional clients in Puerto Rico. SAM also serves as investment adviser to each of the other funds in the First Puerto Rico Family of Funds. The principal office of the investment adviser is located at Santander Tower, Suite 1800, Tabonuco Street B-7, Guaynabo, Puerto Rico 00968-3028.

The Fund pays the investment adviser a monthly fee at an annual rate based on the average weekly net assets of the Fund as provided in the Fund’s prospectus for the investment advisory services rendered to the Fund.

Unless earlier terminated as described below, the investment advisory agreement between SAM and the Fund is for an initial term of two years from the date of execution and will remain in effect from year to year thereafter, if approved annually (a) by the Board of Directors of the Fund or by a majority of the outstanding shares of the Fund and (b) by a majority of the Directors who are independent members of the Board of Directors. The investment advisory agreements are not assignable and may be terminated without penalty (i) on 60 days’ written notice at the option of either party thereto or by the vote of a majority of the outstanding shares of common stock of the Fund or (ii) at any time by an unanimous vote of the independent members of the Board of Directors.
The investment adviser, its affiliates performing services for the Fund under an investment advisory agreement, and the directors, officers and employees of the investment adviser and such affiliates, shall not be liable for any error of judgment or mistake of law or for any loss arising out of any investment or for any act or omission in the management of the Fund, except for willful misfeasance, bad faith, gross negligence in the performance of their duties, or by reason of reckless disregard of their obligations and duties under the investment advisory agreement.

Administrator

Under the terms of an administration agreements with the Fund, SAM, as administrator, performs, or arranges for the performance of, certain administrative services (not related to investment advice and portfolio activities) necessary for the operation of the Fund. These administrative services include, among other things, providing facilities and personnel to the Fund in the performance of certain services including the weekly determination of the net asset value per share of common stock of the Fund, maintaining and preserving the books and records of the Fund, assisting in the preparation and filing of the Fund’s income tax returns, payment of the Fund’s expenses, assisting in the preparation, printing and dissemination of reports and other communications to shareholders and providing regulatory compliance services. SAM also serves as administrator to each of the other funds in the First Puerto Rico Family of Funds.

For the administrative services rendered by SAM to the Fund, the Fund pays SAM a monthly fee at an annual rate based on the average weekly net assets of the Fund, as provided in the Fund’s prospectus, plus out-of-pocket costs for services such as custody services and fund accounting services.

As set forth in the Fund’s prospectus, SAM as administrator and the Fund may enter into sub-administration agreements with other entities for the provision of certain sub-administrative and sub-accounting services to the Fund.

Transfer Agent

Pursuant to a transfer agency agreement with the Fund, Banco Santander, as transfer agent (in such capacity, the “Transfer Agent”), is responsible for the issuance and transfer of shares of common stock and the opening and maintenance of shareholder accounts. For the services rendered by the Transfer Agent to the Fund, the Fund pays the Transfer Agent a monthly fee at an annual rate based on the average weekly net assets of the Fund, as provided in the Fund’s prospectus, plus out of pocket costs for services rendered to the Fund. Banco Santander also serves as transfer agent to each of the other funds in the First Puerto Rico Family of Funds.

The Transfer Agent and the Fund have engaged PNC Global Investment Servicing Inc. (“PNC GIS”), formerly known as PFPC Inc., to act as sub-transfer agent for the Fund. The Fund, in consideration for the services provided by PNC GIS, pays PNC GIS certain fees and reimburses the sub-transfer agent for its out-of-pocket expenses incurred on behalf of the Fund. PNC GIS is a subsidiary of The PNC Financial Services Group Inc. (“PNC”).

On February 1, 2010, PNC and Bank of New York Mellon Corporation (“BNY Mellon”) entered into a definitive agreement for BNY Mellon to acquire PNC GIS. PNC and BNY Mellon have announced that they expect to close this transaction during the third quarter of 2010. The Fund does not expect this transaction to affect the services rendered by PNC GIS to the Fund.

Custodian

Citibank, N.A., as custodian, is responsible for the custody of the securities and cash of the Fund. The Fund pays fees to the custodian and reimburses its expenses. Citibank, N.A also serves as custodian for the assets of each of the other funds in the First Puerto Rico Family of Funds, with the exception of First Puerto Rico Strategic Growth Fund, for which it serves as a sub-custodian. Citibank, N.A. is a national banking association with principal offices located at 111 Wall Street, New York, New York 10005.
TAXATION

This section is not to be construed as a substitute for careful tax planning. Prospective investors are urged to consult their own tax advisors with specific reference to their own tax situations, including the application and effect of other tax laws and any possible changes in the tax law after the date of this offering circular.

In the opinion of Pietrantoni Méndez & Alvarez LLP, counsel to the Fund, based on Regulation 6925 (the “Regulation”) promulgated under the Puerto Rico Internal Revenue Code of 1994, as amended (the “PR Code”) interest on the notes issued by the Fund received by an individual who is a resident of Puerto Rico or a corporation organized in Puerto Rico will be exempt from regular Puerto Rico income taxes to the extent that the total exempt income received or accrued (as of the date of the interest payment) by the Fund which has not been previously paid as exempt interest or exempt dividends equals or exceeds such interest payments.

Puerto Rico resident individuals are subject to alternative minimum tax if their regular tax liability is less than the alternative minimum tax liability. The alternative minimum tax rates range from 10% to 20% depending on the alternative minimum tax net income. The alternative minimum tax net income includes the individual’s net income subject to regular income tax rates, income subject to special tax rates as provided in the PR Code and certain income exempt from the regular income tax, such as interest income derived on the notes that are designated as taxable income by the Fund and long-term capital gains recognized on the disposition of the notes.

While the Puerto Rico Treasury Department has not issued its formal position, in the opinion counsel to the Fund, interest on the notes issued by the Fund that is exempt from regular income taxes should also be exempt from the alternative minimum tax in the case of Puerto Rico resident individuals. The alternative minimum tax liability of Puerto Rico corporations is not affected by the receipt or accrual of interest income on the notes.

The opinions described above are based in part upon representations made by the Fund in the Security Agreement to the effect that the Fund will comply with the requirements imposed by Section 1361 of the PR Code and the Regulation.

Puerto Rico tax law does not provide any rules with respect to the treatment afforded to the difference between the “principal” amount due at maturity of a note and its initial offering price to the public. Under the U.S. Internal Revenue Code of 1986, as amended (the “U.S. Code”), this difference is considered “original issue discount” and is treated as interest. Under current Puerto Rico administrative practice, original issue discount is also treated as interest.

These opinions represent the best judgment of Pietrantoni Méndez & Alvarez LLP as to the probable outcome of the tax issues discussed and are not binding on the Puerto Rico Treasury Department. No assurance can be given that the Puerto Rico Treasury Department will not challenge these conclusions and prevail in the courts in such a manner as to cause adverse tax consequences to some or all of the holders of notes. The opinions described above are based on the documents described herein and certain information and representations provided by the Fund and the investment adviser. Any alteration of such information or representations may affect such opinions.

The opinions described above are based upon the PR Code and the Regulation, any of which could be changed at any time. Any such changes may be retroactive and could significantly modify the statements and such opinions.

Other than as stated above, no opinion is being given as to the tax consequences of an investment in the notes, and no opinion is being given as to the tax consequences under the U.S. Code of an investment in the notes. Investors are directed also to read and consider any discussion contained in the pricing supplements related to specific tax considerations that may be applicable to particular series of notes and that may modify or supplement the opinions set forth in this section as of the date of any such pricing supplement.

RATINGS

Fitch Ratings has rated the notes. The short-term notes of the Fund are rated “F1,” and its medium-term notes are rated “A.” There is no assurance that the rating given to the notes will remain in effect for any given period or that it will not be revised downward or withdrawn entirely by Fitch Ratings if, in its sole judgment, circumstances so warrant. Any
such revision or withdrawal may have an adverse effect on the market price of the notes. The ratings given to the notes reflect only the views of Fitch Ratings. Any explanation of the significance of such rating may be obtained only from Fitch Ratings at One State Street Plaza, New York, New York 10004 and from the website maintained and updated from time to time by Fitch Ratings which is currently at http://www.fitchratings.com. The ratings do not constitute a recommendation to buy, sell or hold the notes. Fitch Ratings was provided with materials relating to the Fund, the notes and other relevant information, and no application has been made to any other rating agency for purposes of obtaining a rating on the notes. However, other rating agencies could decide to rate the notes. In such event, no assurance can be given as to what rating any such rating agency would assign to the notes. The Fund has not been rated by Fitch Ratings.

**PLAN OF DISTRIBUTION; CONFLICTS OF INTEREST**

Santander Securities will offer the notes on behalf of the Fund and will purchase the notes, as principal, from the Fund, for resale to investors at varying prices relating to prevailing market prices at the time of resale as determined by the Fund and the applicable agent, or, if so specified in a pricing supplement, for resale at a fixed public offering price. The Fund may appoint other dealers for the notes from time to time. Unless otherwise specified in any applicable pricing supplement, any note sold to an agent as principal will be purchased by the agent at a price equal to 100% of the principal amount of the note less a percentage of the principal amount equal to the commission applicable to an agency sale as described below of a note of identical maturity. If agreed to by the Fund and an agent, the agent may utilize its reasonable efforts on an agency basis to solicit offers to purchase the notes at 100% of the principal amount of the notes, unless otherwise specified in an applicable pricing supplement. The Fund will also pay a commission to each agent, as agreed upon by the Fund and each agent at the time of sale, with respect to notes sold through that agent. The agents may also be reimbursed for certain out-of-pocket expenses incurred in connection with the sale of the notes. The Fund may also sell notes directly to investors from time to time.

The Fund has also agreed to pay Santander Securities a program fee equal to 0.125% of the principal amount of notes issued by the Fund with maturities exceeding one year and of 0.0625% of the principal amount of notes issued by the Fund with maturities of one year. No fee is due to Santander Securities for notes issued by the Fund with maturities of less than one year. The program fee is compensation to Santander Securities for structuring services and expenses related to the preparation of program documents and related sales presentations.

The agents may sell notes they have purchased from the Fund as principal to other dealers for resale to investors, and may allow any portion of the discount received in connection with such purchasers from the Fund to such dealers. After the initial public offering of notes, the concession and the discount allowed to dealers may be changed.

The Fund reserve the right to withdraw, cancel or modify the offer made by this offering circular without notice and may reject orders, in whole or in part, whether placed directly with the Fund or through an agent. Each agent will have the right, in its discretion reasonably exercised, to reject in whole or in part any offer to purchase notes received by the agent.

Unless otherwise specified in an applicable pricing supplement, payment of the purchase price of the notes will be required to be made in immediately available funds in U.S. dollars in San Juan, Puerto Rico on the date of settlement.

The notes will not have an established trading market when issued. The Fund will not list the notes on any securities exchange. The agents may from time to time purchase and sell notes in the secondary market, both for clients as well as for their own account. The agents are not obligated to make a market in the notes and any such market making may be discontinued at any time at the sole discretion of the agents. Accordingly, no assurance can be given as to the liquidity of, or trading markets for, the notes.

The agents may be deemed to be “underwriters” within the meaning of the Securities Act of 1933. The Fund has agreed to indemnify the agents against or to make contributions relating to certain civil liabilities, including under the Securities Act, or to contribute to payments the agents may be required to make in respect thereof. The Fund also may agree to reimburse the agents for certain expenses.

In connection with the offering of notes purchased by the agents as principal on a fixed price basis, the agents are permitted to engage in certain transactions that stabilize the price of the notes. These transactions may consist of bids
or purchases for the purpose of pegging, fixing or maintaining the price of the notes. If the agents sell notes in an aggregate principal amount exceeding that set forth in the applicable pricing supplement and create a short position, the agents may reduce that short position by purchasing notes in the open market. In general, purchases of notes for the purpose of stabilization or to reduce a short position could cause the price of the notes to be higher than in the absence of these purchases.

The Fund or the agents do not make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the notes. In addition, the Fund or the agents do not make any representation that the agent will engage in any such transactions or that such transactions, once commenced, will not be discontinued without notice.

Santander Securities is the parent company of the investment adviser for the Fund. Santander Securities will conduct the offerings of the notes in compliance with the requirements of NASD Rule 2720 of the Financial Industry Regulatory Authority, Inc., which is commonly referred to as FINRA, regarding a FINRA member firm’s distribution of the securities of an affiliate. In accordance with NASD Rule 2720, Santander Securities or any of our other affiliates may not make sales in those offerings to any discretionary account without the prior written approval of the customer.

THE COLLATERAL AGENT

Banco Santander will act as issuing, paying and transfer agent and registrar on behalf of the Fund, and as the collateral agent on behalf of the holders of the notes, pursuant to the Security Agreement. Banco Santander is the second-largest banking institution in Puerto Rico. Banco Santander is a wholly owned subsidiary of Santander BanCorp, a diversified financial holding company, and is an affiliate of Santander Securities and SAM. The principal offices of Banco Santander are located at Santander Tower, 207 Ponce de León Avenue, San Juan, Puerto Rico 00918.

The Fund will pay the Collateral Agent a fee to be negotiated from time to time in connection with its services under the Security Agreement. In addition, the Fund has agreed to indemnify Banco Santander against any liabilities and expenses arising out of the performance of its obligations under the Security Agreement, except those involving the negligence or misconduct of Banco Santander. Banco Santander is not acting as a trustee on behalf of noteholders, and may resign at any time by giving written notice to the Fund.

LEGAL OPINIONS

Certain legal matters relating to the issuance of the notes will be passed upon by Pietrantoni Méndez & Alvarez LLP, San Juan, Puerto Rico, counsel to the Fund.

FUND PROSPECTUS AND ANNUAL REPORT

Any Fund offering its notes under this offering circular and a corresponding pricing supplement must also deliver to investors in the notes the most recent prospectus of the Fund and its most recent annual report containing the audited financial information of the Fund. No offer of the notes may be made to a prospective investor without delivery of this information about the Fund. You should read such prospectus and annual report before deciding to invest in any notes issued by the Fund.
APPENDIX A

DESCRIPTION OF RATINGS

The short-term notes have been rated ‘F1’ and the medium-term notes have been rated ‘A’ by Fitch Ratings. ‘F1’ is the highest investment grade rating category for short-term debt, while ‘A’ is the third-highest investment grade rating category for long-term debt.

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

Description of Fitch Ratings International Short-Term Credit Ratings

F1

Highest Credit Quality. Indicates the strongest intrinsic capacity for timely payment financial commitments; may have an added “+” to denote any exceptionally strong credit feature.

Description of Fitch Ratings International Long-Term Credit Ratings

A

High credit quality. ‘A’ ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.

“+” or “−” may be appended to a rating to denote relative status within major rating categories. Such suffixes are not added to the ‘AAA’ category or to categories below ‘B.’
APPENDIX B

FITCH RATINGS METHODOLOGY

[COMMENCES ON NEXT PAGE]
Sector-Specific Criteria

Puerto Rico Closed-End Fund Debt and Preferred Stock Rating Criteria

Summary

This report outlines Fitch Ratings’ criteria for rating debt and preferred stock issued by closed-end funds (CEFs) organized in the U.S. commonwealth of Puerto Rico (PR) and regulated by the Investment Company Act of Puerto Rico (the PR Act). This is a subsector criteria report and should be read in conjunction with the master rating criteria report titled “Closed-End Fund Debt and Preferred Stock Rating Criteria,” dated Aug. 17, 2009 (CEF master criteria) and available on Fitch’s Web site at www.fitchratings.com.

This criteria report identifies those additional or unique factors considered when assigning ratings to debt and preferred stock issued by PR CEFs, which are not specifically addressed in the CEF master criteria. Not all rating factors in these criteria may apply to every rating action. Each specific rating action commentary or rating report will discuss those factors most relevant to the individual rating action and highlight deviations from published criteria, if any.

Fitch does not advise issuers on how to structure transactions or whether a given rating level is desirable. Rather, Fitch strives to publish transparent criteria that investors and issuers can understand and evaluate. Similar to U.S. CEFs, Fitch will evaluate PR CEFs’ investment parameters, leverage restrictions, and structural protections in the form of deleveraging/liquidation triggers relative to published criteria.

Criteria Highlights

The key components of Fitch’s updated rating criteria for debt and preferred stock issued by PR CEFs are discussed below.

- **Applicability of the Master CEF Criteria:** Except as identified in this subsector criteria report, Fitch continues to apply all elements of the CEF master criteria in rating debt and preferred stock issued by PR CEFs.

- **Regulatory and Structural Differences Exist for PR CEFs:** PR CEFs have unique regulatory and structural features that differ from the way U.S. CEFs are regulated and operate. Notably, regulatory limits on leverage for PR CEFs apply at the overall fund level, whereas debt and preferred stock issued at the sub-account level may operate at higher levels of leverage. Fitch considers these unique attributes when assigning ratings to debt and preferred stock issued by PR CEFs.

- **Minimum Overall Discount Factors Supplement Asset-Specific Discount Factors:** Fitch’s criteria consider whether minimum overall discount factors are in place at the collateral sub-account level to supplement existing asset-specific discount factors. The presence of minimum overall discount factors at the sub-account level is important due to the lack of regulatory leverage limits at that level and uncertainty of the quality and quantity of unencumbered assets in the overall fund.

- **Diversification Framework:** Fitch has expanded its diversification framework for PR CEFs to recognize market demand for debt and preferred stock at lower ratings levels. Specifically, Fitch’s criteria recognize increased exposure concentrations to state-level general obligation bonds issued by a single state at lower rating levels for purposes of calculating the amount of overcollateralization (OC) available to support-rated liabilities.
Consideration of Overall Market Supply-Demand Dynamics Relative to Size of PR CEFs: Given the current supply-demand dynamics for PR municipal issuers, relative to the current size and portfolio composition of PR CEFs, Fitch believes it may be difficult for PR CEFs to achieve ‘AAA’ ratings on issued debt and preferred stock. This reflects potential concerns related to the size of funds/investors with similar investment strategies and market value-based deleveraging mechanisms relative to the overall market for assets in which they invest.

Scope
This criteria report applies to debt and preferred stock obligations issued by leveraged CEFs registered under the PR Act. This subsector criteria report describes the similarities and differences of PR CEFs’ regulatory and structural features, compared with U.S. CEFs registered under the 1940 Investment Company Act (the 1940 Act).

Limitations
This subsector criteria report applies specifically to PR CEFs, taking into consideration the funds’ unique regulatory framework, structural features, and asset holdings. The criteria do not necessarily apply to other regulated or unregulated market value structures, although Fitch may consider similarities with PR CEFs when rating other market value structures. For more information on Fitch’s rating considerations when rating market value structures other than U.S. and PR CEFs, see the criteria report titled “Rating Market Value Structures,” dated March 26, 2010. Evolutions in the regulatory framework or asset holdings for PR CEFs, as well as the supply-demand dynamics for assets held by PR CEFs, may lead Fitch to revise its criteria and ratings.

In terms of the ratings assigned to debt and preferred stock issued by PR CEFs, Fitch relies on portfolio data, asset-level market values, and other relevant information received from the fund investment manager and/or its agents. In relying on such information, Fitch will make a judgment as to whether the data are sufficiently robust to assign or maintain a rating. The ongoing maintenance of a rating may also depend on the timeliness and accuracy of surveillance information supplied.

Ratings Assigned to Securities Issued by PR CEFs
Fitch assigns long-term credit ratings to note and preferred stock programs with original maturities greater than 270 days and short-term credit ratings to note programs with original maturities of up to 270 days, consistent with market convention as it relates to PR CEF debt issues. The credit ratings address the likelihood of full and timely payment of interest or dividends, if any, on each payment date and principal upon optional or mandatory redemption or at maturity, for all securities. Ratings assigned to PR CEF debt and preferred issues are based on the following considerations:

- **Structural Mechanisms**: OC triggers based on market values, mandatory redemption parameters, and other structural protections for rated debt and preferred stock obligations.
- **Collateral**: Asset coverage based on the current discounted market value of underlying assets.
- **Investment Portfolio**: Evaluation of assets supporting the rated liabilities with a focus on the potential market value loss under appropriate rating stress scenarios.
- **Investment Manager Review**: Qualitative assessment of the funds’ investment manager.
- **Regulatory and Legal Considerations**: Regulatory framework and integrity of the legal structure.
Regulatory Framework: Investment Company Act of Puerto Rico

PR CEFs are regulated under the PR Act. Fitch evaluates the protections afforded to rated debt and preferred stock obligations arising from compliance with the act. The PR Act, as typically incorporated into fund-governing documents, has the benefit of effectively limiting the amount of overall leverage a fund can assume to 50% of total assets. The PR Act also establishes some minimum diversification requirements, which vary depending on whether the fund is classified as a diversified or nondiversified fund. Diversified funds are limited to investing 5% or less of total assets in any single issuer while retaining 20% or less of the outstanding voting securities of any other issuer. Nondiversified funds are limited to investing 25% or less of total assets in any single issuer while retaining 75% or less of the outstanding voting securities of any other issuer.

However, the PR Act does not align perfectly with the 1940 Act, which regulates U.S. CEFs. As such, the PR Act’s regulatory framework may provide fewer protections to debt and preferred stock investors than those available to debt and preferred stock investors in U.S. CEFs. Specifically, the PR Act only limits leverage at the overall fund level and does not limit leverage at each individual sub-account level. This is fundamentally different from how U.S. CEFs operate, and the implications are discussed in greater detail in the Capital Structure and Leverage section below.

Investment Portfolio

From the investment portfolio perspective, PR CEFs closely resemble single-state tax-exempt CEFs operating in the U.S., as both funds seek to generate returns that are exempt from federal and commonwealth/state taxes for investors residing in that commonwealth/state. To qualify for the tax exemption per the PR Act, PR CEFs must generally invest at least two-thirds of their total assets, less cash, in PR general obligation bonds, other PR government-level bonds, PR revenue bonds, or U.S. government agency securities backed by PR mortgages. The remaining one-third may be invested in municipal bonds issued by U.S. state governments and municipalities outside PR.

Capital Structure and Leverage

Leveraged PR CEFs may issue multiple forms of liabilities that include reverse repurchase agreements, medium-term notes, short-term notes, and preferred stock. Similar to U.S. CEFs, there is an overall limit on leverage of 50% under the PR Act, which is equivalent to minimum asset coverage of 200%. Unlike U.S. CEFs that maintain a single portfolio, which is fungible and provides cross-collateralization for all the fund’s rated leverage, PR CEFs segregate portfolio assets into separate sub-accounts, with each sub-account holding collateral for a given fund liability. For instance, a segregated sub-account is set up for notes issued by a medium-term note program, while a different segregated sub-account of the same fund may be set up to support notes issued by a short-term note or a reverse repurchase agreement program. While each fund liability has legal claim only to its allocated collateral sub-account, the liabilities also share jointly in any assets that remain unencumbered. The diagrams on page 4 contrast the vertical capital structure of U.S. CEFs with the horizontal structure of PR CEFs in terms of claims on asset collateral.

In assigning ratings to debt and preferred stock issued by PR CEFs, Fitch primarily looks to the specific collateral at the sub-account level that is encumbered and available to the rated debt and preferred stock due to a perfected security interest on the assets. Under Fitch’s criteria, other collateral sub-accounts and any unencumbered assets in the fund are not recognized for purposes of calculating the OC tests. This treatment reflects the uncertain quality and quantity of assets held elsewhere in the fund, as those assets may be encumbered by other borrowers or have limited liquidity. Thus, a focus at the sub-account level is appropriately conservative.
Fitch PR CEF Rating Guidelines — Augmenting Protections Offered by the PR Act

Applicability of the Master CEF Criteria

Fitch applies many of the rating considerations outlined in the CEF master criteria for purposes of rating debt and preferred stock issued by PR CEFs. As such, this criteria report should be read in conjunction with the CEF master criteria. The items below highlight additional rating considerations unique to PR CEFs.

Fitch Total OC Test

The Fitch Total OC test is a calculation that measures the sufficiency of asset collateral on a mark-to-market basis to meet all required principle and interest/dividend payments outlined in the rated security’s offering documents. The test is calculated based on a given rating stress level, where a ratio in excess of 100%, in the absence of other qualitative considerations, is generally deemed to be consistent with the assigned rating.

As compared with the Fitch Total OC test outlined in the CEF master criteria, Fitch utilizes a modified version of the test in measuring OC for debt and preferred stock issued by PR CEFs. This modified version of the test calculates asset coverage based only on the collateral sub-account assets in which the rated debt or preferred stock retains a perfected security interest. The calculation divides the discounted value of such corresponding sub-account assets by the amount of rated liabilities outstanding, as illustrated below:

Fitch Total OC Test

\[
\text{Fitch Total OC Test Calculation for PR CEFs} = \frac{\text{Segregated Collateral Account’s Net Discounted Assets at Market Value}}{\text{Fitch-Rated Liabilities Issued Out of the Segregated Collateral Account}}
\]

*Net discounted assets at market value equal to collateral account assets at market value plus accrued income, discounted in accordance with Fitch’s criteria, and less the collateral account’s current liabilities that settle in 10 business days or less. 
*Fitch-rated liabilities include accrued interest and any early prepayment obligations as described in the subsector criteria report titled “Closed-End Funds: Fitch Clarifies Criteria for Make-Whole Amounts and Other Prepayment Obligations,” dated March 18, 2010.

Fitch Asset Discount Factors

Fitch utilizes the same discount factors provided in the CEF master criteria for assets held by PR CEFs. These discount factors were developed assuming a typical 45-business-day deleveraging exposure period, compared with the 10-business-day exposure period typically employed by PR CEFs. The treatment reflects Fitch’s view that there is a trade-off between a longer exposure period, during which further market value declines could occur, and a shorter exposure period, during which losses may be exacerbated by rapid forced selling.

The PR government and its municipalities typically issue bonds in two series — one intended for sale to all U.S. and PR residents (U.S. series) and the other intended for sale specifically to PR residents (PR series). The U.S. series typically enjoys increased issue

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Puerto Rico Closed-End Fund Debt and Preferred Stock Rating Criteria  March 30, 2010
size and liquidity, as investors across the U.S. and PR are eligible to receive tax-exempt interest on the bonds free from federal and commonwealth/state taxes, regardless of the investors’ residence. The PR series more closely resemble obligations issued by municipalities of many U.S. states, in that they provide tax-exempt interest only to residents of that state and, therefore, typically have smaller issue sizes and lower liquidity. PR CEFs invest primarily in the PR series because the after-tax interest income for the funds’ investors is typically greater.

In evaluating the sufficiency of asset coverage available to debt and preferred stock issued by PR CEFs, Fitch uses the standard municipal discount factors published in the CEF master criteria as a function of the bonds’ maturity and credit rating. The following table outlines the ‘AAA’, ‘AA’, ‘A’, and ‘BBB’ asset discount factors for the asset collateral types most typically supporting PR CEF debt and preferred stock. Discount factors for assets not described below are outlined in the CEF master criteria. For PR CEFs, these discount factors should be considered in conjunction with the minimum overall discount factors supplement described in the next section.

### Asset-Specific Discount Factors for Typical Assets Underlying PR CEFs

<table>
<thead>
<tr>
<th>Assets</th>
<th>Discount Factors Appropriate for Different Rating Levels of CEF Debt and Preferred Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>AAA</td>
</tr>
<tr>
<td><strong>Cash and Short-Term Investments</strong></td>
<td></td>
</tr>
<tr>
<td>Cash and Receivables Due in 10 Business Days or Less</td>
<td>1.00</td>
</tr>
<tr>
<td>Securities Rated ‘F1+/F1’; &lt; 1 Year</td>
<td>1.10</td>
</tr>
<tr>
<td><strong>U.S. Government Securities</strong></td>
<td></td>
</tr>
<tr>
<td>Treasuries, Supranationals, Direct U.S. Agency Debt, and U.S. Agency-Backed MBS; 1–10 Years</td>
<td>1.10</td>
</tr>
<tr>
<td>Treasuries, Supranationals, Direct U.S. Agency Debt, and U.S. Agency MBS; &gt; 10 Years</td>
<td>1.25</td>
</tr>
<tr>
<td><strong>Municipals</strong></td>
<td></td>
</tr>
<tr>
<td>Obligations in ‘AAA’ or ‘AA’ Rating Categories; 1–10 Years</td>
<td>1.20</td>
</tr>
<tr>
<td>Obligations in ‘A’ Rating Category; 1–10 Years</td>
<td>1.30</td>
</tr>
<tr>
<td>Obligations in ‘AAA’ Or ‘AA’ Rating Categories; &gt; 10 Years</td>
<td>1.45</td>
</tr>
<tr>
<td>Obligations in ‘BBB’ Rating Category; 1–10 Years</td>
<td>1.45</td>
</tr>
<tr>
<td>Obligations in ‘A’ Rating Category; &gt; 10 Years</td>
<td>1.50</td>
</tr>
<tr>
<td>Obligations Rated ‘BBB’; &gt; 10 Years</td>
<td>1.70</td>
</tr>
<tr>
<td>Obligations Below Investment Grade or Unrated</td>
<td>2.50</td>
</tr>
</tbody>
</table>

*Asset category for agency-backed mortgage-backed securities (MBS) excludes interest- and principal-only issues. *Rated municipal bonds that are refunded/pre-refunded and backed by U.S. government collateral are deemed consistent with an ‘AAA’ discount factor category and a maturity equal to the refunding date. Rated municipal bonds that are escrowed to maturity and backed by U.S. government collateral are deemed consistent with an ‘AAA’ discount factor category and a maturity equal to the bond’s final maturity. *For purposes of determining the applicable discount factor category based on the bond’s rating, Fitch first looks at the Fitch rating, if available. If a Fitch rating is not available, Fitch looks to the lowest of the ratings made available by other global rating agencies.

Consistent with the CEF master criteria, Fitch will apply a 1.10x multiple to the asset-specific discount factors above with respect to collateral underlying PR CEFs, which maintain exposure to an individual state/commonwealth in excess of 25% of the market value of the total sub-account. This is intended to address the additional potential idiosyncratic risk associated with portfolios concentrated in a single state/commonwealth relative to the indices utilized to derive discount factors for municipal securities.

**Minimum Overall Discount Factors Supplement Asset-Specific Discount Factors**

While the PR Act limits overall leverage to 50% of fund assets (equal to a 2.00 discount factor), it also permits PR CEFs to operate with higher leverage at the underlying sub-account level, as long as the average leverage of the fund does not exceed 50%. This contrasts with U.S. CEFs, which are not able to segregate portfolio collateral to exceed the 50% leverage limit mandated by the 1940 Act (33% for senior debt obligations).
As described in the CEF master criteria, Fitch recognizes and derives additional comfort from the substantial protections afforded by the leverage limits of the 1940 Act. Fitch views the absence of the same regulation-imposed leverage limits for PR CEFs, where the leverage restrictions are not applicable to sub-accounts, as an additional risk factor. As such, Fitch supplements its standard CEF criteria and asset-specific discount factors used to calculate OC tests with an additional criteria element. Specifically, for purposes of the Fitch total OC test calculation, Fitch’s PR CEF criteria also include a 2.00 minimum discount factor for each rated obligation and sub-account as a benchmark for an ‘AAA’ rating level. In the U.S., this minimum discount factor was introduced by the Securities and Exchange Commission following the Great Depression and has served to minimize losses to CEF debt and preferred stock investors through various market dislocations, including the most recent credit and liquidity pressures experienced in 2008. For lower rating levels, Fitch’s PR CEF criteria scale down the 2.00 minimum overall discount factor (see table below).

### Minimum Overall Discount Factors at the Sub-Account Level

<table>
<thead>
<tr>
<th>Liability Rating</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum Discount Factor</td>
<td>2.00</td>
<td>1.70</td>
<td>1.40</td>
<td>1.10</td>
</tr>
</tbody>
</table>

Note: Fitch applies the more conservative of standard asset discount factors or overall discount factors for purposes of calculating the Fitch total OC test at different rating levels of PR CEF debt and preferred stock.

### Expansion of the Diversification Framework

PR CEF portfolios are typically highly concentrated in municipal bonds issued by the commonwealth of PR, while most U.S. tax-exempt CEFs invest modestly in state-level bonds. Although the CEF master criteria report outlines a 20% concentration limit for state-level general obligation bonds of a single state, for purposes of calculating the Fitch total OC test, the guideline was intended for assets supporting fund liabilities rated ‘AAA’. Given that all Fitch-rated PR CEFs are currently rated in the ‘AA’ or ‘A’ rating categories, the PR CEF criteria provide further clarity on the diversification framework for lower liability rating levels as presented below:

### Fitch Municipal Issuer Diversification Guidelines

<table>
<thead>
<tr>
<th>Maximum % Eligible for Fitch Net OC Testa</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-Level General Obligations and Other Municipal Issues Backed by State-Level Taxing Authority</td>
<td>20</td>
<td>40</td>
<td>60</td>
<td>80</td>
</tr>
<tr>
<td>Largest Obligorb</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Next Five Largest Obligors</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>5</td>
</tr>
<tr>
<td>All Other Obligors</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

Note: Fitch applies standard discount factors for different rating levels of PR CEF debt and preferred stock. aOn a case-by-case basis, Fitch may raise its issuer concentration thresholds for funds where it rates the issued debt or preferred stock below investment grade, since such rating already reflects, to an extent, the increased risk associated with the idiosyncratic risk in the fund’s portfolio. bExcluding state level general obligation and other municipal issues backed by state-level taxing authority, on a case-by-case basis, Fitch may raise its issuer concentration thresholds for exposure to broadly diversified investment portfolios or holding companies.

For the purposes of calculating concentration in PR state-level obligations, Fitch treats bonds issued by Puerto Rico Sales Tax Financing Corporation (COFINA) and PR pension obligation bonds as general obligation bonds.
Market Supply-Demand Considerations

PR CEFs, like all market value structures, are reliant on the liquidity of underlying assets to repay liabilities during periods of mandatory redemption/deleveraging. To the extent Fitch observes funds/investors with similar investment strategies and market value-based deleveraging mechanisms increase in size, so that they represent an outsized percentage of an overall market for assets in which they invest, this could alter Fitch’s assessment of the liquidity of underlying assets relative to historically observed worst case price declines. Such a scenario could have negative rating implications and/or result in Fitch placing ratings caps on top of what quantitative analysis may otherwise indicate. This is intended to address the risk of a simultaneous liquidation by multiple funds/investors, which could potentially depress asset prices beyond Fitch’s standard expectations. Consideration of the current supply-demand dynamics for municipal issuers within PR, relative to the current size and portfolio composition of PR CEFs, presents challenges to achieving ‘AAA’ ratings on debt and preferred stock issued by PR CEFs.

Index-Linked Notes and Preferred Stock

Certain liabilities issued by PR CEFs contain index-linked payment provisions, whereby the payment of interest or dividends (but not principal repayment) are linked to the performance of an index specified in the transaction documents. For example, payment of interest or dividends may be a function of the percentage change in the S&P 500 during the life of the transaction. The interest or dividend payment may range from 0% to a much higher, albeit capped, percentage figure, depending on the performance of the reference index during the life of the transaction. PR CEFs typically seek to hedge this exposure by entering into an interest or dividend rate swap with a swap counterparty.

When rating such hedged index-linked notes and preferred stock, Fitch reviews the master swap agreement and the credit risk of the swap counterparty as described in the Fitch criteria report “Counterparty Criteria for Structured Finance Transactions: Derivative Addendum,” dated Oct. 23, 2009. The effectiveness of the hedge and, therefore, the rating assigned to the notes or preferred stock may be linked to the performance of the swap counterparty. Therefore, the ratings may change with a downgrade or default of the swap counterparty, absent structural mitigants that de-link this risk. When Fitch deems the fund’s index-linked interest or dividend obligation to be effectively hedged with an appropriately rated counterparty, only the accrued fees and interest associated with the swap agreement will be included as part of total liability for purposes of calculating the Fitch total OC test. The interest or dividends on the obligations are excluded. Equity-linked notes and preferred stock not hedged or determined to be ineffectively hedged will be evaluated on a case-by-case basis. Per Fitch’s criteria for PR CEFs, counterparties are typically rated ‘A/F1’ or higher, but other structural mitigants may be considered as well.

Fitch would also note that, in the case of debt or preferred stock that pays interest or dividends as a function of the performance of a reference index, Fitch’s rating only addresses the ability of the fund to pay interest or dividends pursuant to its stated terms. Therefore, if the material underperformance of the reference index results in interest or dividends payable to the investor being reduced or eliminated, this would not, on its own, have negative rating implications. Rather, Fitch would view this as the applicable debt or preferred stock being paid pursuant to its stated terms.
Puerto Rico Closed-End Fund Debt and Preferred Stock Rating Criteria

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Background

This report updates and replaces the criteria report titled “Closed-End Fund Debt and Preferred Stock Rating Criteria,” published on March 3, 2006, and finalizes the proposed changes outlined in Fitch Ratings’ exposure draft report on the topic published on May 1, 2009. The updated rating criteria for debt and preferred stock issued by CEFs follow a firmwide initiative to update Fitch’s methodology for related market value structures in recognition of heightened market volatility and asset correlation, as noted in Fitch Research on “Rating Market Value Structures,” dated April 18, 2008 (available on Fitch’s web site at www.fitchratings.com).

This criteria report addresses only U.S. leveraged CEFs regulated under the Investment Company Act of 1940, as amended (1940 Act). CEFs domiciled outside the U.S., such as CEFs operating under Puerto Rican securities regulation, will be addressed in separate rating criteria to be published in the near future.

Criteria Highlights

The key components of Fitch’s updated rating criteria for debt and preferred stock issued by CEFs are discussed below.

Continued Emphasis on Portfolio Market Value Analysis

Stress-testing a portfolio’s market value to determine a fund’s ability to redeem rated liabilities through asset dispositions remains a core element of Fitch’s rating methodology for CEFs. The structural protections afforded by the 1940 Act provide a baseline set of protections. However, Fitch also considers credit, market value, and/or structural risks not addressed in the 1940 Act, as well as additional protections within the offering memorandum and other governing documents that may differ from 1940 Act requirements.

Updated Asset Discount Factors

Discount factors applicable to fund portfolio assets used to calculate the amount of overcollateralization (OC) in place to support rated liabilities were revised by Fitch. The number of asset categories and corresponding discount factors have also been simplified and consolidated. The revised discount factors incorporate heightened asset price volatility, observed across many asset classes in the past 18 months, and Fitch’s updated view on asset market value risk, resulting in an overall more conservative view across most asset classes.

CEFs have dynamic portfolios, both in terms of composition and market value. As such, Fitch expects the value of assets and the discount factors applied to portfolio assets to change over time. The potential for variability of these elements, together with Fitch’s view that the exposure period for potential market value deterioration prior to redemption is approximately 45 business days, necessitates regular reviews of both portfolio assets and leverage, as well as recalculation of the Fitch OC and 1940 Act coverage tests.

Correction

This report was originally published on July 17, 2009. Changes were made to clarify certain discount factors for convertible preferred stock and Fitch’s treatment of putable securities. The changes are as follows: language pertaining to the 1940 Act, pages 6, 8, 13, 14, and 16; certain discount factors for treatment of busted convertible preferred stock, page 10; definition of FFELP students loans, page 11; clarification on Fitch’s treatment of putable securities, page 11; and inclusion of certain corporate industries, page 17.
Enhanced Diversification Guidelines
Issuer and industry concentration thresholds, reflecting Fitch’s view on idiosyncratic, systemic, and portfolio asset correlation risks, were enhanced. Higher than expected issuer and/or sector concentrations may result in higher discount factors and/or lower ratings.

Explicit Recognition of Potential Subordination Risks
An additional overcollateralization test, the Fitch Net OC test, has been added to capture subordination risks faced by the rated debt and preferred stock due to the presence of any other unrated or senior debt in the fund’s capital structure, which may have a first priority on fund assets.

Inclusion of Leverage and Derivative Securities When Calculating Asset Coverage
Various forms of leverage utilized by CEFs, including derivative securities, have been included into Fitch’s analysis to determine total effective leverage and the degree of downside protection available to rated preferred stock and noteholders. This is intended to reflect the systemic changes in fund capital structures following the auction-rate security crisis in February 2008. Revisions also reflect significant developments in the capital markets, including greater use of off balance sheet derivatives, which may increase asset value volatility experienced by funds.

More Flexibility for Fund Governing Documents
Fitch’s rating analysis of debt and preferred stock issued by CEFs will focus on the appropriateness of portfolio holdings and asset coverage relative to the agency’s published criteria. The absence of a detailed framework outlining Fitch’s criteria in fund bylaws or other operating documents will not, on its own, have adverse rating implications. However, Fitch will continue to evaluate the appropriateness of liquidation/redemption procedures as outlined within fund bylaws or other operating documents. The absence of such mechanisms within fund bylaws or other operating documents could have adverse rating implications.

Reliance on 1940 Act-Mandated Asset Coverage for Certain CEFs
In certain instances, Fitch believes it may be possible to assign ratings to obligations of CEFs based on the nature of the assets and the protections afforded by the 1940 Act. Fitch would view such treatment as being potentially applicable for funds that: invest only in lower risk assets (defined as assets with Fitch discount factors less conservative than those implied by the 1940 Act); have appropriate levels of issuer and industry diversification (as consistent with the Fitch diversification criteria); restrict forms of leverage to those envisioned under the 1940 Act; and have mandatory deleveraging provisions and an exposure period similar to standards set forth under the Fitch Total OC and Fitch Net OC tests.

Standardized Surveillance Reporting Process
Fitch has developed a standardized surveillance template for reporting portfolio holdings for reviewing 1940 Act and Fitch OC tests. This template is intended to aid in a fund’s implementation of the changes to Fitch criteria and provide for more timely, transparent, and accurate surveillance of outstanding ratings.

Additional Considerations
The existing regulatory guidelines of the 1940 Act provide a number of unique structural protections for investors in CEF debt and preferred stock, including
minimum OC ratios and mechanisms designed to protect these investors from losses. Additional protections documented in fund bylaws, prospectus, and statement of preferences typically require funds to redeem a portion or all of their outstanding debt and preferred stock if minimum asset coverage ratios are breached and remain uncured following applicable grace periods.

Wherever possible, Fitch recognizes the structural protections afforded by the 1940 Act in its rating analysis while acknowledging that developments in the CEF industry may expose investors to additional risks that are not directly addressed by the 1940 Act. These risks include an expanded universe of portfolio assets, higher concentration risks, more complex capital structures, and on- and off-balance sheet liabilities not explicitly addressed or captured in the 1940 Act coverage ratios. As such, Fitch’s rating criteria seeks to go beyond the regulatory requirements for CEFs, wherever necessary, to capture these risks in the ratings Fitch assigns to debt and preferred stock issued by CEFs.

Ratings Assigned to Securities Issued by Closed-End Funds
Fitch assigns long-term credit ratings to debt and preferred stock issued by leveraged CEFs. The long-term credit ratings address the likelihood of full and timely payment of interest or dividends on each payment date and principal upon optional or mandatory redemption or at maturity. While Fitch’s criteria is applicable to lower rating categories, historically the majority of Fitch-rated CEFs have operated to maintain ‘AAA’ or ‘AA’ ratings, which in some measure reflects the baseline protections afforded by the 1940 Act.

Fitch rates debt and preferred stock issued by CEFs on the basis of the protections afforded by the fund’s operating documents and the extent to which the fund is viewed as operating in a manner consistent with Fitch’s current rating criteria. Historically, CEF governing documents incorporated most, if not every, aspect of the rating criteria that prevailed when the fund was originally rated. Going forward, the absence of detailed descriptions of Fitch’s CEF rating criteria, including asset-specific discount factors, will not, on its own, have adverse rating implications, provided that the fund maintains sufficient deleveraging mechanisms and adheres to the current Fitch rating criteria, available on Fitch’s web site at www.fitchratings.com. From the perspective of the investor and the manager, Fitch believes this change offers greater transparency and easier implementation of any future criteria changes.

Long-term credit ratings assigned to securities issued by CEFs are based on the following:

- **Structural Mechanisms:** OC triggers, mandatory redemption parameters, and other structural protections for rated debt obligations.
- **Capital Structure:** The fund’s capital structure and sufficiency of asset coverage, according to seniority of the liabilities.
- **Investment Portfolio:** Evaluation of the fund’s portfolio assets with a focus on the potential market value loss under stress scenarios.
- **Investment Manager Review:** Qualitative assessment of the fund’s investment manager.
- **Legal Considerations:** Integrity of the legal structure.

In some cases, Fitch may also assign short-term credit ratings that address the likelihood of full and timely payment of principal and interest or dividends to the debt or preferred stock investors on the next payment date. Short-term credit ratings are
assigned only to issues of notes and preferred stock that offer a demand feature for investors to put the securities back to the fund or the liquidity provider on pre-specified periods or dates. The ratings are based on the following:

- **Liquidity Provider’s Obligation**: The liquidity provider’s obligation to purchase all debt or preferred stock tendered for sale that has not been sold on the tender date (and whether there are any “outs” to the liquidity provider’s obligation).
- **Liquidity Provider’s Credit Strength**: The credit strength of the liquidity provider or the guarantor supporting the liquidity provider’s obligation.
- **Legal Considerations**: The integrity of the legal structure.

Fitch’s ratings do not address liquidity in the secondary markets, such as those where auction-rate securities trade. In these cases, only long-term ratings are assigned that address the credit risk based on the instrument’s stated maturity rather than the ability to access secondary market liquidity.

### Structural Mechanisms

Fitch’s rating criteria for CEF debt and preferred stock assess the amount of OC available to debt and preferred stock, which depends on the amount and type of asset collateral held by the fund. The analytical focus is on the structural mechanisms in place to protect investors from market value risk, or the risk that the market value of the portfolio may decline and jeopardize the ability to meet interest or dividends on the next payment date (and repayment of principal upon an optional or mandatory redemption or the repayment of principal upon maturity to debt investors). CEF debt and preferred stock investors are exposed to various risks including:

- **Credit Risk**: The risk of loss due to spread widening or an actual obligor default.
- **Interest Rate Risk**: The risk that a fixed-income security’s value will decline due to an increase in general interest rates.
- **Liquidity Risk**: The risk that a security cannot be sold quickly enough in the market to prevent a further loss. This risk is only present in the event of mandatory redemption as typically required, per the fund’s governing documents, in case of a breach of certain asset coverage ratios.
- **Leverage Risk**: The risk that leverage carried by the fund will exacerbate market losses allocated to investors and, depending on the exact nature of each form of debt, may also subordinate rated noteholders.
- **Moral Hazard Risk**: The risk that an investment manager may manage a fund’s portfolio and leverage to the benefit of common stockholders and to the detriment of debt and preferred stockholders.

### Overcollateralization

OC is measured by evaluating the market value of collateral available to retire rated liabilities adjusted by discount factors to address the possibility that market values could decline further prior to sale. The presence of market-based OC is a major mitigant to the aforementioned risks and serves as the primary source of credit enhancement and protection for rated obligations. Consequently, Fitch expects CEFs with rated instruments to maintain overcollateralization guidelines within their governing documents demonstrated by asset coverage tests. Fitch will assign ratings by analyzing how funds ensure sufficient OC compared with Fitch OC tests. By ensuring a minimum standard for OC, the asset coverage tests are designed to protect CEF debt and
preferred stock investors against default on principal and any accrued interest or dividends.

**Mandatory Redemption**

To ensure CEFs maintain sufficient OC for debt and preferred stock for a given rating level, Fitch reviews the fund’s governing documents for mandatory deleveraging provisions that set forth procedures for curing breaches to either the 1940 Act or Fitch OC tests. Deleveraging provisions usually take the form of a cure period followed by a set period for mandatory redemptions if needed. For instance, upon a breach of either the 1940 Act or Fitch OC tests, the fund is first afforded a cure period within which it may take voluntary action to bring the tests back into compliance. During this period, funds may sell assets and use proceeds to deleverage the portfolio or seek a capital injection through an equity offering. With respect to curing a breach to the Fitch OC tests, fund managers may also elect to rebalance the portfolio toward more liquid and less risky assets.

If the manager fails to cure a breach of either test within the available cure period, the governing documents require redemption of debt and preferred stock within a predefined period in sufficient amounts so as to restore the coverage levels above the failed test(s) to compliance. Fitch’s CEF rating criteria are based on an expectation of deleveraging provisions outlining mandatory redemptions over a pre-specified and limited timeframe. Fitch expects that, in addition to mandatory deleveraging provisions, CEFs would have other provisions to help increase asset coverage upon breaching the tests (such as ceasing distributions to common shareholders until the OC is restored). In the absence of such deleveraging mechanisms, Fitch would expect to apply more conservative rating criteria than outlined in this report.

**Exposure Period**

The exposure period is the time between the valuation date prior to an asset coverage test breach and the final date allowed for mandatory redemption, as specified in the fund governing documents. During this period, investors in fund debt and preferred stock are exposed to market value declines. A given fund’s exposure period is determined in accordance with the frequency of OC tests and the mandatory redemption guidelines under which the fund operates. Fitch calculates investor exposure as the sum of the following periods:

- **Valuation Period:** The frequency with which the fund calculates coverage ratios to ensure it is passing the tests (usually weekly for Fitch OC tests).
- **Cure Period:** The number of days the fund has to cure any breach before entering into a mandatory redemption period (usually 10 business days for Fitch OC tests).
- **Mandatory Redemption Period:** The covenanted time allotted for redeeming shares or notes, during which time funds cannot issue additional leverage nor declare/pay common stock dividends (usually 30 days). This period is set to account for mandated shareholder notification periods, auction dates, and other structural considerations.

The average of the aforementioned periods is 45 business days for Fitch-rated CEFs. The actual exposure period is the central factor in Fitch’s rating analysis, as it limits the maximum number of days that a CEF debt or preferred stock investor is exposed to portfolio market value declines before deleveraging or being redeemed at par plus accrued interest or dividends. In determining the asset discount factors presented in the table on pages 10–11, Fitch assumed a 45-business-day exposure period to determine the maximum potential market value loss an asset may experience in a stressed scenario.
Bylaws or statements of preferences specifying an exposure period greater than 45 business days may result in more conservative discount factors being applied to the fund’s portfolio assets to achieve the same rating level on the debt and preferred stock of the CEF. For example, the exposure period to comply with the 1940 Act test typically averages 78 business days (given month-end coverage valuation, a one-month cure period, and a one-month mandatory redemption period). Fitch notes that the 1940 Act alone does not mandate fund deleveraging upon breach but restricts payments/declaration of common dividends and limits the issuance of new leverage until sufficient 1940 Act asset coverage is attained. However, fund operating documents usually include mandatory redemptions as a provision for curing a breach. Conversely, should the bylaws or statements of preferences specify an exposure of less than 45 business days, this may result in less conservative discount factors being applied to the fund’s portfolio assets. Such instances will be assessed by Fitch on a case-by-case basis.

**Capital Structure**

*1940 Act Coverage Ratio Test — Baseline Protection to Rated Debt and Preferred Stockholders*

Fitch monitors funds’ compliance with the 1940 Act test, as it remains the regulatory framework under which U.S. CEFs operate. However, Fitch also acknowledges certain shortcomings in the 1940 Act test, including that it does not capture certain forms of collateralized leverage more recently utilized by CEFs nor does it differentiate between investments in different asset classes. That said, the 1940 Act test, as typically incorporated into fund governing documents, has the benefit of effectively limiting the amount of leverage a fund can assume by requiring a minimum asset OC of 200% for preferred stock leverage and a minimum asset OC of 300% for senior debt leverage. The 200% asset coverage for preferred stock is typically calculated in one of two ways, both of which yield the same result:

\[
\frac{[\text{Total Assets at MV} - \text{Current Liabilities}^a]}{[\text{All } 1940 \text{ Act Leverage}^b + \text{Accrued Expenses and Fees on Leverage}]}
\]

or

\[
\frac{[\text{Common Equity} + \text{All } 1940 \text{ Act Leverage} + \text{Accrued Expenses and Fees on Leverage}]}{[\text{All } 1940 \text{ Act Leverage} + \text{Associated Accrued Expenses and Fees}]}
\]

^aCurrent liabilities do not include any liabilities associated with fund leverage, as recognized by the 1940 Act in Section 18.

^b1940 Act Leverage only includes leverage that funds interpret to be recognized as leverage under Section 18 of the 1940 Act (e.g., preferred stock, notes, and bank facility). This typically excludes all types of economic leverage, reverse repurchase agreements, mortgage dollar rolls, and others.

The 300% asset coverage for senior debt is typically calculated in one of two ways, both of which also yield the same result:

\[
\frac{[\text{Total Assets at MV} - \text{Current Liabilities}]}{[\text{All Senior } 1940 \text{ Act Leverage}^c + \text{Accrued Expenses and Fees on Leverage}]}
\]

or

\[
\frac{[\text{Common Equity} + \text{All Senior } 1940 \text{ Act Leverage} + \text{Accrued Expenses and Fees on Leverage}]}{[\text{All Senior } 1940 \text{ Act Leverage} + \text{Accrued Expenses and Fees on Leverage}]}
\]

^cSenior 1940 Act Leverage only includes leverage that funds interpret to be recognized as Senior Securities other than preferred stock under Section 18 of the 1940 Act. (e.g., notes, bank facility). This typically also excludes all types of economic leverage, reverse repurchase agreements, mortgage dollar rolls, and others.
Fitch incorporates compliance with 1940 Act coverage ratios into its rating criteria, as noncompliance with the ratios has important consequences for investors of debt and preferred stock issued by CEFs. For instance, funds breaching the mandated asset coverage ratios are not permitted to pay declared dividends or declare new dividends to common stockholders, thus effectively trapping cash in the portfolio to help improve the asset coverage ratios and acting as a strong incentive for restoring asset coverage. Furthermore, fund governing documents are typically written to ensure compliance with the ratios by requiring mandatory redemptions of debt upon breach of the 1940 Act test.

With respect to certain asset classes, the implied discount factors of the 1940 Act are more conservative than those set forth by Fitch. For example, Fitch’s discount factor for U.S. government securities is 1.10, whereas the 1940 Act would impose a discount factor of 2.00 on a CEF backed by such collateral. Given the more conservative nature of the 1940 Act, in such instances, Fitch may elect to rely on the guidelines of the 1940 Act when evaluating such funds. That said, the guidelines of the 1940 Act are not always sufficiently conservative for all funds and underlying assets types to achieve an ‘AAA’ rating in all instances.

To determine the sufficiency of the 1940 Act for a given CEF, Fitch will seek to determine that the fund: only purchases lower risk assets; has appropriate levels of issuer and industry diversification; restricts forms of leverage to those envisioned under the 1940 Act; and maintains conservative mandatory deleveraging provisions. This further presumes that appropriate triggers are in place to promote deleveraging and redemption of rated obligations within a 45-business-day period and that the governing documents are sufficiently restrictive. The chart on page 12 depicts which assets on a stand-alone basis have Fitch discount factors that are lower than those implied by the 1940 Act test and, therefore, may be more suitable to be analyzed on the basis of the asset coverage afforded under the terms of the 1940 Act test. Fitch’s guidelines for determining the appropriateness of fund diversification are outlined in Diversification Guideline, pages 14–17.

**Fitch CEF Ratings Guidelines — Augmenting 1940 Act Protections**

Similar to the 1940 Act, Fitch’s CEF rating criteria also measure the OC of debt and preferred stock but utilize the Fitch Total OC and Fitch Net OC tests (together, the Fitch OC tests), which address the potential for additional forms of leverage and further market value declines in fund assets during the redemption period. Fitch OC tests seek to measure the sufficiency of fund assets to meet all principal and interest/dividends payments of debt and preferred stock upon optional or mandatory redemption. In the absence of other qualitative considerations, Fitch OC and Fitch Net OC ratios in excess of 100% are generally deemed to be consistent with the rating assigned to the debt and preferred stock.

In developing and formulating the updated discount factors, Fitch sought to reflect each asset class’s unique risk profile based on historically observed worst-case performance as well as expectations for potential continued adverse performance in the future. Fitch sought to determine the magnitude and implied stress of historically observed market value price declines and then increased such declines to derive an expected ‘AAA’ market value stress (for more information on Fitch’s determination of asset-specific discount factors, see Appendix 3: Market Value Approach to Discount Factor Development, pages 23–25).

While for certain asset classes the discount factors are lower than those implied by the 1940 Act, in many cases the discount factors may be higher (more conservative) and in some cases substantially so. For example, the discount factor for preferred...
stock is 2.5 (see Fitch Discount Factors table, pages 10–11), compared to an implied
discount factor of 2.0 under the 1940 Act for preferred stock leverage. When rating
the debt and preferred stock of a CEF that invests in higher risk asset classes, Fitch
will evaluate the sufficiency of the fund’s asset coverage in the context of the Fitch
OC and Fitch Net OC tests, in addition to the fund’s compliance with the parameters
of the 1940 Act.

The calculation of fund leverage — both on and off balance sheet — is another area
Fitch’s criteria address risks not fully captured by the 1940 Act. Such leverage may
take the form of reverse repurchase agreements or certain derivative transactions.
For funds utilizing such nontraditional forms of leverage, the full effect of leverage on
asset value, asset coverage, and income volatility may potentially be understated for
the purposes of the 1940 Act. This is in contrast to the Fitch OC tests, which seek to
capture such leverage exposure.

Fitch’s rating criteria also seeks to evaluate the priority of claims of various CEF
liabilities in a more explicit fashion than the 1940 Act tests. Specifically, the Fitch Net
OC test measures the amount of OC remaining for Fitch-rated securities after other
portfolio assets have been allocated to more senior securities. In other words, the
Fitch Net OC test measures OC on a net basis after taking into account certain fund
assets that are held as collateral for other fund liabilities. The Fitch Net OC test also
assesses whether the remaining unencumbered fund assets continue to be consistent
with Fitch’s diversification guidelines.

Fitch Total Overcollateralization Test: Sufficiency of Asset Coverage
Fitch evaluates a fund’s asset coverage on the basis of the Fitch Total OC test for each
rated class of leverage in the fund’s capital structure. The calculation of the Fitch Total
OC test includes, in the numerator, all portfolio assets on a discounted basis regardless
of whether such assets are serving as collateralization for a senior liability or are
otherwise unencumbered. The calculation includes, in the denominator, all portfolio
liabilities that are pari passu or are senior to the rated debt or preferred stock. The
rationale behind capturing all assets, even those that are held as collateral for other
fund liabilities, is to assess whether the assets are sufficient to meet liability payments
associated with debtholders senior to or pari passu with the rated debt and preferred
stock (based on Fitch’s expectation of potential market value declines in those assets).
In the absence of other qualitative considerations and for a given rating level, the test
output is expected to remain in excess of 100% and is calculated as follows:

\[
\text{Fitch Total OC} = \frac{\text{Total Net Discounted Assets at MV}^*}{\text{Fitch Rated Liability} + \text{Other Liabilities Pari Passu and Senior to Rated Liability}}
\]

*Total net discounted assets at market value (MV) equal total portfolio assets at MV and accrued income, including assets
held as collateral for other fund liabilities, less current liabilities that settle in 10 days that are not part of a rolling
leverage strategy (such as to-be-announced [TBA] securities, futures, forwards, among others), then discounted at the
Fitch discount factors in the table on pages 10–11 and adjusted as per the Fitch diversification criteria discussed on
pages 14–17.

Fitch Net Overcollateralization Test: Protection Against Subordination Risk
If a fund has liabilities that are senior to the Fitch-rated debt and preferred stock or if it
has liabilities that are secured by specific asset collateral, Fitch will also evaluate a
fund’s asset coverage on the basis of the Fitch Net OC test. The Fitch Net OC test
assesses whether the fund has sufficient assets to provide asset coverage for the rated
debt or preferred stock after first repaying other more senior liabilities and/or liabilities
secured by specific asset collateral. The Fitch Net OC test also includes any assets in the
fund that remain unencumbered by senior liabilities. Similar to the Fitch Total OC test, the result of this test should be greater than 100% and is calculated as follows:

\[
\text{Fitch Net OC} = \frac{\text{Available Net Discounted Assets}^a}{\text{Fitch Rated Liability} + \text{Other Liabilities That Are Pari Passu}}
\]

^Available net discounted assets equals total portfolio assets at MV and accrued income minus all assets that are either held as collateral for other fund liabilities and/or subject to a first claim of a senior liability in the capital structure minus current liabilities that settle in 10 days that are not part of a rolling leverage strategy (such as TBA security rolls, futures, forwards, among others), then discounted at the Fitch discount factors in the table on pages 10-11 and adjusted per the Fitch diversification criteria presented on pages 14-17.

Examples of when the Fitch Net OC test may be relevant include CEFs that utilize senior bank lines. Depending on the collateral requirements of other more senior fund liabilities, the Fitch Total OC test may be either more or less conservative than the Fitch Net OC test. For instance, if more senior liabilities are secured by specific assets, which result in the remaining portfolio assets being more highly concentrated by issuer and/or industry, this could result in a more conservative evaluation of asset coverage under the Fitch Net OC test versus the Fitch Total OC test.

**Fitch Asset Discount Factors**

The table on the following pages outlines the discount factors for ‘AAA’, ‘AA’, ‘A’, and ‘BBB’ rating stresses for each group of assets, assuming a 45-day redemption period. Fitch will determine discount factors for other collateral types, redemption periods, and rating stresses on a case-by-case basis.
## Fitch Discount Factors

Discount Factors Appropriate for Different Rating Levels of CEF Debt and Preferred Stock

<table>
<thead>
<tr>
<th>Assets</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and Short-Term Investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and Receivables Due in 10 business Days or Less</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securities Rated 'F1+/F1-', &lt; 1 Year</td>
<td>1.10</td>
<td>1.08</td>
<td>1.05</td>
<td>1.00</td>
</tr>
<tr>
<td>U.S. Government Securities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Treasuries, Supranationals, Direct U.S. Agency Debt, and U.S. Agency-Backed MBS, 1–10 Years</td>
<td>1.10</td>
<td>1.08</td>
<td>1.05</td>
<td>1.00</td>
</tr>
<tr>
<td>Treasuries, Supranationals, Direct U.S. Agency Debt and U.S. Agency MBS: &gt;10 Years</td>
<td>1.25</td>
<td>1.20</td>
<td>1.15</td>
<td>1.10</td>
</tr>
<tr>
<td>*Asset category for agency-backed mortgage-backed securities (MBS) excludes interest- and principal-only issues.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| **Sovereigns**                                                      |     |     |     |     |
| Debt of Developed Countries, 1–10 Years b c                         | 1.15| 1.10| 1.08| 1.05|
| Debt of Developed Countries, >10 Years                              | 1.30| 1.25| 1.20| 1.15|
| Debt of Emerging Countries*                                          | 3.10| 2.40| 1.75| 1.50|
| *Sovereign debt excludes U.S.  **Developed countries are advanced economies, as defined by the IMF.  *Emerging countries are defined as all countries not included in the aforementioned definition of developed countries. |

| **Municipals**                                                      |     |     |     |     |
| Obligations in ‘AAA’ or ‘AA’ Rating Categories, 1–10 Years*          | 1.20| 1.15| 1.10| 1.08|
| Obligations in ‘A’ Rating Category, 1–10 Years                      | 1.30| 1.20| 1.15| 1.10|
| Obligations in ‘AAA’ or ‘AA’ Rating Categories, >10 Years            | 1.45| 1.35| 1.25| 1.20|
| Obligations in ‘BBB’ Rating Category, 1–10 Years                    | 1.45| 1.35| 1.25| 1.20|
| Obligations in ‘A’ Rating Category, >10 Years                       | 1.50| 1.40| 1.30| 1.20|
| Obligations Rated ‘BBB’, >10 Years                                   | 1.70| 1.50| 1.40| 1.25|
| Obligations Below Investment Grade or Unrated                        | 2.50| 2.00| 1.70| 1.45|
| **AAA** rated municipals include refunded and pre-refunded municipal bonds, backed by U.S. government collateral. |

| **Corporates**                                                      |     |     |     |     |
| Bonds, Developed Countries, in ‘AAA’ or ‘AA’ Rating Categories, 1–10 Years | 1.30| 1.20| 1.15| 1.10|
| Bonds, Developed Countries, in ‘A’ or ‘BBB’ Rating Categories, 1–10 Years | 1.40| 1.30| 1.25| 1.20|
| Bonds, Developed Countries, in ‘AAA’ or ‘AA’ Rating Categories, >10 Years | 1.40| 1.30| 1.25| 1.20|
| Bonds, Developed Countries, in ‘A’ or ‘BBB’ Rating Categories, >10 Years | 1.65| 1.50| 1.35| 1.25|
| Bonds, Developed Countries, in ‘BB’ Rating Category                 | 1.80| 1.60| 1.40| 1.30|
| Bonds, Developed Countries, in ‘B’ Rating Category                  | 2.15| 1.80| 1.55| 1.40|
| Bonds, Developed Countries, Rated ‘CCC’ or Lower or Unrated         | 3.70| 2.55| 1.95| 1.60|
| Bonds, Emerging Countries                                           | 4.60| 2.90| 2.10| 1.65|

| **Convertibles**                                                    |     |     |     |     |
| Busted Convertible Debt, Developed Countries, in ‘AAA’ or ‘AA’ Rating Categories or Unrated, 1–10 Years | 1.30| 1.20| 1.15| 1.10|
| Busted Convertible Debt, Developed Countries, in ‘A’ or ‘BBB’ Rating Categories, 1–10 Years | 1.40| 1.30| 1.25| 1.20|
| Busted Convertible Debt, Developed Countries, in ‘AAA’ or ‘AA’ Rating Categories or Unrated, >10 Years | 1.40| 1.30| 1.25| 1.20|
| Busted Convertible Debt, Developed Countries, in ‘A’ or ‘BBB’ Rating Categories, >10 Years | 1.65| 1.50| 1.35| 1.25|
| Typical Convertible Debt, Typical Convertible Preferred Stock and Busted Convertible Preferred Stock, Developed Countries, Investment Grade or Unrated | 1.80| 1.60| 1.40| 1.30|
| Busted Convertible Debt and Busted Convertible Preferred Stock, Developed Countries, in ‘BB’ Rating Category | 1.80| 1.60| 1.40| 1.30|
| Busted Convertible Debt and Busted Convertible Preferred Stock, Developed Countries, in ‘B’ Rating Category | 2.15| 1.80| 1.55| 1.40|
| Equity Sensitive Convertible Debt and Equity Sensitive Convertible Preferred Stock, Investment Grade or Unrated | 2.15| 1.80| 1.55| 1.40|
| Typical Convertible Debt and Typical Convertible Preferred Stock, Below Investment Grade | 2.55| 2.05| 1.65| 1.45|
| Busted Convertible Debt and Busted Convertible Preferred Stock, Rated ‘CCC’ or Lower or Unrated Distressed Convertible Debt and Distressed Convertible Preferred Stock, Developed Countries | 3.70| 2.55| 1.95| 1.60|
| Equity Sensitive Convertible Debt and Equity Sensitive Convertible Preferred Stock, Below Investment Grade | 4.00| 2.70| 2.05| 1.60|
| Convertible Debt and Convertible Preferred Stock, Emerging Countries | 5.00| 3.50| 2.10| 1.75|

*Busted convertible securities are defined as convertible securities having a conversion premium in excess of 70%. Conversion premium is calculated as: (MV of the convertible security – MV of total stock into which the security may be converted to)/MV of the convertible security.  **Typical convertible securities are defined as convertible securities that have a conversion premium between 20% and 70%.  *Equity sensitive convertible securities are defined as convertible securities that have a conversion premium less than 20%.  Distressed convertibles have a bid price below 60% of par, as defined on page 303 of the March 2008 edition of "A Guide to the Lehman Brothers Global Family of Indices."
## Discount Factors Appropriate for Different Rating Levels of CEF Debt and Preferred Stock

<table>
<thead>
<tr>
<th>Assets</th>
<th>AAA</th>
<th>AA</th>
<th>A</th>
<th>BBB</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Leveraged Loans</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Performing U.S. and European Union (EU) First Lien Term Loans Not Covenant Light</td>
<td>1.55</td>
<td>1.40</td>
<td>1.30</td>
<td>1.25</td>
</tr>
<tr>
<td>Performing U.S. and EU Second Lien and Covenant Light First Lien</td>
<td>2.50</td>
<td>2.00</td>
<td>1.60</td>
<td>1.40</td>
</tr>
<tr>
<td>Performing U.S. and EU Third Lien and Covenant Light Second Lien</td>
<td>5.00</td>
<td>3.50</td>
<td>2.10</td>
<td>1.65</td>
</tr>
</tbody>
</table>

1Performing loans are defined as loans which remain current on principal and interest payment obligations. Covenant light loans are defined as loans without maintenance-style financial covenants, such as maximum leverage and minimum interest and cash flow coverage tests, which are required to be tested (and passed) each quarter or half-year.

<table>
<thead>
<tr>
<th>Equity</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>MLPs, RITs, and MTS, US$0.5+ Billion Float-Adjusted Market Capitalization</td>
<td>2.20</td>
<td>1.75</td>
<td>1.50</td>
<td>1.35</td>
</tr>
<tr>
<td>U.S. and Developed Countries, Large Capitalization</td>
<td>2.60</td>
<td>2.10</td>
<td>1.70</td>
<td>1.50</td>
</tr>
<tr>
<td>U.S. and Developed Countries, Medium Capitalization, and Small Capitalization, and MLPs, RITs and MTS, with Less Than US$1.5 Billion Float-Adjusted Market Capitalization</td>
<td>4.00</td>
<td>2.70</td>
<td>2.05</td>
<td>1.60</td>
</tr>
<tr>
<td>Emerging and Developing Markets</td>
<td>5.50</td>
<td>3.75</td>
<td>2.20</td>
<td>1.75</td>
</tr>
</tbody>
</table>

Defined as excluding closely held stock and cross holdings, among others, consistent with the calculation methodology of the Alerian MLP Index. Medium capitalization is defined as company stock that has market capitalization of less than US$5bn and equal to or more than US$1 billion. Small capitalization is defined as company stock that has market capitalization of less than US$1 billion.

<table>
<thead>
<tr>
<th>Preferred Stock</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Preferred Stock</td>
<td>2.50</td>
<td>2.00</td>
<td>1.60</td>
<td>1.40</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Foreign Currency</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unhedged Foreign Currency Exposure, Investment-Grade Countries (In Addition to Standard Asset Discount Factors)</td>
<td>1.50</td>
<td>1.40</td>
<td>1.30</td>
<td>1.25</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Structured Securities</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>ABS Student Loans ‘AAA’ FFELP Non-ARS &lt; 5 Years</td>
<td>1.45</td>
<td>1.35</td>
<td>1.25</td>
<td>1.20</td>
</tr>
<tr>
<td>CMBS Issued 2005 or Earlier: Super-Senior Tranches Rated ‘AAA’</td>
<td>1.45</td>
<td>1.35</td>
<td>1.25</td>
<td>1.20</td>
</tr>
<tr>
<td>CMBS Issued After 2005: Super-Senior Tranches Rated ‘AAA’</td>
<td>1.70</td>
<td>1.50</td>
<td>1.35</td>
<td>1.30</td>
</tr>
<tr>
<td>ABS Student Loans ‘AAA’ FFELP Non-ARS: 5–10 Years</td>
<td>2.00</td>
<td>1.70</td>
<td>1.50</td>
<td>1.35</td>
</tr>
<tr>
<td>ABS Student Loans ‘AAA’ FFELP Non-ARS: &gt;10 Years</td>
<td>3.15</td>
<td>2.50</td>
<td>1.80</td>
<td>1.50</td>
</tr>
<tr>
<td>CMOs, Other ABS, and Non-Agency MBS Rated ‘AAA’</td>
<td>3.30</td>
<td>2.50</td>
<td>1.80</td>
<td>1.50</td>
</tr>
<tr>
<td>CLOs – Super-Senior Tranches Rated ‘AAA’</td>
<td>3.45</td>
<td>2.60</td>
<td>1.90</td>
<td>1.55</td>
</tr>
</tbody>
</table>

FFELP non-ARS student loans refer to the private sector student loan programs organized through one of the U.S. federal agencies’ family education loan program. These loans have either full or almost full support of the U.S. government, depending on vintage. Non-ARS refers to those investments that do not trade as an auction rate security. Super-senior tranche refers to a tranche that has at least one other ‘AAA’ rated tranche junior to it and no other tranches senior to it in the capital structure. Furthermore, such tranche should not be on Rating Watch Negative or Rating Outlook Negative. Other asset-backed securities (ABS) includes ‘AAA’ rated obligations securitised by credit card and automobile loan receivables and student loans that are not already captured by other security-type categories in the above table.

<table>
<thead>
<tr>
<th>Debt</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Nonperforming/Defaulted Debt Securities</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
<td>NC</td>
</tr>
</tbody>
</table>
| NC – No credit given unless evidence of stable market value risk can be demonstrated.

<table>
<thead>
<tr>
<th>Other</th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>All Other Assets</td>
<td>s</td>
<td>s</td>
<td>s</td>
<td>s</td>
</tr>
</tbody>
</table>

Case-by-case basis. Note: For all asset classes, asset maturity is calculated on the basis of the security’s final maturity, except for securities that contain a put provision at the security holder’s option, with no outs to exercise such right. In such instances and for the purpose of determining the appropriate asset discount factor, the next available put date may be assumed to be the asset maturity date.
Accounting for CEF Liabilities in Fitch OC Tests

The market dislocation in 2007 and 2008 caused CEF managers to meaningfully change the capital structures of closed-end funds in ways not always expected by the 1940 Act. For example, failures in the auction-rate security market led to traditional retail-oriented leverage being partially replaced with nontraditional institutional-oriented leverage.

Fitch defines traditional leverage as fund liabilities captured by the 1940 Act asset coverage tests, such as preferred stock, notes, bank credit facilities, and financing through asset-backed commercial paper (ABCP) conduits. Fitch defines nontraditional leverage as fund leverage that is typically excluded from the 1940 Act asset coverage tests, such as reverse repurchase agreements, floating-rate certificates of tender option bonds, securities lending arrangements, to be announced (TBA) security rolls, forwards, futures, total return swaps, credit default swaps, and purchased and written put and call options, among others. Guidelines of the 1940 Act generally allow funds to exclude such leverage from their asset coverage tests if the leverage is fully collateralized by segregated liquid assets or if completely offsetting leverage positions exist, e.g. long and short credit default swaps referencing the same name.

Given the significant changes in the industry, the asset coverage ratios of the 1940 Act regulation do not fully capture the spectrum of potential forms of leverage that can be assumed by a CEF. For example, the 1940 Act asset coverage ratio for a CEF with reverse repurchase agreement leverage will understate the amount of leverage presented and overstate the amount of asset coverage to rated debt or preferred stockholders. To address these issues, Fitch seeks to capture the leveraged asset exposure associated with these various new forms of liabilities. (For more information on how to calculate the Fitch Total OC test and Fitch Net OC test based on various types of traditional and nontraditional leverage, see Appendix 1: Fund Liabilities, pages 20–21.)

Furthermore, if a fund has other liabilities in its capital structure, the rated debt and preferred stock may be exposed to subordination risk and refinancing risk as follows:

- **Subordination Risk**: Senior liabilities generally have priority of claim on portfolio assets over the rated debt or preferred stock. At times, such liabilities may also have specific earmarked collateral. The Fitch Net OC test seeks to assess whether such earmarked collateral serves to the detriment of the rated debt or preferred stockholders by selecting the highest quality assets for collateral and leaving lower quality and less diversified assets available for the rated liabilities. Fitch reviews the governing documents of senior liabilities to determine the level of security over fund assets.

- **Refinancing Risk**: Refinancing risk occurs when senior debt is called early, forcing the fund to liquidate portfolio assets to repay the loan. Fitch views longer termination notice periods more favorably, as they may serve to minimize forced asset sales into a distressed environment and offer additional time to find alternative financing sources.

Fitch may assign ‘AAA’ ratings to notes and preferred stock that are subordinate to other forms of leverage due to a combination of the following: the 1940 Act framework limits most forms of senior leverage to 33% and total traditional leverage to 50%; the Fitch Net OC test measures the sufficiency of assets unencumbered by senior leverage to meet principal and interest/dividend payments of rated liabilities; and the longer term nature of financing typically employed by CEFs minimizes the risk of forced asset liquidation associated with not being able to maintain leverage during a period of...
illiquidity. In situations where these factors are not deemed sufficient, a rating may be assigned that is lower than asset coverage ratios alone would otherwise indicate.

**Investment Portfolio**

**Diversification Guidelines**

Fitch developed its discount factors for various asset classes based on extensive analysis of historical price declines and volatility of various indices. As a result, the discount factors implicitly assume that the CEF portfolio being evaluated has diversification levels comparable to the proxy index. From this perspective, the main source of potential disparity is a portfolio not being as diverse as the underlying index in terms of issuer and/or corporate industry or municipal sector/state composition, contributing to potentially higher idiosyncratic and systemic risks. To address these risks, Fitch’s ratings guidelines for CEFs include a minimum diversification framework.

Fitch acknowledges the minimum overcollateralization guidelines set forth by the 1940 Act as a baseline diversification framework to support debt and preferred stock. Specifically, funds regulated under the 1940 Act may elect to register as a diversified or nondiversified company with respect to single issuer concentration and register their intent to either concentrate or not concentrate in a particular industry. With respect to issuer concentration, the guidelines of the 1940 Act generally permit diversified funds to invest up to 5% in a single issuer (with no more than 10% of voting rights) as part of 75% of their portfolio and up to 25% in a single issuer as part of their remaining 25% of the portfolio (also known as the Safe Harbor provision), together not exceeding 25% in any single issuer. With respect to corporate industry or municipal sector concentration, the guidelines of the 1940 Act generally permit funds to register their intent to either not concentrate in any particular industry/sector and be subject to a 25% concentration limitation or concentrate in a particular industry/sector and invest more than 25% in that industry/sector. Naturally, the nondiversified/concentrated fund status is utilized primarily by sector funds, such as real estate- and energy-sector CEFs.

Although these provisions serve as baselines of protection, Fitch views them as being insufficient to protect rated debt and preferred stock investors from increased systemic and idiosyncratic risks present in portfolios concentrated in a particular industry or issuer, respectively. As such, Fitch’s rating criteria includes the following issuer diversification and industry diversification framework.

**Issuer Diversification**

Portfolios with a small number of assets, or those where individual asset balances represent a disproportionately high exposure in a given portfolio, carry added risk that portfolio performance may be adversely affected by the underperformance of a few assets. For purposes of calculating the numerator of the Fitch OC tests, eligible exposure to a single issuer is calculated based on the following:

- Up to 10% exposure to one obligor can be counted toward the Fitch OC tests. Any excess exposure to that obligor is not eligible for credit.
- Up to 5% exposure to five other obligors can be counted towards the Fitch OC tests. Any excess exposure to those five obligors is not eligible for credit.
- Up to 3% exposure in all other obligors can be counted toward the Fitch OC tests. Any excess exposure to such obligors is not eligible for credit.
Fitch Corporate Issuer Diversification Guidelines

<table>
<thead>
<tr>
<th>Obligor</th>
<th>Maximum Amount Eligible for Fitch OC Tests (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Largest Obligor</td>
<td>10^a</td>
</tr>
<tr>
<td>Next Five Largest Obligors</td>
<td>5</td>
</tr>
<tr>
<td>All Other Obligors</td>
<td>3</td>
</tr>
</tbody>
</table>

*aOn a case-by-case basis, Fitch may raise its issuer concentration thresholds for funds where Fitch rates the their issued debt or preferred stock below investment grade, since such rating already reflects, to an extent, the increased risk associated with the idiosyncratic risk in the fund’s portfolio. bOn a case-by-case basis, Fitch may raise its issuer concentration thresholds for exposure to broadly diversified investment portfolios or holding companies.

The 10%, 5%, and 3% concentrations shown in the table above are measured as the sum of all securities issued by such obligors at the market value of such securities plus accrued income relative to total portfolio assets at market value plus accrued income. This methodology does not restrict a fund from having individual issuer exposure in excess of these guidelines but seeks to exclude such exposure from the calculation of the Fitch OC tests. Obligor concentrations for corporate obligors are a sum of debt and equity securities issues by an entity at both the holding and operating company level, if applicable. It is not uncommon for some fund managers to invest in other diversified funds, indices, or investment vehicles. In such cases, Fitch’s single obligor guidelines may not apply.

For municipal obligors, concentration is aggregated by obligations, the repayment of which relies on the same sources of revenue.

Fitch Municipal Issuer Diversification Guidelines

<table>
<thead>
<tr>
<th>Obligor</th>
<th>Maximum Amount Eligible for Fitch OC Tests (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>State-Level General Obligations and Other Municipal Issues Backed by State-Level Taxing Authority</td>
<td>20</td>
</tr>
<tr>
<td>Largest Obligor</td>
<td>10^a</td>
</tr>
<tr>
<td>Next Five Largest Obligors</td>
<td>5</td>
</tr>
<tr>
<td>All Other Obligors</td>
<td>3</td>
</tr>
</tbody>
</table>

*aOn a case-by-case basis, Fitch may raise its issuer concentration thresholds for funds where Fitch rates the their issued debt or preferred stock below investment grade, since such rating already reflects, to an extent, the increased risk associated with the idiosyncratic risk in the fund’s portfolio. bOn a case-by-case basis, Fitch may raise its issuer concentration thresholds for exposure to broadly diversified investment portfolios or holding companies.

Corporate Industry and Municipal Sector/State Diversification

Assets within a single corporate industry tend to behave similarly in terms of price movements, default rates, and rating migration. Of course, this is sensible since companies within a particular industry are subject to similar economic factors, as well as trends in supply and demand. It has also been observed that the financing characteristics of a particular industry can influence the likelihood of asset co-behavior. In periods of credit expansion, particular industries have seen dramatic increases in the level of financing provided by the capital markets. The general increase in leverage within an industry makes companies in the industry more vulnerable to default during periods of economic contraction. To a certain extent, the same can be said for municipal securities, as the financial condition of a given state will likely affect the performance of securities backed by the revenue of such state. Municipal securities of the same sector may also exhibit higher levels of co-behavior. For example, healthcare and higher education securities may be affected by nationwide economic/regulatory factors that extend beyond state borders.

Fitch applies a 25% concentration threshold to corporate industry, municipal sector, or municipal state exposure to address the potential systemic risk associated with outsized exposures by industry, sector, or state. That is not to say that a fund cannot have exposure in excess of 25% but that excess exposure will be discounted to a greater...
degree to account for increased risks. Specifically, the discount factor for exposure in excess of the 25% threshold will be increased by an additional 1.1 times (x) the applicable discount factor for municipal asset types and 1.5x the applicable discount factor for nonmunicipal asset types to reflect increased correlation risk to the fund.

The multiples applied to the discount factors on the basis of portfolio concentration were derived by comparing the performance of broad market indices to indices concentrated in particular corporate industries and municipal sectors and states. The 25% level of concentration was chosen as it has regulatory significance set forth by the 1940 Act. As discussed, guidelines of the 1940 Act distinguish between industry concentrated and nonconcentrated investment companies using a 25% concentration threshold, where registered industry nonconcentrated investment companies are limited to a 25% single industry concentration and registered industry concentrated investment companies are not.

To implement the diversification framework, corporate industry and municipal sector and state exposures are calculated as a percentage of the total portfolio market value plus accrued income. For corporate securities, Fitch uses industry designations consistent with its structured credit rating criteria, as illustrated in the top right table on the page 17.

As mentioned, Fitch’s discount factors are based on historical price declines of representative indices, which are typically diversified by corporate industry or municipal sector/state. That said, certain indices utilized by Fitch to derive discount factors, such as and the Merrill Lynch Preferred Stock indices for preferred stock securities and the Alerian MLP Index for equity securities issued by master limited partnerships (MLPs), are inherently sector concentrated. As such, Fitch will not apply an additional discount factor multiple with respect to preferred stock securities or securities issued by MLPs, royalty income trusts, or marine transportation securities.

When evaluating sector concentration for municipal securities, Fitch considers all investments, with the exception of state-level general obligation (GO) bonds and other issues backed by state-level taxing authority. This is intended to ensure an appropriate amount of portfolio diversification without creating an incentive for portfolios to diversify away from what is traditionally the most creditworthy and liquid of municipal issuances.

When evaluating state concentration for municipal securities, Fitch considers all securities issued by entities within the state, including state-level GO bonds and other issues backed by state-level taxing authority. This is intended to capture overall risk exposure to a given state, regardless of the security or issuer type.

Fitch considers the effect of the municipal diversification framework to be more pronounced with respect to single-state funds, which typically invest nearly all portfolio assets in municipal obligations of issuers within a single state. Fitch defines single-state funds as those investing more than 25% in a single state. In the event a portfolio has both high sector and state concentrations, both multiples to the asset

### Summary of Industry Diversification Guidelines for Corporate Closed-End Funds

<table>
<thead>
<tr>
<th>Exposure in Excess of 25% to a Single Industry</th>
<th>Additional 1.5 times (x) Multiple to Applicable Asset Discount Factor</th>
</tr>
</thead>
</table>

To implement the diversification framework, corporate industry and municipal sector and state exposures are calculated as a percentage of the total portfolio market value plus accrued income. For corporate securities, Fitch uses industry designations consistent with its structured credit rating criteria, as illustrated in the top right table on the page 17.

As mentioned, Fitch’s discount factors are based on historical price declines of representative indices, which are typically diversified by corporate industry or municipal sector/state. That said, certain indices utilized by Fitch to derive discount factors, such as and the Merrill Lynch Preferred Stock indices for preferred stock securities and the Alerian MLP Index for equity securities issued by master limited partnerships (MLPs), are inherently sector concentrated. As such, Fitch will not apply an additional discount factor multiple with respect to preferred stock securities or securities issued by MLPs, royalty income trusts, or marine transportation securities.

When evaluating sector concentration for municipal securities, Fitch considers all investments, with the exception of state-level general obligation (GO) bonds and other issues backed by state-level taxing authority. This is intended to ensure an appropriate amount of portfolio diversification without creating an incentive for portfolios to diversify away from what is traditionally the most creditworthy and liquid of municipal issuances.

When evaluating state concentration for municipal securities, Fitch considers all securities issued by entities within the state, including state-level GO bonds and other issues backed by state-level taxing authority. This is intended to capture overall risk exposure to a given state, regardless of the security or issuer type.

Fitch considers the effect of the municipal diversification framework to be more pronounced with respect to single-state funds, which typically invest nearly all portfolio assets in municipal obligations of issuers within a single state. Fitch defines single-state funds as those investing more than 25% in a single state. In the event a portfolio has both high sector and state concentrations, both multiples to the asset
Municipal Sectors for Purposes of Determining Funds’ Single Sector Exposure*

Sectors Subject to 25% Threshold*
- General Obligation
- Healthcare
- Higher Education
- Housing Revenue
- Investor-Owned Utilities
- Lease and Tax-Backed
- Municipal
- Transportation
- Utility Revenue

*Based on Fitch financial guarantors criteria. Investments in state-level general obligation bonds issued and other issues backed by state-level taxing authority are exempt from the 25% threshold.

The aforementioned issuer, industry, sector, and state concentration frameworks exclude U.S. government and agency securities. Also, direct or indirect (e.g. derivatives, exchange traded funds) investments in diversified indices (e.g. S&P 500) are not subject to issuer or sector diversification frameworks given that they represent exposure to diversified indices with limited idiosyncratic or systemic risks; however, they exhibit systematic (market) risk, which is addressed by the asset discount factors. Alternatively, if the investment exposure is to a sector-specific index (e.g. S&P Financials), the sector diversification framework continues to apply to address sector-specific or systemic risks.

Summary of Sector/State Diversification Guidelines for Municipal Closed-End Funds*

<table>
<thead>
<tr>
<th>Exposure in Excess of 25% to a Single State</th>
<th>Exposure in Excess of 25% Exposure to a Single Municipal Sector*</th>
<th>Exposure in Excess of 20% to State-Level General Obligations (or Other Issues Backed by State-Level Taxing Authority) of a Single State</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional 1.1x Multiple to Applicable Asset Discount Factor</td>
<td>Additional 1.1x Multiple to Applicable Asset Discount Factor</td>
<td>No Credit</td>
</tr>
</tbody>
</table>

*This table summarizes sector/state diversification guidelines that are applicable to municipal CEFs. Other general guidelines, such as the issuer diversification framework, continue to apply. *Excludes state-level general obligation bonds and issues backed by state-level taxing authority.

Within a given fund, exposure to a specific corporate industry or municipal sector/state may take the form of various security types with differing discount factors. For example, a real estate fund may have exposure to both common equity and preferred stock of such issuers. In instances where a fund has industry concentration in excess of 25%, the intention of Fitch’s industry diversification framework is to apply the discount factor multiple on a pro rata basis across all instruments within such industry to avoid selectively applying the uplift to securities with higher (or lower) discount factors (for an example of how the uplift for excess industry concentration is allocated to portfolio assets, see Appendix 2, page 22).

Investment Manager Review

Surveillance
Fitch monitors fund compliance with Fitch OC and 1940 Act tests as follows:

- On a weekly basis, funds internally calculate the Fitch OC and 1940 Act tests. If
the resultant ratios are less than 10% above the minimum passing threshold (e.g. 105% for a Fitch OC tests and 205% for a 1940 Act test for preferred stock), Fitch would expect to have more frequent dialogue with the investment manager.

- On at least a monthly basis, funds calculate and provide Fitch with updated portfolio holdings and completed Fitch OC and 1940 Act test results.

- Typically, on an annual basis, Fitch performs a review of each rated fund and its investment manager. The review includes reviewing the fund’s adherence to its stated investment objectives and constraints, net asset value performance, recent coverage ratios, an evaluation of the alignment of interests between the fund manager and the rated noteholders, and a discussion with the fund manager to determine future investment strategies, plans, and other forms of research.

- In periods of heightened credit and/or liquidity stress, Fitch reserves the right to initiate more frequent/detailed surveillance procedures.

The regular reporting of asset coverage tests and updated portfolio holdings to Fitch by the fund manager and/or administrator is central to Fitch’s surveillance process and critical to maintaining the outstanding ratings on CEF debt and preferred stock. Failure to receive this information in a timely manner may result in negative rating actions and/or the withdrawal of assigned ratings.

To facilitate standardized reporting of fund information and to assist in the adoption of the new criteria and weekly testing, Fitch has developed a reporting template. The Microsoft Excel-based template includes a coverage page that summarizes the fund’s assets, liabilities, and relevant asset coverage ratios and a portfolio holdings page, with built-in formulas for determining asset discount factors and diversification guidelines. Parties interested in receiving a copy of the reporting template may contact any of the analysts listed on page 1.

In addition to the information and analysis provided by the funds, Fitch performs its own internal analysis to support ratings surveillance. First, to assist in developing a current credit opinion for each fund and to measure up-to-date performance for all rated CEF debt and preferred stock, Fitch will internally calculate a 1940 Act ratio on a regular basis to gauge portfolio volatility between monthly surveillance reports. The internal monitoring serves as a trigger point for further dialogue with managers and helps Fitch verify performance figures noted in the monthly/weekly surveillance reports received from funds. Fitch also periodically monitors ongoing asset price movements to ensure discount factors remain appropriate.

In determining the appropriate rating for debt or preferred stock issued by a CEF, Fitch will evaluate the sufficiency of asset coverage on the basis of the Fitch OC tests relative to the applicable rating stress. Should a fund maintain insufficient asset coverage at a given rating stress, a downgrade may be forthcoming, with the magnitude of the downgrade being dictated by the rating stress under which the fund is able to pass the Fitch OC tests. For example, absent other qualitative considerations, if a fund does not satisfy the Fitch OC tests under an ‘AAA’ rating stress but satisfies the Fitch OC tests under an ‘AA’ rating stress, the debt or preferred stock will likely be rated ‘AA’.

Fitch’s rating analysis will also include dialogue with the fund manager and other qualitative considerations, such as the volatility and cushion of asset coverage ratios relative to price decline expectations.
Finally, Fitch’s rating analysis also considers the sufficiency of asset coverage as calculated pursuant to the 1940 Act. While Fitch believes the Fitch OC tests are more robust measures of asset coverage, it recognizes that failure of the 1940 Act coverage ratios can have implications for the fund in terms of forced asset sales and deleveraging.

The Rating Process
Fitch assigns ratings at the request of a fund’s management and after reviewing all pertinent material and conducting an on-site manager review. Specifically, Fitch’s initial and ongoing reviews of CEFs encompass an analysis of the following areas:

- **Investment Policies and Procedures:** Sector overview, sector allocation and diversification, portfolio strategy construction and target composition, use of derivatives, and asset liquidity.
- **Operations:** Asset pricing and portfolio valuation, fair value pricing procedures, trading and settlement trade, reconciliation, and technology support;
- **Legal and Compliance:** Regulatory compliance, including compliance with the governing documents on the 1940 Act and Fitch OC asset coverage tests, SEC examinations, board of directors structure, and external and internal audits.
- **Organization:** Organizational and management structure, assets by amount and type under management, key personnel biographies and track records, product marketing, and distribution.

The on-site review includes meetings with the portfolio management team and related personnel. During the on-site review, the company has an opportunity to present information on its history, ownership structure, business plans, and investment strategies, as well as demonstrate its credit selection and portfolio monitoring capabilities. Fitch also evaluates the appropriateness of the alignment of interests between the fund manager and the rated noteholders. The organization is expected to provide detailed information on its operating processes, related technologies, and controls, as well as comprehensive profiles of its staffing resources.
### Appendix 1: Fund Liabilities

#### Treatment of Fund Liabilities for Fitch OC Test Calculations

<table>
<thead>
<tr>
<th>Column 1 Treatment of Nonrated Liabilities in Fund's Capital Structure</th>
<th>Column 2 Fitch OC Tests for Rated Debt or Preferred Stock</th>
<th>Column 3 Fitch Net OC Test</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Column 4</td>
<td>Column 5</td>
</tr>
<tr>
<td>Current Liabilities</td>
<td>+ Discounted MV of reinvested assets</td>
<td>No adjustments</td>
</tr>
<tr>
<td>Notes or Preferred Stock (Subordinate to Rated Liability)</td>
<td>+ Discounted MV of reinvested assets + Accrued interest and fees</td>
<td>No adjustments</td>
</tr>
<tr>
<td>Notes or Preferred Stock (Pari Passu to Rated Liability)</td>
<td>+ Discounted MV of reinvested assets + Accrued interest and fees</td>
<td>+ Outstanding liability</td>
</tr>
<tr>
<td>Notes or Preferred Stock (Senior to Rated Liability)</td>
<td>+ Discounted MV of reinvested assets + Accrued interest and fees</td>
<td>+ Outstanding liability</td>
</tr>
<tr>
<td>Bank Credit Facilities</td>
<td>+ Discounted MV of reinvested assets + Accrued interest and fees</td>
<td>+ Outstanding liability</td>
</tr>
<tr>
<td>ABCP Conduit Financing Facilities</td>
<td>+ Discounted MV of reinvested assets + Accrued interest and fees</td>
<td>+ Outstanding liability</td>
</tr>
<tr>
<td>Reverse Repurchase Agreements</td>
<td>+ Discounted MV of reinvested assets + Accrued interest and fees</td>
<td>+ Outstanding liability</td>
</tr>
<tr>
<td>Floating Rate Certificates of Tender Option Bonds (TOB)</td>
<td>+ Discounted MV of reinvested assets + Bond collateral MV held in TOB trust</td>
<td>+ Note liability; + Accrued interest and fees</td>
</tr>
<tr>
<td>Securities Lending</td>
<td>+ Discounted MV of securities lent + Discounted MV of collateral held for securities lent + Liability due upon return of securities</td>
<td>+ Amount in column 2</td>
</tr>
<tr>
<td>Security Rolls (e.g. Mortgage Dollar Rolls)</td>
<td>+ Discounted referenced assets’ MV + Discounted MV of collateral held</td>
<td>+ Liability due on settlement date</td>
</tr>
<tr>
<td>Futures and Forwards (Long)</td>
<td>+ Discounted referenced assets’ MV + Discounted MV of collateral held + Amount receivable on settlement date + Referenced asset MV multiplied by 1 + [1 / (1/Discount Factor)] + MV of floating rate leg</td>
<td>+ Liability due on settlement date</td>
</tr>
<tr>
<td>Futures and Forwards (Short)</td>
<td>+ Discounted referenced assets’ MV + Discounted MV of collateral held + Amount receivable on settlement date + Referenced asset MV multiplied by 1 + [1 / (1/Discount Factor)] + MV of floating rate leg</td>
<td>+ Liability due on settlement date</td>
</tr>
<tr>
<td>Interest Rate Swaps (Long, Receive Fixed and Pay Floating)</td>
<td>+ Discounted referenced assets’ MV + Discounted MV of collateral held + Amount receivable on settlement date + Referenced asset MV multiplied by 1 + [1 / (1/Discount Factor)] + MV of floating rate leg</td>
<td>+ Liability due on settlement date</td>
</tr>
<tr>
<td>Interest Rate Swaps (Short, Receive Floating and Pay Fixed)</td>
<td>+ Discounted referenced assets’ MV + Discounted MV of collateral held + Amount receivable on settlement date + Referenced asset MV multiplied by 1 + [1 / (1/Discount Factor)] + MV of floating rate leg</td>
<td>+ Liability due on settlement date</td>
</tr>
<tr>
<td>Total Return Swaps (Long)</td>
<td>+ Discounted referenced assets’ MV + Discounted MV of collateral held + Amount receivable on settlement date + Referenced asset MV multiplied by 1 + [1 / (1/Discount Factor)] + MV of floating rate leg</td>
<td>+ Liability due on settlement date</td>
</tr>
<tr>
<td>Credit Default Swaps (Long Credit, Protection Seller, Not as Hedge or Offset To Another CDS)</td>
<td>+ Discounted (CDS notional + MV) + Discounted MV of assets’ reinvested proceeds or assets segregated as a result of entering into the position (such as received upfront fee and any collateral held) + CDS notional</td>
<td>+ Amount in column 2 – Amount in column 3</td>
</tr>
<tr>
<td>Credit Default Swaps (Short Credit, Protection Buyer, Not as Hedge or Offset to Another CDS)</td>
<td>+ Lower of 0 or (CDS MV – present value of future payments)</td>
<td>+ Amount in column 2</td>
</tr>
<tr>
<td>Put Options (Purchased)</td>
<td>+ Max (0, (Strike price – Reference Asset MV) x [1 + (1 – (1/Discount Factor))])</td>
<td>No adjustments</td>
</tr>
<tr>
<td>Call Options (Purchased)</td>
<td>+ Max (0, (Reference Asset MV / Discount Factor) – Strike Price)</td>
<td>No adjustments</td>
</tr>
</tbody>
</table>
### Appendix 1: Fund Liabilities (continued)

#### Treatment of Fund Liabilities for Fitch OC Test Calculations (continued)

<table>
<thead>
<tr>
<th>Treatment of Nonrated Liabilities in Fund's Capital Structure</th>
<th>Fitch OC Tests for Rated Debt or Preferred Stock</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Fitch OC Test</strong></td>
<td><strong>Fitch Net OC Test</strong></td>
</tr>
<tr>
<td></td>
<td>Column 2</td>
<td>Column 3</td>
</tr>
<tr>
<td>Put Options (Written)</td>
<td>Numerator</td>
<td>Denominator</td>
</tr>
<tr>
<td></td>
<td>$+ \min (0, \text{Reference Asset MV} / \text{Discount Factor} - \text{Strike Price})$</td>
<td>No adjustments</td>
</tr>
<tr>
<td>Call Options (Written)</td>
<td>Numerator</td>
<td>Denominator</td>
</tr>
<tr>
<td></td>
<td>$+ \min (0, \text{Strike price} - \text{Reference Asset MV} \times {1 + {1 - (1/\text{Discount Factor})}}$</td>
<td>No adjustments</td>
</tr>
<tr>
<td>Any On- and Off-Balance Sheet Liabilities Not Addressed Above</td>
<td>Case-by-case basis</td>
<td>Case-by-case basis</td>
</tr>
</tbody>
</table>

Note: derivative positions that are used to hedge portfolio assets should first be netted before determining any net long or short derivative exposure. Treatment for any net derivative exposure (an amount not used to hedge or offset other derivatives or portfolio assets) is described in the table above. Appropriate discount factors from the Fitch Discount Factors table on pages 10–11 apply where noted. Fitch expects funds to transact with highly rated counterparties. Significant negative market values on derivative positions with low rated or nonrated counterparties may result in negative rating implications.
Appendix 2: Calculation of Industry and Sector Concentration

The table below is an example of a portfolio with two assets in the real estate industry that, in aggregate, constitute 27.50% of the portfolio (exceeding the 25% Fitch industry concentration threshold). The example illustrates how the multiple of 1.5x the base discount factor for industry overconcentration is allocated to securities in that industry.

### Allocation of Excess Industry Concentration

<table>
<thead>
<tr>
<th>Security</th>
<th>Industry</th>
<th>Portfolio (%)</th>
<th>MV (USD)</th>
<th>Industry's Weight in Portfolio (%)</th>
<th>Fitch Industry Concentration Threshold (%)</th>
<th>Total Excess (USD)</th>
<th>Allocated Excess (USD)</th>
<th>Asset's Standard Discount Factor</th>
<th>Standard DF Applied to % of Asset</th>
<th>Excess DF Applied to % of Asset</th>
<th>Weighted Average DF</th>
<th>Total Discount Asset (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset A</td>
<td>Real Estate</td>
<td>17.50</td>
<td>7.00</td>
<td>27.50</td>
<td>25.00</td>
<td>2.5</td>
<td>1.00</td>
<td>0.64</td>
<td>2.50</td>
<td>0.36</td>
<td>0.36</td>
<td>2.61</td>
</tr>
<tr>
<td>Asset B</td>
<td>Real Estate</td>
<td>10.00</td>
<td>4.00</td>
<td>27.50</td>
<td>25.00</td>
<td>2.5</td>
<td>1.00</td>
<td>0.36</td>
<td>2.50</td>
<td>0.36</td>
<td>0.36</td>
<td>2.22</td>
</tr>
<tr>
<td>Asset C</td>
<td>Telecoms</td>
<td>22.50</td>
<td>9.00</td>
<td>27.50</td>
<td>25.00</td>
<td>0.0</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>2.6</td>
</tr>
<tr>
<td>Asset E</td>
<td>Healthcare</td>
<td>25.00</td>
<td>10.00</td>
<td>25.00</td>
<td>25.00</td>
<td>0.0</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>2.6</td>
</tr>
<tr>
<td>Asset F</td>
<td>Utilities</td>
<td>25.00</td>
<td>10.00</td>
<td>25.00</td>
<td>25.00</td>
<td>0.0</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>---</td>
<td>2.6</td>
</tr>
</tbody>
</table>

**Step 1:** First, total dollar amount of excess concentration is determined by industry. This is depicted as USD1.00 in column D and calculated as 2.5% of the industry’s excess concentration, multiplied by the USD40 total portfolio value.

**Step 2:** The dollar amount is then allocated to individual securities based on the weights of those securities in that industry (USD0.64 and USD0.36 in column E). This represents each security’s dollar share of their industry’s overconcentration.

**Step 3:** Discount factors are then allocated to each security based on its share of the industry’s concentration. Column F is the standard discount factor for the security and column G is the percentage of that asset’s market value (MV) to which it is applicable. Column H is the standard discount factor for the security multiplied by the additional 1.5 multiple that captures systemic risk from industry overconcentration. Column I is the percentage of the security’s MV to which the more conservative discount factor is applicable.

**Step 4:** Column J is the weighted average discount factor for each asset and the portfolio.

**Step 5:** Finally, the total discounted assets used in Fitch’s OC tests in the last column is calculated by discounting the security’s MV by the appropriate discount factors (Column J) and their weights obtained in Step 3.
Appendix 3: Market Value Approach to Discount Factor Development

Fitch has developed discount factors through historical worst-loss stress testing, an approach that is consistent with its criteria as detailed in the research report titled “Rating Market Value Structures,” published on April 18, 2008. To reflect the dynamic and diverse nature of CEF portfolios, Fitch has developed specific discount factors for common asset types.

Discounted portfolio assets are used as the numerator for the Fitch OC tests and are calculated by dividing current portfolio market value by the appropriate discount factor for each asset type. Discount factors are not intended to provide a static view of asset performance, rather they express current views of potential market value loss through current economic conditions and the credit cycle. Fitch will perform a periodic review of discount factors using the methodology described in this criteria report. Fitch’s determination of asset discount factors was primarily based on worst-loss events experienced by each asset class. Therefore, even if future analysis indicates more positive and/or stable asset performance than implied in the currently presented discount factors, Fitch may leave the discount factors unchanged.

Fitch established discount factors through determination of the appropriate asset categorization, quantitative analysis, and modeling of historical asset price movements, and other qualitative considerations.

Categorization of Asset Classes

Fitch reviewed major asset classes within the CEF investable universe and assigned asset groups differentiated by type and exhibited magnitude of market value risk (for a list of Fitch-identified asset classes, see table, page 10–11). This approach segregated assets by sector, subordination in the issuer’s capital structure, domicile, credit rating, and duration. Market-based characteristics, such as price or spread measures, were not utilized when segregating assets into distinct categories for the purposes of assigning asset discount factors. The grouping of asset types is intended to strike an appropriate balance between differences in market value performance of asset subclasses and the diminishing benefit of overly specific classification (due to the correlation of similar assets and the challenges a more expanded approach would bring to implementation by funds). Assigning portfolio assets to broader groups is intended to allow funds to allocate discount factors and perform the Fitch OC tests in an efficient and transparent manner.

Quantitative Analysis and Modeling

For each asset class, Fitch constructed a base-case stress based on historical index performance and considered the volatility and liquidity of the given index. The base-case stress was then converted into an expected loss at each rating level by multiplying the base-case stress by a representative factor for higher rating stress scenarios.

Volatility

Fitch’s analysis of a given asset category was based on observation of the worst-case price decline experienced by the index, given a rolling 45-business-day exposure period. The analysis used historical price data drawn from an asset’s representative index. At times, Fitch used multiple indices for its analysis, looking at both price volatility and index constituents. Qualified indices typically had at least 10 years of available data.

Representative indices for each asset class were selected on the basis of the best fit
between the index constituents. Factors Fitch considered in determining robustness included: frequency of data points; length of pricing history; inclusion of multiple stress periods and business cycles; and appropriateness of data series for the asset category under consideration. Examples of indices used include the S&P 500 Index, as a proxy for historical price volatility of U.S. large cap common stock; the Alerian MLP Index, for MLPs; the LSTA Leveraged Loan Index, for first lien leveraged loans; and the Lehman Intermediate Corporate Index, for U.S. investment-grade corporate debt that matures in less than 10 years.

As an added measure of conservatism, in certain instances, Fitch increased historically observed worst losses if the asset class had experienced its worst 45-business-day loss within the preceding six months. This was intended to address the uncertainty of potential further price declines in the near future. The size of the increase was based on the timing of the observed worst loss and the degree of historical volatility experienced by the index.

**Liquidity**

Fitch views market liquidity in periods of stress to be particularly relevant to ensure deleveraging mechanisms work as intended. Therefore, Fitch constructed separate liquidity stresses based on observations of stressed liquidations and discussions with various internal sector analysts and external market participants. The amount of liquidity adjustments varied by asset type; for example, publicly traded equities received no additional liquidity haircut given the deep, established market for such securities.

Overall, Fitch made an assessment of an asset’s liquidity profile based on factors such as:

- Market size.
- Market volumes (current and historical).
- Bid/offer spreads, both in regular and stressed markets.
- Observed liquidation prices during periods of stress.
- Breadth and diversity of investors.
- Size of issue.
- Transparency of the issuer.
- Assessment of normal and large block trading sizes.
- Depth of market-making and stability in times of stress.

**Expected Loss**

A base-case stress was calculated for each asset class as the sum of the worst loss plus any illiquidity adjustment. Each base-case stress was classified by Fitch as being consistent with a particular rating stress, as determined by reviewing the main worst-loss drivers, the scale of decline during the specific economic period, and the magnitude of worst loss compared to other historical losses. Once a rating level was determined for each base-case stress, the base-case stress was increased using corresponding multipliers to reflect higher expected losses under higher rating stress scenarios. The multiplier was based on historical asset performance by rating category. For example, to increase a ‘BBB’ stress to an ‘AAA’ level, a multiple of two was used. Therefore, if an asset class’s observed worst case loss for a 45-business-day period was 11% and this loss was deemed consistent with a ‘BBB’ stress, then an ‘AAA’ level worst loss was estimated at 22% over the 45-day period.
Qualitative Assessment
Calculating base-case historical stresses per asset category was only one of a number of factors Fitch considered when determining discount factors. Fitch also analyzed the fundamental characteristics of assets, which included an analysis of the asset’s structure (e.g. convertible securities) and information transparency (e.g. liquidity). The asset’s place in the issuer’s capital structure was also analyzed, with assets falling lower in the capital structure typically receiving higher discount factors. For example, equities received more conservative discount factors compared to bonds. However, this was not always the case; for instance, third-lien secured leveraged loans received lower discount factors than unsecured high-yield bonds, primarily due to the relatively poor liquidity associated with such loans.

Furthermore, given the importance of robust historical data in determining worst-loss estimates, asset classes that did not include significant periods of stress were afforded little to no credit for the purpose of Fitch’s analysis.
## Example of CEF Surveillance Template Cover Sheet

<table>
<thead>
<tr>
<th>Asset Coverage Summary</th>
<th>Components</th>
<th>Calculation (USD)</th>
<th>Ratio (%)</th>
<th>Minimum (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1940 Act Preferred</strong></td>
<td>Total assets</td>
<td>3,701,073,706</td>
<td>409</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td>Current liabilities</td>
<td>10,500,000</td>
<td>200</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Debt and preferred stock</td>
<td>900,350,000</td>
<td>300</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest and dividends</td>
<td>1,350,000</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>1940 Act Debt</strong></td>
<td>Recognized debt</td>
<td>500,000,000</td>
<td>737</td>
<td>300</td>
</tr>
<tr>
<td></td>
<td>Interest</td>
<td>1,000,000</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>Fitch Total OC Test (for Rated Preferred Stock)</strong></td>
<td>Total net discounted assets</td>
<td>1,046,949,630</td>
<td>115</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Total leverage</td>
<td>911,350,000</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest and dividends</td>
<td>1,350,000</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>Fitch Net OC Test (for Rated Preferred Stock)</strong></td>
<td>Avail net discounted assets</td>
<td>545,949,630</td>
<td>136</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>Fitch rated preferred</td>
<td>400,000,000</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest and dividends</td>
<td>1,350,000</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td><strong>Bank Line Test</strong></td>
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<td>380</td>
<td>300</td>
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<tr>
<td><strong>Other Relevant Leverage Tests</strong></td>
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</table>
### CEF Surveillance Template

**CEF Surveillance Template**

**Report Date:**
**Fund Name:**

<table>
<thead>
<tr>
<th>Type</th>
<th>Account</th>
<th>Notes</th>
<th>Market Value (USD)</th>
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<tr>
<td><strong>Assets</strong></td>
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<td></td>
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</tr>
<tr>
<td>Cash</td>
<td>Cash unrestricted</td>
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<td>5,000,000</td>
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<tr>
<td>Investments</td>
<td>Investments not held as collateral</td>
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<td>3,646,073,706</td>
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<tr>
<td>Collateral</td>
<td>Cash and investments held as collateral</td>
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<tr>
<td>Receivables</td>
<td>Receivables sold</td>
<td></td>
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<tr>
<td></td>
<td>Receivables interest and dividends</td>
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<td>25,000,000</td>
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<tr>
<td>Derivatives</td>
<td>Unrealized appreciation of derivatives</td>
<td>List types of derivatives</td>
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<tr>
<td>Other</td>
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<tr>
<td><strong>Total Assets</strong></td>
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<td></td>
<td>3,701,073,706</td>
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<tr>
<td><strong>Liabilities</strong></td>
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<tr>
<td>Current liabilities</td>
<td>Payable for investments purchased</td>
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<tr>
<td>Leverage</td>
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<td>Dollar, mortgage and treasury rolls</td>
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<td></td>
<td>Reverse repurchase agreements</td>
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<td>Tender option bonds</td>
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<td>Bank credit facility</td>
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<td>Notes (if Fitch rated, list all series and number of shares)</td>
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</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>20,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>20,000,000</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>20,000,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>20,000,000</td>
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<tr>
<td>Notes series E</td>
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<tr>
<td>All other senior debt</td>
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<tr>
<td>Payables</td>
<td>Payable interest on borrowings</td>
<td>List types of derivatives</td>
<td>1,500,000</td>
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<tr>
<td>Derivatives</td>
<td>Unrealized depreciation on derivatives</td>
<td></td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>Payables not associated with leverage or current liabilities</td>
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<td></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
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<td>523,000,000</td>
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<tr>
<td><strong>Equity</strong></td>
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<tr>
<td>Leverage</td>
<td>Preferred stock (if Fitch rated, list all series and number of shares)</td>
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</tr>
<tr>
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<td>Preferred series A</td>
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<td>100,000,000</td>
</tr>
<tr>
<td></td>
<td>Preferred series B</td>
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</tr>
<tr>
<td></td>
<td>Preferred series C</td>
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<td>100,000,000</td>
</tr>
<tr>
<td></td>
<td>Preferred series D</td>
<td>4,000</td>
<td>350,000</td>
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<td></td>
<td>Accrued dividends</td>
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<td>Common</td>
<td>Common stock</td>
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<td>Other</td>
<td>Remaining equity</td>
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<td><strong>Total Equity</strong></td>
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<tr>
<td><strong>Common Stock Price Per Share</strong></td>
<td>USD6.00</td>
<td>Fund's NAV</td>
<td>9.26</td>
</tr>
</tbody>
</table>

**Fund’s NAV:** 9.26
APPENDIX C

PUERTO RICO RESIDENCY REPRESENTATION LETTER

Date of Purchase: _____________________

TO: Santander Securities Corporation
    or [name of other dealer] (“Dealer”)
    __________, Puerto Rico

Banco Santander Puerto Rico
San Juan, Puerto Rico

First Puerto Rico Tax-Exempt Fund, Inc.
Guaynabo, Puerto Rico

Re: First Puerto Rico Tax-Exempt Fund, Inc.
    Collateralized Exempt Obligations (“CEOs”)

Dear Sirs:

The undersigned (the “Purchaser”), has purchased or intends to purchase from time to time short-term or
medium-term collateralized exempt obligations (the “Notes”) issued by First Puerto Rico Tax-Exempt Fund, Inc. (the
“Fund”) through the Dealer. The Notes are issued from time to time by the Fund pursuant to the terms of an Amended
and Restated Custodial, Pledge and Security Agreement (the “Agreement”) between the Fund, the First Puerto Rico
Target Maturity Funds, and Banco Santander Puerto Rico. The Purchaser acknowledges having received a copy of the
offering circular for the Notes and hereby represents to you that:

1. The Purchaser (i) is acquiring the Notes for its own account, is not acquiring the Notes with a view to
    resell or distribute the Notes, and is the sole beneficial owner of the Notes, or (ii) is registered as a broker-dealer in
    Puerto Rico and is buying and offering the Notes solely from its branch office in Puerto Rico to residents of Puerto Rico
    as an agent for the account of its clients, in which case the Purchaser further represents that it has received from each
    such client a letter substantially in the form hereof and agrees to maintain such letter on file for a period of not less than
    five years and to make such letter available to the Fund upon their reasonable request.

2. At the time the Notes were offered to the Purchaser, and as of the date of this letter, the Purchaser is a
    resident of the Commonwealth of Puerto Rico (“Puerto Rico”), in that the Purchaser is either (i) an individual whose
    principal residence is in Puerto Rico or (ii) a corporation, partnership, trust or other form of business organization that
    has its principal office and principal place of business within Puerto Rico and has not been organized for the purpose of
    acquiring the Notes.

3. In compliance with all applicable U.S. Federal and Puerto Rico securities laws, the Purchaser
    understands (i) that the Notes have not been registered under the U.S. Securities Act of 1933, as amended, and the Fund
    has not been registered under the U.S. Investment Company Act of 1940, as amended, and that neither the Fund nor the
    Dealer, nor any of their affiliates, is required to so register the Notes or the Fund under said statutes, (ii) that the Notes
    may not be resold, transferred or disposed of except as provided in the offering circular for the Notes and then, only to an
    individual or an entity that executes a letter that contains the same representations as to residency as are set forth in this
    letter and (iii) the transfer agent for the Notes may not register the transfer of ownership of any Notes unless it receives
    from the transferee of the Notes a letter of representation substantially similar to this letter and that the terms of the Notes
    provide that any purported transfer to anyone other than a resident of Puerto Rico will be null and void.
4. If a business organization, the Purchaser is not an employee benefit plan subject to Section 406 of the Employee Retirement Income Security Act of 1974, as amended, and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (or comparable provisions of any subsequent enactments), or a trustee of any such plan. The Purchaser represents that, to the extent necessary, it has consulted its legal and/or tax advisers as to its status as an employee benefit plan or a trustee of such plan.

5. If the Purchaser ceases to be a resident of Puerto Rico, the Purchaser will notify the Dealer, Banco Santander Puerto Rico and the Fund immediately, and agrees to transfer its Notes to a qualified resident of Puerto Rico or otherwise liquidate its investment in the Notes as soon as such transfer or liquidation becomes economically feasible. Any person who is not a resident of Puerto Rico as described above will not be considered a noteholder for any purpose.

6. The Purchaser will comply with all applicable federal, state and Puerto Rico securities laws in connection with any subsequent resale of the Notes by the Purchaser.

7. The Purchaser hereby agrees to indemnify the Fund and the Dealer against any liability that may result if the transfer is not made in accordance with applicable law, the Agreement, and this letter of representation.

8. The Purchaser hereby agrees that each purchase of a Note shall constitute a representation by the Purchaser that the foregoing representations are true and correct as of the date of each such purchase. The Purchaser further represents and warrants to the Fund and the Dealer that they may continue to rely on the representations contained in this letter in connection with any future purchases of Notes by the Purchaser, unless and until the Purchaser shall have given written notice to the contrary to the Fund and the Dealer.

Very truly yours,

By: ____________________________
Name: __________________________
Title: __________________________
Company: _________________________