

FLAHERTY & CRUMRINE PREFERRED INCOME FUND INC  
Form N-CSR  
January 29, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM N-CSR**

**CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT**

**INVESTMENT COMPANIES**

Investment Company Act file number 811-06179

Flaherty & Crumrine Preferred Income Fund Incorporated

(Exact name of registrant as specified in charter)

301 E. Colorado Boulevard, Suite 720

Pasadena, CA 91101

(Address of principal executive offices) (Zip code)

Donald F. Crumrine

Flaherty & Crumrine Incorporated

301 E. Colorado Boulevard, Suite 720

Pasadena, CA 91101

(Name and address of agent for service)

registrant's telephone number, including area code: 626-795-7300

Date of fiscal year end: November 30

Date of reporting period: November 30, 2012

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget (OMB) control number. Please direct

comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

**Item 1. Reports to Stockholders.**

The Report to Shareholders is attached herewith.

*FLAHERTY & CRUMRINE PREFERRED INCOME FUND*

To the Shareholders of Flaherty & Crumrine Preferred Income Fund:

Fiscal 2012 concluded with positive returns total return on net asset value<sup>1</sup> for the final fiscal quarter<sup>2</sup> was +5.1%. Over the full fiscal year, return on NAV was +28.2%. Since the Fund's inception almost 22 years ago, the average annual return is +10.1%. The table below puts these numbers in context, comparing the Fund to two broad indices, one for equities and one for bonds. In the discussion section below, we dig deeper into performance; hopefully, investors will come away with a clear understanding of the factors underlying the numbers as well as our outlook for the months ahead.

**TOTAL RETURN ON NET ASSET VALUE FOR PERIODS ENDED NOVEMBER 30, 2012**

|  | Actual Returns |            |          | Average Annualized Returns |            |           |                             |
|--|----------------|------------|----------|----------------------------|------------|-----------|-----------------------------|
|  | Three Months   | Six Months | One Year | Three Years                | Five Years | Ten Years | Life of Fund <sup>(1)</sup> |
| Flaherty & Crumrine Preferred Income Fund            | 5.1%           | 13.1%      | 28.2%    | 21.2%                      | 10.9%      | 8.5%      | 10.1%                       |
| Barclays Capital U.S. Aggregate Index <sup>(2)</sup> | 0.5%           | 2.0%       | 5.5%     | 5.7%                       | 6.0%       | 5.4%      | 6.8%                        |
| S&P 500 Index <sup>(3)</sup>                         | 1.3%           | 9.3%       | 16.1%    | 11.2%                      | 1.3%       | 6.4%      | 8.9%                        |

(1) Since inception on January 31, 1991.

(2) The Barclays Capital U.S. Aggregate Index is an unmanaged index considered representative of the U.S. investment grade, fixed-rate bond market.

(3) The S&P 500 is a capitalization-weighted index of 500 common stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

*Current performance may be lower or higher than the quoted past performance, which cannot guarantee future results. In addition, NAV performance will vary from market price performance, and you may have a taxable gain or loss when you sell your shares.*

We encourage shareholders with long-term investment horizons to focus on performance on net asset value; we also realize performance based on the market price of Fund shares is important. During the fiscal quarter the return based on income plus change in the Fund's market price was -0.5%. For the fiscal year, this measure was +18.4%.

On December 10, 2012 the Fund announced it would make a special year-end distribution of \$0.12 per share (in addition to the regular December dividend). The special year-end dividend results from the Fund earning slightly more than we anticipated during the past year.

At the same time, the Fund announced a small decrease in the monthly distribution to be paid to shareholders. The new rate, \$0.09 per share, is 3.2% lower than the previous amount. As readers may recall, we have cautioned that a decline in the dividend was inevitable as some of the higher-yielding

<sup>1</sup> Following the methodology required by the SEC, total return includes income and principal change, plus the impact of the Fund's leverage and expenses.

<sup>2</sup> September 1, 2012 - November 30, 2012

securities in the Fund's portfolio are redeemed and replaced with lower-yielding securities. The relatively small reduction is evidence that so far, we have been able to manage the redemption trend with some success. A more comprehensive discussion about the Fund's dividends can be found in the section following this letter.

At this time last year, we were writing with a measure of concern over the outlook for financial markets and world economies. Since then, European economies have been mired in recession, and the United States has marched steadfastly toward its own fiscal cliff. Political leaders around the world have yet to deal decisively with their economic problems, but they have made some progress. We also witnessed several natural catastrophes, most notably super storm Sandy.

Despite this ominous backdrop, the market for preferred securities is in fine shape. The financial condition of the U.S. banking industry has improved significantly; in most instances, banks now have more capital and greater transparency than at any time we can recall. Property and casualty insurance companies easily withstood the impact of major catastrophes thanks to disciplined underwriting and conservative capital levels. Even life insurance companies, under pressure from low interest rates, have generally managed to produce consistently good earnings.

Demand for preferred securities is strong as evidenced by a gradual decline in coupon rates on new issues. The pace of issuance has been steady, and the variety of issuers and structures have kept us on our toes. We anticipate issuers will continue to raise new preferred capital for the foreseeable future. Much new issuance has been to replace older and more expensive issues. Conversely, some issuers have redeemed preferred securities without issuing replacements. As a result, the size of the preferred market has shrunk modestly.

It's not in our nature to be cheerful, so despite a very cheery 2012, we plan to approach the new year as we always do with healthy levels of vigilance and skepticism. In the section below, we dig deeper into topics mentioned here as well as others important to shareholders. In addition, we encourage you to visit the Fund's website [www.preferredincome.com](http://www.preferredincome.com) for timely and important information.

Sincerely,

Donald F. Crumrine

Chairman

December 31, 2012

Robert M. Ettinger

President

## DISCUSSION TOPICS

### The Fund's Portfolio Results and Components of Total Return on NAV

The table below reflects performance over both the recent six months and the Fund's fiscal year of each element comprising total return for the Fund, namely: (a) investing in a portfolio of securities; (b) hedging that portfolio of securities against significant increases in long-term interest rates (see the following discussion on status of the Fund's interest-rate hedging strategy); and (c) utilizing leverage to enhance returns to shareholders. Next, we compute the impact of the Fund's operating expenses. All of the parts are summed to determine total return on NAV.

#### Components of PFD's Total Return on NAV

for the Fiscal Year Ended November 30, 2012

|  | <i>Six Months*</i> | <i>One Year</i> |
|--|--------------------|-----------------|
| Total Return on Unleveraged Securities Portfolio (including principal change and income) | 9.5%               | 20.1%           |
| Return from Interest Rate Hedging Strategy   | N/A                | N/A             |
| Impact of Leverage (including leverage expense)  | 4.3%               | 9.5%            |
| Expenses (excluding leverage expense)  | -0.7%              | -1.4%           |
| <i>Total Return on NAV</i>   | <b>13.1%</b>       | <b>28.2%</b>    |

\* Actual, not annualized.

For comparison, the following table displays returns over the same time periods on three indices compiled by Bank of America Merrill Lynch, reflecting various segments of the preferred market. Because the index returns exclude all expenses and the impact of leverage, they compare most directly to the top line in the Fund's performance table above (Total Return on Unleveraged Securities Portfolio).

#### Total Returns of Bank of America Merrill Lynch Preferred Securities Indices\*

for Periods Ended November 30, 2012

|  | <i>Six Months</i> | <i>One Year</i> |
|--|-------------------|-----------------|
| BofA Merrill Lynch 8% Capped DRD Preferred Stock Index <sup>SM</sup>               | 5.7%              | 12.5%           |
| BofA Merrill Lynch 8% Capped Hybrid Preferred Securities Index <sup>SM</sup>       | 4.7%              | 12.4%           |
| BofA Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index <sup>SM</sup> |                   | 19.4%           |

\* The Bank of America Merrill Lynch 8% Capped DRD Preferred Stock Index<sup>SM</sup> (P8D0) includes investment grade preferred securities issued by both corporations and government agencies that qualify for the corporate dividend received deduction with issuer concentration capped at a maximum of 8%. The Bank of America Merrill Lynch 8% Capped Hybrid Preferred Securities Index<sup>SM</sup> (P8HO) includes taxable, fixed-rate, U.S. dollar-denominated investment-grade, preferred securities listed on a U.S. exchange with issuer concentration capped at 8%. The Bank of America Merrill Lynch 8% Capped Corporate U.S. Capital Securities Index<sup>SM</sup> (C8CT) includes investment grade fixed rate or fixed-to-floating rate \$1,000 par securities that receive some degree of equity credit from the rating agencies or their regulators with issuer concentration capped at a maximum of 8%. All index returns include interest and dividend income, and, unlike the Fund's returns, are unmanaged and do not reflect any expenses.

Over the past six-month and one-year time periods, the Fund's (unleveraged) securities portfolio has either beaten or modestly underperformed each of the three indices shown above.

During fiscal 2012, the Fund's total return on NAV significantly exceeded the returns on the indices, aided by the Fund's use of leverage. While leverage can reduce returns during periods of adverse market conditions, during the recent fiscal year the Fund's use of leverage enhanced both income distributed by the Fund and its total return over the period.

#### **Total Return on Market Price of Fund Shares**

While our focus is primarily on managing the Fund's investment portfolio, our shareholders' actual return is comprised of the Fund's monthly dividend payments *plus* changes in its *market price*. During the twelve month period ending November 30, 2012, total return on market price of Fund shares was +18.4%.

Historically, the preferred securities market has experienced price volatility consistent with those of fixed income securities. However, since mid-2007 it has become clear that preferred security valuations, including both Fund NAV and market price of its shares, can move dramatically when there is volatility in stock prices. The chart below contrasts the relative stability of the Fund's earlier period with the more recent decline and recovery in both its NAV and market price, during and following the Great Recession.

The decline and recovery in their valuations over this period was not unique to preferred securities. Virtually all fixed-income asset classes, excluding U.S. Treasury securities, experienced some volatility during this period. However, both the market price and NAV of the Fund have recovered sufficiently that long-term shareholders have experienced returns consistent with those received prior to 2007.

In a more perfect world, the market price of Fund shares and its NAV, as shown in the above chart, would track more closely. If so, the resulting premium or discount of the Fund, calculated as the difference between these two inputs and expressed as a percentage, would remain relatively close to zero. However, as can be seen from the chart on page 5, over the life of the Fund this often has not been the case, and since 2010 the market price of Fund shares has typically traded at a premium to NAV. The Fund began

fiscal 2012 with its market price at a significant premium to NAV. By the end of fiscal 2012 this premium had contracted considerably, and, as a result, the total return earned on market price, while still impressive, trailed the total return on NAV shown in the table on page 3.

Although divergence between NAV and market price of a closed-end fund is generally driven by supply/demand imbalances affecting its market price, we can only speculate about why the relationship between the Fund's market price and NAV hasn't been closer over time.

Based on a closing price of \$13.63 on December 31<sup>st</sup>, the current annualized yield on market price of Fund shares (assuming its new current monthly distribution of \$0.09 does not change) is 7.92%.

#### **Monthly Distributions to Fund Shareholders**

The Fund makes monthly distributions of income to shareholders consistent with its primary objective of providing high current income. The Fund earns its income both by investing its shareholder capital in income-producing securities, such as preferred securities, and employing leverage by borrowing additional money to invest in more income-producing securities.

This use of leverage is important in the Fund's strategy for producing high current income. Over time, the cost of leverage tends to be lower than the yield on the Fund's portfolio. The difference between what the Fund earns on its investments and pays on the borrowed money increases income available to common shareholders.

A lot of good things happened in 2012 that added to the success of this strategy and resulted in extra income being available for common shareholders at year end. For calendar year 2012, total distributions to shareholders (including the special distribution in December) were 10.5% higher than the sum of ordinary monthly distributions during the year. Although interest rates across the entire yield curve have declined in



recent years, the Fund has held securities with coupons above current market levels. Income the Fund was earning continued to benefit from those higher-coupon securities. At the same time, the Fund's cost of leverage continued to move lower (1.09% as of this writing), as it is tied to the level of 3-Month LIBOR. We have also had an opportunity over the past couple of years to adjust the terms of the leverage to be more favorable in both cost and flexibility. Lastly, the Fund received income from a bankruptcy settlement late in the year that added to December's special distribution.

We have written over the past year about the impact of changes in the regulatory environment (e.g., Dodd-Frank, Basel III), sustained low levels of interest rates, and the transition in the preferred securities market to more traditional preferred stock (versus trust preferred securities). The Fund has already completed much of the reinvestment related to Dodd-Frank redemptions of bank trust preferreds, with only about 3.7% of the portfolio remaining in bank trust preferreds that are still subject to early redemption. We do expect issuers to continue to refinance higher-coupon securities, even beyond bank trust preferreds, given the low absolute level of interest rates.

In determining the new monthly dividend announced in December, we have looked out over the next year and anticipated necessary reinvestment. We expect that leverage costs will remain low, given our outlook for the economy and guidance from the Federal Reserve. As such, we hope that current monthly dividends can be sustained through the fiscal year, consistent with our belief that shareholders are better served by stable monthly distributions than by distributions that change from month-to-month. As we have cautioned before, however, it is important not to confuse stable dividend with constant dividend. When it comes to distributions, there is no such thing as forever.

The two primary factors that could alter this course are greater-than-expected declines in top-line portfolio income, and increases in the cost of leverage from these historically-low levels. Both are probably inevitable, but we believe they are not likely to happen at exactly the same time and, in both cases, the pace should be gradual. We also believe preferred securities offer attractive total returns currently and that the Fund will continue to offer a competitive distribution rate.

#### **Preferred Market Conditions**

Conditions in the market for preferred securities<sup>1</sup> are very positive. In our view the market is healthier than any time in recent memory. Slow economic growth in the U.S., uncertainty about the fiscal cliff, and the ongoing debt problems in Europe, have steered more investors to preferred securities. The sector offers some of the highest yields in the fixed income universe, and recently prices have been much less volatile than for common stocks.

Two important trends, *refinancing of high cost issues* and *par redemptions of bank trust preferred securities* continue to impact the market. These have been in motion for several years and we have discussed them often in the past.

Briefly, by *refinancing*, issuers take advantage of the current low interest-rate environment to redeem outstanding preferred securities, replacing them with less expensive new issues. Of course, for investors the impact is a decline in investment income.

<sup>1</sup> For our purposes, the market is defined to include deeply subordinated debt and preferred stock denominated in US dollars.

The pace of *par redemptions of bank trust preferred securities* is winding down. Made possible by provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, these redemptions have resulted in a meaningful reduction in the size of the market.

In 2012, we saw \$68 billion of preferred securities redeemed<sup>2</sup> by issuers (this does not include purchases made by issuers in the open market, a harder number to calculate). Of this amount, \$44 billion or 64% is attributable to regulatory change. The balance (\$24 billion or 36%) were calls made to remove higher coupon issues and may or may not have been replaced.

Investors eagerly bought most new issues throughout the year. A total of \$57 billion from 127 issuers was added to the market in 2012. The numbers breakdown as follows:

|                |     |
|----------------|-----|
| Bank           | 31% |
| Insurance      | 22% |
| REIT           | 20% |
| Finance        | 14% |
| Miscellaneous  | 5%  |
| Utility        | 5%  |
| Communications | 2%  |
| Energy         | 1%  |
| Retail         | 71% |
| Institutional  | 29% |
| Domestic       | 85% |
| Foreign        | 15% |
| QDI Eligible   | 45% |
| Fully Taxable  | 55% |

A vibrant market for new issues helps overall market liquidity, a key barometer of market health. The number of market participants, including market makers and end-users, appears to be growing. We expect the level of activity in preferred markets to remain strong in 2013 to the benefit of almost everyone in the space.

#### **Preferreds Performance in Periods of Market Stress**

After taking a shellacking during the financial crisis, preferred securities have posted stellar returns over the past three years, pushing yields on most new issues down to a 5-6% range. What should investors expect going forward?

Investors need to remember that preferred securities have characteristics of both equity and debt securities. In times of economic or financial stress, preferreds' equity-like characteristics come to the fore. Issuers can defer or for noncumulative issues, skip dividends. In addition, prices of preferred securities can drop sharply, reflecting higher probability of issuer default or regulatory seizure during a period of stress. Regulatory changes have made preferred securities more explicitly loss-absorbing and equity-like. In short, investors should expect that in the future preferred securities will absorb losses if and when issuing companies come under significant financial strain. At the same time, preferred securities pay fixed- or floating-rate dividends that do not increase as an issuer's earnings or capital rise (although they improve prospects that an issuer will make full and timely payment of those dividends). This means that, when held to redemption, investors earn, at most, the dividend yield on that security, plus or minus the difference between the purchase and redemption price of the issue; upside is limited. Of course, active management of preferred securities can add (or subtract) return over time, but when the market is trading near par value, as it is now, dividend yield is the primary driver of prospective returns.

<sup>2</sup> A portion of these were announced in 2012 to be redeemed in 2013.



Applying those notions to preferred securities in today's market, we anticipate dividend plus a bit returns over the next year or two. The U.S. economy is growing moderately, inflation is low, and monetary policy is accommodative; interest rates are likely to remain low. Credit quality continues to improve; problem loans are falling, housing is recovering, and household balance sheets are improving. Europe is making tentative progress toward resolving its sovereign debt crisis. Banking regulation is driving higher common equity capital and lower risk. Add it up, and we foresee low risk of a sharp, widespread drop in preferred securities prices. Meanwhile, preferred securities yields remain attractive relative to other fixed-income alternatives, and there is reason for their prices to move modestly higher. We do not anticipate a repeat of recent double-digit returns, simply because starting yields are lower and the market is no longer trading at a discount to par.

In a low-return world, investors should welcome the yields offered by preferred securities today. But investors need to understand the downside risks presented by preferreds' equity-like features, even if those risks appear remote for now.

#### **Changes to Fund Industry Concentration Policy**

On April 19, 2012 Fund shareholders approved a change in Fund concentration policy so that under normal market conditions it will invest at least 25% of its total assets in the financial sector. Formerly, under normal conditions the Fund invested at least 25% of its total assets in the utilities industry and at least 25% of its total assets in the banking industry. The change was recommended because utility issues now comprise a much smaller part of the preferred universe, and financials a much larger part, than when the Fund was formed.

The new concentration policy requires the Fund to invest, under normal market conditions, at least 25% of its total assets in the financial sector, which for this purpose is comprised of the banking, thrifts & mortgage finance, diversified financial services, finance, consumer finance, capital markets, asset management & custody, investment banking & brokerage, insurance, insurance brokers and real estate investment trust (REIT) industries. From time to time, the Fund may have 25% or more of its total assets invested in any one of these industries.

The Fund now has flexibility to go above or below 25% in any one type of company in the financial sector as long as at least 25% of its total assets is invested in the financial sector in aggregate. For example, the Fund could have more than 25% of its total assets in insurance companies, while at other times it could have that portion invested in banks. At all times, though, the Fund would have at least 25% of its total assets invested in the financial sector.

#### **Status of the Fund's Hedging Strategy**

The Fund suspended its interest rate hedging program as the financial crisis intensified in the autumn of 2008. There were three principal reasons why the Fund stopped hedging the long-term interest-rate risk of its portfolio. First, the relationship between preferred securities prices and Fund hedging instruments (Treasury bond futures, interest rate swaps, or options on both) broke down during the financial crisis, and hedging lost its effectiveness. Second, the cost of hedging rose dramatically, as the yield curve steepened, volatility increased, and options prices rose. Finally, preferred securities became exceptionally cheaper and were likely to offer attractive returns to shareholders even if long-term Treasury yields increased. We believed hedging simply would not work under these market conditions.

Today, the correlation between preferred securities and our hedge instruments has improved, but it remains both weaker and significantly less stable than historic norms. We will continue to evaluate market conditions and the composition of the Fund's portfolio, and we may reinstate the hedge if we judge that conditions warrant it.

#### **Federal Tax Advantages of 2012 Calendar Year Distributions**

In 2012, the Fund passed on a portion of its income to individuals in the form of qualified dividend income, or QDI. Under federal law for 2012, QDI was taxed at a minimum of 0% and a maximum 15% rate instead of an individual's ordinary income tax rate.

In calendar year 2012, approximately 49.1% of distributions made by the Fund was eligible for QDI treatment. For an individual in the 28% marginal tax bracket, this means that the Fund's total distributions will only be taxed at a blended 21.6% rate versus the 28% rate which would apply to distributions by a fund containing traditional corporate bonds. This tax advantage means that, all other things being equal, such an individual who held 100 shares of Common Stock of the Fund for the calendar year would have had to receive approximately \$121.17 in distributions from a fully-taxable bond fund to net the same after-tax amount as the \$111.30 distributions paid by the Fund.

For detailed information about tax treatment of particular distributions received from the Fund, please see the Form 1099 you receive from either the Fund or your broker.

Corporate shareholders also receive a federal tax benefit from the 20.5% distributions that were eligible for the inter-corporate dividends received deduction, or DRD.

It is important to remember that composition of the portfolio and income distributions can change from one year to the next, and that the QDI or DRD portions of 2013's distributions may not be the same (or even similar) to 2012. In addition, the maximum QDI tax rate is increasing in 2013 from 15% to 20% for certain high-income individuals.

Flaherty & Crumrine Preferred Income Fund Incorporated

## PORTFOLIO OVERVIEW

November 30, 2012 (Unaudited)

### Fund Statistics

|                                 |    |            |
|---------------------------------|----|------------|
| Net Asset Value                 | \$ | 13.51      |
| Market Price                    | \$ | 14.85      |
| Premium                         |    | 9.92%      |
| Yield on Market Price           |    | 7.52%      |
| Common Stock Shares Outstanding |    | 10,922,232 |

### Moody's Ratings

|                          | % of Net Assets |
|--------------------------|-----------------|
| A                        | 0.4%            |
| BBB                      | 60.0%           |
| BB                       | 31.3%           |
| Below BB                 | 4.2%            |
| Not Rated*               | 2.4%            |
| Below Investment Grade** | 24.7%           |

\* Does not include net other assets and liabilities of 1.7%

\*\* Below investment grade by all of Moody's, S&P, and Fitch.

### Industry Categories

% of Net Assets

### Top 10 Holdings by Issuer

|                          | % of Net Assets |
|--------------------------|-----------------|
| Banco Santander, S.A.    | 4.4%            |
| MetLife                  | 4.2%            |
| HSBC PLC                 | 4.0%            |
| Liberty Mutual Group     | 4.0%            |
| Goldman Sachs Group      | 3.7%            |
| Barclays Bank PLC        | 3.1%            |
| PNC Financial Services   | 3.1%            |
| XL Group PLC             | 2.6%            |
| Enbridge Energy Partners | 2.6%            |
| Wells Fargo              | 2.5%            |

% of Net Assets\*\*\*

|   |     |
|---|-----|
| Holdings Generating Qualified Dividend Income (QDI) for Individuals | 46% |
|---|-----|

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Holdings Generating Income Eligible for the Corporate Dividends Received Deduction (DRD)

28%

\*\*\* This does not reflect year-end results or actual tax categorization of Fund distributions. These percentages can, and do, change, perhaps significantly, depending on market conditions. Investors should consult their tax advisor regarding their personal situation. See accompanying notes to financial statements for tax characterization of 2012 distributions.

Net Assets include assets attributable to the use of leverage.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS**

November 30, 2012

| Shares/\$ Par                          |   | Value                            |
|--|---|----------------------------------|
| <b>Preferred Securities 87.3%</b>      |   |                                  |
| <b>Banking 35.0%</b>                   |   |                                  |
| Astoria Financial:                     |   |                                  |
| \$ 2,750,000                           | Astoria Capital Trust I, 9.75% 11/01/29, Series B                     | \$ 2,860,481 <sup>(1)</sup>      |
| Banco Bilbao Vizcaya Argentaria, S.A.: |   |                                  |
| \$ 1,500,000                           | BBVA International Preferred, 5.919%                                  | 1,140,000** <sup>(1)(3)</sup>    |
| Banco Santander, S.A.:                 |   |                                  |
| 355,000                                | Banco Santander, 10.50% Pfd., Series 10                               | 9,762,500** <sup>(1)(3)</sup>    |
| Bank of America:                       |   |                                  |
| 154,972                                | Bank of America Corporation, 8.625% Pfd.                              | 3,961,472* <sup>(1)</sup>        |
| 2,500                                  | Countrywide Capital IV, 6.75% Pfd. 04/01/33                           | 63,081                           |
| 20,000                                 | Countrywide Capital V, 7.00% Pfd. 11/01/36                            | 503,126                          |
| Barclays Bank PLC:                     |   |                                  |
| \$ 3,250,000                           | Barclays Bank PLC, 6.278%   | 2,989,461** <sup>(1)(2)(3)</sup> |
| 58,000                                 | Barclays Bank PLC, 7.10% Pfd.   | 1,454,640** <sup>(3)</sup>       |
| 3,700                                  | Barclays Bank PLC, 7.75% Pfd., Series 4                               | 93,240** <sup>(3)</sup>          |
| 90,000                                 | Barclays Bank PLC, 8.125% Pfd., Series 5                              | 2,301,300** <sup>(1)(3)</sup>    |
| BB&T Corp:                             |   |                                  |
| 34,000                                 | BB&T Corporation, 5.625% Pfd., Series E                               | 865,300* <sup>(1)(2)</sup>       |
| BNP Paribas:                           |   |                                  |
| \$ 1,750,000                           | BNP Paribas, 7.195%, 144A****   | 1,747,813** <sup>(1)(2)(3)</sup> |
| Capital One Financial:                 |   |                                  |
| \$ 500,000                             | Capital One Capital V, 10.25% 08/15/39                                | 505,000 <sup>(1)</sup>           |
| \$ 500,000                             | Capital One Capital VI, 8.875% 05/15/40                               | 505,250 <sup>(1)</sup>           |
| Citigroup:                             |   |                                  |
| \$ 1,200,000                           | Citigroup Inc., 5.95%   | 1,222,500*                       |
| 15,000                                 | Citigroup Capital VII, 7.125% Pfd. 07/31/31                           | 380,157                          |
| 62,300                                 | Citigroup Capital XIII, 7.875% Pfd. 10/30/40                          | 1,748,294 <sup>(1)(2)</sup>      |
| CoBank ACB:                            |   |                                  |
| 10,000                                 | CoBank ACB, 6.25% Pfd., 144A****                                      | 1,021,250*                       |
| Colonial BancGroup:                    |   |                                  |
| \$ 5,210,000                           | Colonial BancGroup, 7.114%, 144A****                                  | 7,815 <sup>(4)(5)</sup>          |
| FBOP Corp:                             |   |                                  |
| 9,000                                  | FBOP Corporation, Adj. Rate Pfd., 144A****                            | 4,500* <sup>(4)(5)</sup>         |
| Fifth Third Bancorp:                   |   |                                  |
| \$ 750,000                             | Fifth Third Capital Trust IV, 6.50% 04/15/37                          | 754,687                          |
| First Horizon:                         |   |                                  |
| 795                                    | First Tennessee Bank, Adj. Rate Pfd., 3.75% <sup>(6)</sup> , 144A**** | 574,388* <sup>(1)</sup>          |
| \$ 500,000                             | First Tennessee Capital II, 6.30% 04/15/34, Series B                  | 485,000                          |
| 1                                      | FT Real Estate Securities Company, 9.50% Pfd., 144A****               | 1,100,625                        |
| First Niagara Financial Group:         |   |                                  |
| 112,500                                | First Niagara Financial Group, Inc., 8.625% Pfd.                      | 3,336,334* <sup>(1)(2)</sup>     |

The accompanying notes are an integral part of the financial statements.





Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2012

| Shares/\$ Par                           |  | Value                         |
|---|--|-------------------------------|
| <b>Preferred Securities (Continued)</b> |  |                               |
| <b>Banking (Continued)</b>              |  |                               |
| First Republic Bank:                    |  |                               |
| 10,050                                  | First Republic Bank, 6.70% Pfd.                      | \$ 271,978*                   |
| Goldman Sachs Group:                    |  |                               |
| \$ 2,605,300                            | Goldman Sachs, Capital I, 6.345% 02/15/34            | 2,691,382 <sup>(1)(2)</sup>   |
| HSBC PLC:                               |  |                               |
| \$ 1,000,000                            | HSBC Capital Funding LP, 10.176%, 144A****           | 1,370,000 <sup>(1)(3)</sup>   |
| 132,900                                 | HSBC Holdings PLC, 8.00% Pfd., Series 2              | 3,686,978** <sup>(1)(3)</sup> |
| \$ 130,000                              | HSBC USA Capital Trust I, 7.808% 12/15/26, 144A****  | 132,438                       |
| \$ 145,000                              | HSBC USA Capital Trust II, 8.38% 05/15/27, 144A****  | 146,520 <sup>(1)</sup>        |
| 110,350                                 | HSBC USA, Inc., 6.50% Pfd., Series H                 | 2,810,482* <sup>(1)</sup>     |
| ING Groep NV:                           |  |                               |
| 35,000                                  | ING Groep NV, 7.05% Pfd.                             | 876,453** <sup>(3)</sup>      |
| 23,400                                  | ING Groep NV, 7.20% Pfd.                             | 587,399** <sup>(3)</sup>      |
| 35,000                                  | ING Groep NV, 7.375% Pfd.                            | 884,800** <sup>(3)</sup>      |
| 15,000                                  | ING Groep NV, 8.50% Pfd.                             | 386,400** <sup>(3)</sup>      |
| JPMorgan Chase:                         |  |                               |
| 10,200                                  | JPMorgan Chase & Company, 5.50% Pfd.                 | 254,490*                      |
| \$ 3,334,000                            | JPMorgan Chase & Company, 7.90%, Series 1            | 3,779,886* <sup>(1)</sup>     |
| KeyCorp:                                |  |                               |
| 1,000                                   | KeyCorp, 7.75% Pfd., Series A                        | 124,250*                      |
| Lloyds Banking Group PLC:               |  |                               |
| \$ 550,000                              | Lloyds Banking Group PLC, 6.657%, 144A****           | 466,125** <sup>(3)</sup>      |
| Morgan Stanley:                         |  |                               |
| 40,000                                  | Morgan Stanley Capital Trust VI, 6.60% Pfd. 02/01/46 | 1,006,252                     |
| 5,000                                   | Morgan Stanley Capital Trust VII, 6.60% Pfd.         | 125,500                       |
| PNC Financial Services:                 |  |                               |
| 14,995                                  | PNC Financial Services, 6.125% Pfd., Series P        | 412,685* <sup>(1)</sup>       |
| 179,962                                 | PNC Financial Services, 9.875% Pfd., Series L        | 4,610,896* <sup>(1)</sup>     |
| \$ 1,750,000                            | PNC Preferred Funding Trust III, 8.70%, 144A****     | 1,771,798 <sup>(1)(2)</sup>   |
| Sovereign Bancorp:                      |  |                               |
| 1,750                                   | Sovereign REIT, 12.00% Pfd., Series A, 144A****      | 2,108,208                     |
| Webster Financial Corp:                 |  |                               |
| 15,000                                  | Webster Financial Corporation, 6.40% Pfd.            | 376,875*                      |
| Wells Fargo:                            |  |                               |
| \$ 1,500,000                            | First Union Capital II, 7.95% 11/15/29               | 1,784,283 <sup>(1)(2)</sup>   |
| 1,750                                   | Wells Fargo & Company, 7.50% Pfd., Series L          | 2,163,875* <sup>(1)</sup>     |
| 55,500                                  | Wells Fargo & Company, 8.00% Pfd., Series J          | 1,649,543*                    |
| Zions Bancorporation:                   |  |                               |
| 93,000                                  | Zions Bancorporation, 7.90% Pfd., Series F           | 2,670,030*                    |
| 36,500                                  | Zions Bancorporation, 9.50% Pfd., Series C           | 950,825*                      |
|   |  | 77,488,565                    |

The accompanying notes are an integral part of the financial statements.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2012

| Shares/\$ Par                           |   | Value                             |
|---|---|-----------------------------------|
| <b>Preferred Securities (Continued)</b> |   |                                   |
| <b>Financial Services 1.0%</b>          |   |                                   |
| Credit Suisse Group:                    |   |                                   |
| \$ 1,280,000                            | Claudius, Ltd. - Credit Suisse AG, 7.875%, Series B, 144A**** | \$ 1,374,400 <sup>(3)</sup>       |
| HSBC PLC:                               |   |                                   |
| 30,000                                  | HSBC Finance Corporation, 6.36% Pfd., Series B                | 749,064 <sup>*(1)</sup>           |
|   |   | 2,123,464                         |
| <b>Insurance 23.4%</b>                  |   |                                   |
| Ace Ltd.:                               |   |                                   |
| \$ 975,000                              | Ace Capital Trust II, 9.70% 04/01/30                          | 1,391,813 <sup>(1)(2)(3)</sup>    |
| Aon Corporation:                        |   |                                   |
| \$ 400,000                              | AON Corp, 8.205% 01/01/27                                     | 508,328                           |
| Arch Capital Group:                     |   |                                   |
| 88,950                                  | Arch Capital Group, Ltd., 6.75% Pfd., Series C                | 2,359,977 <sup>** (1)(2)(3)</sup> |
| AXA SA:                                 |   |                                   |
| \$ 3,500,000                            | AXA SA, 6.379%, 144A****                                      | 3,316,250 <sup>** (1)(2)(3)</sup> |
| Axis Capital:                           |   |                                   |
| 200,000                                 | Axis Capital Holdings, 6.875% Pfd., Series C                  | 5,440,300 <sup>** (1)(2)(3)</sup> |
| Delphi Financial:                       |   |                                   |
| 90,600                                  | Delphi Financial Group, 7.376% Pfd. 05/15/37                  | 2,265,000 <sup>(1)</sup>          |
| Endurance Specialty Holdings:           |   |                                   |
| 15,000                                  | Endurance Specialty Holdings, 7.50% Pfd.                      | 399,375 <sup>** (3)</sup>         |
| Everest Re Group:                       |   |                                   |
| \$ 4,350,000                            | Everest Re Holdings, 6.60% 05/15/37                           | 4,434,825 <sup>(1)(2)</sup>       |
| Liberty Mutual Group:                   |   |                                   |
| \$ 4,100,000                            | Liberty Mutual Group, 10.75% 06/15/58, 144A****               | 6,129,500 <sup>(1)(2)</sup>       |
| Lincoln National Corp:                  |   |                                   |
| \$ 190,000                              | Lincoln National Corporation, 7.00% 05/17/66                  | 192,850                           |
| MetLife:                                |   |                                   |
| \$ 2,496,000                            | MetLife, Inc., 10.75% 08/01/39                                | 3,834,480 <sup>(1)(2)</sup>       |
| \$ 279,000                              | MetLife Capital Trust IV, 7.875% 12/15/37, 144A****           | 343,170 <sup>(1)(2)</sup>         |
| \$ 3,635,000                            | MetLife Capital Trust X, 9.25% 04/08/38, 144A****             | 5,034,475 <sup>(1)(2)</sup>       |
| PartnerRe Ltd.:                         |   |                                   |
| 36,010                                  | PartnerRe Ltd., 7.250% Pfd., Series E                         | 966,148 <sup>** (1)(3)</sup>      |
| Principal Financial:                    |   |                                   |
| 13,000                                  | Principal Financial Group, 5.563% Pfd., Series A              | 1,281,719 <sup>*(1)</sup>         |
| 90,000                                  | Principal Financial Group, 6.518% Pfd., Series B              | 2,410,317 <sup>*(1)</sup>         |
| Prudential Financial:                   |   |                                   |
| \$ 750,000                              | Prudential Financial Inc., 5.625% 06/15/43                    | 755,625                           |
| QBE Capital Funding:                    |   |                                   |
| \$ 1,100,000                            | QBE Capital Funding III Ltd., 7.25% 05/24/41, 144A****        | 1,135,506 <sup>(3)</sup>          |

The accompanying notes are an integral part of the financial statements.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2012

| Shares/\$ Par                            |  | Value                       |
|--|--|-----------------------------|
| <b>Preferred Securities (Continued)</b>  |  |                             |
| <b>Insurance (Continued)</b>             |  |                             |
| Renaissancere Holdings:                  |  |                             |
| 25,945                                   | Renaissancere Holdings Ltd, 6.60% Pfd.                     | \$ 652,257** <sup>(3)</sup> |
| StanCorp Financial Group:                |  |                             |
| \$ 2,250,000                             | StanCorp Financial Group, 6.90% 06/01/67                   | 2,238,750 <sup>(1)(2)</sup> |
| The Travelers Companies:                 |  |                             |
| \$ 679,500                               | USF&G Capital, 8.312% 07/01/46, 144A****                   | 868,148 <sup>(1)(2)</sup>   |
| XL Group PLC:                            |  |                             |
| \$ 6,440,000                             | XL Capital Ltd., 6.50%, Series E                           | 5,866,840 <sup>(1)(3)</sup> |
|  |  | 51,825,653                  |
| <b>Utilities 18.2%</b>                   |  |                             |
| Alabama Power:                           |  |                             |
| 10,350                                   | Alabama Power Company, 6.45% Pfd.                          | 298,856* <sup>(1)</sup>     |
| Baltimore Gas & Electric:                |  |                             |
| 10,000                                   | Baltimore Gas & Electric Company, 6.70% Pfd., Series 1993  | 1,021,250* <sup>(1)</sup>   |
| 2,400                                    | Baltimore Gas & Electric Company, 7.125% Pfd., Series 1993 | 245,625*                    |
| Commonwealth Edison:                     |  |                             |
| \$ 2,953,000                             | COMED Financing III, 6.35% 03/15/33                        | 3,130,180 <sup>(1)</sup>    |
| Constellation Energy:                    |  |                             |
| 15,000                                   | Constellation Energy Group, 8.625% Pfd. 06/15/63, Series A | 396,000                     |
| Dominion Resources:                      |  |                             |
| \$ 250,000                               | Dominion Resources Capital Trust I, 7.83% 12/01/27         | 252,732                     |
| \$ 3,500,000                             | Dominion Resources, Inc., 7.50% 06/30/66                   | 3,888,066 <sup>(1)(2)</sup> |
| Energy Future Competitive Holdings Corp: |  |                             |
| \$ 636,000                               | TXU Electric Capital V, 8.175% 01/30/37                    | 159,000 <sup>(4)</sup>      |
| Entergy Arkansas:                        |  |                             |
| 50,000                                   | Entergy Arkansas, Inc., 6.45% Pfd.                         | 1,265,625* <sup>(1)</sup>   |
| Entergy Louisiana:                       |  |                             |
| 30,000                                   | Entergy Louisiana, Inc., 6.95% Pfd.                        | 3,007,500* <sup>(1)</sup>   |
| Georgia Power:                           |  |                             |
| 25,000                                   | Georgia Power Company, 6.50% Pfd., Series 2007A            | 2,837,500* <sup>(1)</sup>   |
| Indianapolis Power & Light:              |  |                             |
| 26,000                                   | Indianapolis Power & Light Company, 5.65% Pfd.             | 2,611,375*                  |
| Interstate Power & Light:                |  |                             |
| 181,208                                  | Interstate Power & Light Company, 8.375% Pfd., Series B    | 4,705,754* <sup>(1)</sup>   |
| Nextera Energy:                          |  |                             |
| \$ 3,400,000                             | FPL Group Capital, Inc., 6.65% 06/15/67                    | 3,660,280 <sup>(1)(2)</sup> |
| PECO Energy:                             |  |                             |
| \$ 500,000                               | PECO Energy Capital Trust III, 7.38% 04/06/28, Series D    | 566,345 <sup>(1)(2)</sup>   |

The accompanying notes are an integral part of the financial statements.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2012

| Shares/\$ Par                                   |  | Value                          |
|---|--|--------------------------------|
| <b>Preferred Securities (Continued)</b>         |  |                                |
| <b>Utilities (Continued)</b>                    |  |                                |
|   | PPL Corp:  |                                |
| \$ 2,500,000                                    | PPL Capital Funding, 6.70% 03/30/67, Series A                | \$ 2,646,725 <sup>(1)(2)</sup> |
|   | Puget Energy:  |                                |
| \$ 3,800,000                                    | Puget Sound Energy, Inc., 6.974% 06/01/67                    | 4,032,298 <sup>(1)(2)</sup>    |
|   | Scana Corp:  |                                |
| 47,392  | Scana Corporation, 7.70% Pfd. 01/30/65                       | 1,290,010 <sup>(1)(2)</sup>    |
|   | Southern California Edison:                                  |                                |
| 13,600  | Southern California Edison, 6.00% Pfd., Series C             | 1,374,876 <sup>*(1)</sup>      |
| 22,410  | Southern California Edison, 6.50% Pfd., Series D             | 2,362,854 <sup>*(1)</sup>      |
|   | Virginia Electric & Power:                                   |                                |
| 3,000   | Virginia Electric & Power Company, \$6.98 Pfd.               | 302,250*                       |
|   | Wisconsin Public Service:                                    |                                |
| 3,700   | Wisconsin Public Service Corporation, 6.88% Pfd.             | 376,128*                       |
|   |  | 40,431,229                     |
| <b>Energy 6.2%</b>                              |  |                                |
|   | Enbridge Energy Partners:                                    |                                |
| \$ 5,000,000                                    | Enbridge Energy Partners LP, 8.05% 10/01/37                  | 5,655,715 <sup>(1)(2)</sup>    |
|   | Enterprise Products Partners:                                |                                |
| \$ 4,500,000                                    | Enterprise Products Partners, 8.375% 08/01/66, Series A      | 5,100,309 <sup>(1)(2)</sup>    |
|   | Kinder Morgan:   |                                |
| 3,500   | Kinder Morgan GP, Inc., 4.209% <sup>(6)</sup> Pfd., 144A**** | 2,975,219*                     |
|   |  | 13,731,243                     |
| <b>Real Estate Investment Trust (REIT) 0.9%</b> |  |                                |
|   | Duke Realty Corp:  |                                |
| 25,000  | Duke Realty Corp, 6.60% Pfd.                                 | 629,063                        |
|   | Kimco Realty Corp:   |                                |
| 50,000  | Kimco Realty Corporation, 5.625% Pfd.                        | 1,231,250                      |
|   | PS Business Parks:   |                                |
| 7,500   | PS Business Parks, Inc., 6.875% Pfd., Series R               | 203,100                        |
|   |  | 2,063,413                      |
| <b>Miscellaneous Industries 2.6%</b>            |  |                                |
|   | Ocean Spray Cranberries:                                     |                                |
| 37,400  | Ocean Spray Cranberries, Inc., 6.25% Pfd., 144A****          | 3,412,750*                     |
|   | Stanley Black & Decker:                                      |                                |
| 18,704  | Stanley Black & Decker, Inc., 5.75% Pfd. 07/25/52            | 493,903 <sup>(1)(2)</sup>      |

The accompanying notes are an integral part of the financial statements.





Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2012

| Shares/\$ Par                               |   | Value                       |
|---|---|-----------------------------|
| <b>Preferred Securities (Continued)</b>     |   |                             |
| <b>Miscellaneous Industries (Continued)</b> |   |                             |
|   | Textron, Inc.:  |                             |
| \$ 2,125,000                                | Textron Financial Corporation, 6.00% 02/15/67, 144A****   | \$ 1,870,310                |
|   |   | 5,776,963                   |
|   | <b>Total Preferred Securities</b><br>(Cost \$183,608,034) | 193,440,530                 |
| <b>Corporate Debt Securities 11.0%</b>      |   |                             |
| <b>Banking 5.9%</b>                         |   |                             |
|   | Goldman Sachs Group:                                      |                             |
| \$ 4,988,800                                | Goldman Sachs Group, 6.75% 10/01/37, Sub Notes            | 5,568,793 <sup>(1)(2)</sup> |
|   | Morgan Stanley:   |                             |
| \$ 2,580,000                                | Morgan Stanley, 6.375% 07/24/42                           | 3,033,252 <sup>(1)</sup>    |
|   | Regions Financial:  |                             |
| \$ 2,710,000                                | Regions Financial Corporation, 7.375% 12/10/37, Sub Notes | 2,957,287 <sup>(1)</sup>    |
|   | Texas Capital Bank:                                       |                             |
| 59,000                                      | Texas Capital Bancshares Inc., 6.50% 9/21/42              | 1,494,028                   |
|   |   | 13,053,360                  |
| <b>Financial Services 0.3%</b>              |   |                             |
|   | Affiliated Managers Group:                                |                             |
| 20,825                                      | Affiliated Managers Group, Inc., 6.375% 08/15/42          | 533,359                     |
|   | Raymond James Financial:                                  |                             |
| 6,500                                       | Raymond James Financial, 6.90% 03/15/42                   | 179,969                     |
|   |   | 713,328                     |
| <b>Insurance 2.3%</b>                       |   |                             |
|   | Liberty Mutual Group:                                     |                             |
| \$ 2,500,000                                | Liberty Mutual Insurance, 7.697% 10/15/97, 144A****       | 2,627,000 <sup>(1)(2)</sup> |
|   | Unum Group:   |                             |
| \$ 2,000,000                                | UnumProvident Corporation, 7.25% 03/15/28                 | 2,398,844 <sup>(1)(2)</sup> |
|   |   | 5,025,844                   |
| <b>Utilities 1.6%</b>                       |   |                             |
|   | Energy Transfer Equity:                                   |                             |
| \$ 2,700,000                                | Southern Union Company, 8.25% 11/15/29                    | 3,453,764 <sup>(1)(2)</sup> |
|   |   | 3,453,764                   |

The accompanying notes are an integral part of the financial statements.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

November 30, 2012

| Shares/\$ Par                                |   | Value                       |
|--|---|-----------------------------|
| <b>Corporate Debt Securities (Continued)</b> |   |                             |
| <b>Energy 0.9%</b>                           |   |                             |
| Nexen, Inc.:                                 |   |                             |
| 79,305                                       | Nexen, Inc., 7.35% 11/01/43                                   | \$ 2,027,234 <sup>(3)</sup> |
|  |   | 2,027,234                   |
|  | <b>Total Corporate Debt Securities</b><br>(Cost \$20,333,331) | 24,273,530                  |
| <b>Common Stock 0.2%</b>                     |   |                             |
| <b>Banking 0.1%</b>                          |   |                             |
| CIT Group:                                   |   |                             |
| 3,620  | CIT Group, Inc.   | 134,121*                    |
|  |   | 134,121                     |
| <b>Insurance 0.0%</b>                        |   |                             |
| WMI Holdings Corporation:                    |   |                             |
| 19,801                                       | WMI Holdings Corporation, 144A****                            | 9,504*                      |
|  |   | 9,504                       |
| <b>Utilities 0.1%</b>                        |   |                             |
| Exelon Corp:                                 |   |                             |
| 9,380  | Exelon Corporation  | 283,464*                    |
|  |   | 283,464                     |
|  | <b>Total Common Stock</b><br>(Cost \$1,728,325)               | 427,089                     |
| <b>Money Market Fund 0.4%</b>                |   |                             |
| BlackRock Liquidity Funds:                   |   |                             |
| 952,423                                      | T-Fund  | 952,423                     |
|  | <b>Total Money Market Fund</b><br>(Cost \$952,423)            | 952,423                     |
|  | <b>Total Investments</b> (Cost \$206,622,113***)              | 98.9% 219,093,572           |
|  | <b>Other Assets And Liabilities</b> (Net)                     | 1.1% 2,528,541              |
|  | <b>Total Managed Assets</b>                                   | 100.0% \$ 221,622,113       |

|   |                       |
|---|-----------------------|
| <b>Loan Principal Balance</b>                     | (74,100,000)          |
| <b>Total Net Assets Available To Common Stock</b> | <b>\$ 147,522,113</b> |

The accompanying notes are an integral part of the financial statements.

Flaherty & Crumrine Preferred Income Fund Incorporated

**PORTFOLIO OF INVESTMENTS (Continued)**

**November 30, 2012**

\* Securities eligible for the Dividends Received Deduction and distributing Qualified Dividend Income.

\*\* Securities distributing Qualified Dividend Income only.

\*\*\* Aggregate cost of securities held.

\*\*\*\* Securities exempt from registration under Rule 144A of the Securities Act of 1933. These securities may be resold in transactions exempt from registration to qualified institutional buyers. At November 30, 2012, these securities amounted to \$39,547,712 or 17.8% of total managed assets.

(1) All or a portion of this security is pledged as collateral for the Fund's loan. The total value of such securities was \$148,953,081 at November 30, 2012.

(2) All or a portion of this security has been rehypothecated. The total value of such securities was \$68,091,083 at November 30, 2012.

(3) Foreign Issuer.

(4) Illiquid.

(5) Valued at fair value as determined in good faith by or under the direction of the Board of Directors as of November 30, 2012.

(6) Represents the rate in effect as of the reporting date.

Non-income producing.

The issuer has filed for bankruptcy protection. As a result, the Fund may not be able to recover the principal invested and also does not expect to receive income on this security going forward.

The percentage shown for each investment category is the total value of that category as a percentage of total managed assets.

**ABBREVIATIONS:**

**Pfd.** Preferred Securities  
**REIT** Real Estate Investment Trust

The accompanying notes are an integral part of the financial statements.

Flaherty & Crumrine Preferred Income Fund Incorporated

**STATEMENT OF ASSETS AND LIABILITIES**

**November 30, 2012**

|   |                       |
|---|-----------------------|
| <b>ASSETS:</b>  |                       |
| Investments, at value (Cost \$206,622,113)                | \$ 219,093,572        |
| Cash  | 153,226               |
| Receivable for investments sold                           | 3,593,051             |
| Dividends and interest receivable                         | 2,630,368             |
| Prepaid expenses  | 38,009                |
| <b>Total Assets</b>                                       | <b>225,508,226</b>    |
| <b>LIABILITIES:</b>                                       |                       |
| Loan Payable  | \$ 74,100,000         |
| Payable for investments purchased                         | 3,555,069             |
| Dividends payable to Common Stock Shareholders            | 96,338                |
| Investment advisory fee payable                           | 101,163               |
| Administration, Transfer Agent and Custodian fees payable | 29,878                |
| Professional fees payable                                 | 66,520                |
| Directors fees payable                                    | 784                   |
| Accrued expenses and other payables                       | 36,361                |
| <b>Total Liabilities</b>                                  | <b>77,986,113</b>     |
| <b>NET ASSETS AVAILABLE TO COMMON STOCK</b>               | <b>\$ 147,522,113</b> |
| <b>NET ASSETS AVAILABLE TO COMMON STOCK</b> consist of:   |                       |
| Undistributed net investment income                       | \$ 1,245,254          |
| Accumulated net realized loss on investments sold         | (21,516,696)          |
| Unrealized appreciation of investments                    | 12,471,459            |
| Par value of Common Stock                                 | 109,222               |
| Paid-in capital in excess of par value of Common Stock    | 155,212,874           |
| <b>Total Net Assets Available to Common Stock</b>         | <b>\$ 147,522,113</b> |
| <b>NET ASSET VALUE PER SHARE OF COMMON STOCK:</b>         |                       |
| Common Stock (10,922,232 shares outstanding)              | \$ 13.51              |

The accompanying notes are an integral part of the financial statements.

Flaherty & Crumrine Preferred Income Fund Incorporated

**STATEMENT OF OPERATIONS**

**For the Year Ended November 30, 2012**

|   |                      |
|---|----------------------|
| <b>INVESTMENT INCOME:</b>   |                      |
| Dividends   | \$ 7,285,227         |
| Interest  | 8,984,356            |
| Rehypothecation Income  | 33,313               |
| <b>Total Investment Income</b>  | <b>16,302,896</b>    |
| <b>EXPENSES:</b>  |                      |
| Investment advisory fees  | \$ 1,160,950         |
| Administrator s fees  | 207,952              |
| Professional fees   | 59,454               |
| Insurance expenses  | 95,475               |
| Transfer Agent fees   | 52,769               |
| Directors fees  | 70,396               |
| Custodian fees  | 28,079               |
| Compliance fees   | 37,503               |
| Interest expenses   | 858,645              |
| Other   | 152,665              |
| <b>Total Expenses</b>   | <b>2,723,888</b>     |
| <b>NET INVESTMENT INCOME</b>  | <b>13,579,008</b>    |
| <b>REALIZED AND UNREALIZED GAIN/(LOSS) ON INVESTMENTS</b>                       |                      |
| Net realized gain on investments sold during the year                           | 1,700,779            |
| Change in net unrealized appreciation/depreciation of investments               | 19,671,602           |
| <b>NET REALIZED AND UNREALIZED GAIN ON INVESTMENTS</b>                          | <b>21,372,381</b>    |
| <b>NET INCREASE IN NET ASSETS TO COMMON STOCK<br/>RESULTING FROM OPERATIONS</b> | <b>\$ 34,951,389</b> |

For Federal income tax purposes, a significant portion of this amount may not qualify for the inter-corporate dividends received deduction ( DRD ) or as qualified dividend income ( QDI ) for individuals.

The accompanying notes are an integral part of the financial statements.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE TO COMMON STOCK**

|  | Year Ended<br>November 30, 2012 | Year Ended<br>November 30, 2011 |
|--|---------------------------------|---------------------------------|
| <b>OPERATIONS:</b>   |                                 |                                 |
| Net investment income  | \$ 13,579,008                   | \$ 12,284,036                   |
| Net realized gain/(loss) on investments sold during the year   | 1,700,779                       | 8,429,046                       |
| Change in net unrealized appreciation/depreciation of investments                                      | 19,671,602                      | (13,072,757)                    |
| <b>Net increase in net assets resulting from operations</b>  | <b>34,951,389</b>               | <b>7,640,325</b>                |
| <b>DISTRIBUTIONS:</b>  |                                 |                                 |
| Dividends paid from net investment income to Common Stock Shareholders <sup>(1)</sup>                  | (12,658,771)                    | (12,115,178)                    |
| <b>Total Distributions to Common Stock Shareholders</b>  | <b>(12,658,771)</b>             | <b>(12,115,178)</b>             |
| <b>FUND SHARE TRANSACTIONS:</b>  |                                 |                                 |
| Increase from shares issued under the Dividend Reinvestment and Cash Purchase Plan                     | 1,134,328                       | 1,008,897                       |
| <b>Net increase in net assets available to Common Stock resulting from Fund share transactions</b>     | <b>1,134,328</b>                | <b>1,008,897</b>                |
| <b>NET INCREASE/(DECREASE) IN NET ASSETS AVAILABLE TO COMMON STOCK FOR THE YEAR</b>                    | <b>\$ 23,426,946</b>            | <b>\$ (3,465,956)</b>           |
| <b>NET ASSETS AVAILABLE TO COMMON STOCK:</b>   |                                 |                                 |
| Beginning of year  | \$ 124,095,167                  | \$ 127,561,123                  |
| Net increase/(decrease) in net assets during the year  | 23,426,946                      | (3,465,956)                     |
| End of year (including undistributed net investment income of \$1,245,254 and \$488,602, respectively) | \$ 147,522,113                  | \$ 124,095,167                  |

<sup>(1)</sup> May include income earned, but not paid out, in prior fiscal year.

The accompanying notes are an integral part of the financial statements.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**STATEMENT OF CASH FLOWS**

For the Year Ended November 30, 2012

**INCREASE/(DECREASE) IN CASH****CASH FLOWS FROM OPERATING ACTIVITIES:**

Net increase in net assets resulting from operations \$ 34,951,389

**ADJUSTMENTS TO RECONCILE NET INCREASE IN NET ASSETS RESULTING****FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:**

|  |              |
|--|--------------|
| Purchase of investment securities                                | (79,811,228) |
| Proceeds from disposition of investment securities               | 70,891,019   |
| Purchase of short-term investment securities, net                | 1,376,435    |
| Cash received from litigation claim                              | 66,704       |
| Increase in dividends and interest receivable                    | (20,639)     |
| Increase in receivable for investments sold                      | (3,522,841)  |
| Net amortization/(accretion) of premium/(discount)               | (238,588)    |
| Increase in payable for investments purchased                    | 3,555,069    |
| Increase in payables to related parties                          | 8,742        |
| Decrease in accrued expenses and other liabilities               | (8,074)      |
| Change in net unrealized appreciation/depreciation on securities | (19,671,602) |
| Net realized gain from investments sold                          | (1,700,779)  |

Net cash provided by operating activities 5,875,607

**CASH FLOWS FROM FINANCING ACTIVITIES:**

|  |              |
|--|--------------|
| Proceeds from loan   | 5,800,000    |
| Dividend paid (net of reinvestment of dividends and change in dividends payable) to common stock shareholders from net investment income | (11,522,381) |

Net cash used by financing activities (5,722,381)

Net increase/(decrease) in cash 153,226

**CASH:**

Beginning of the year

End of the year \$ 153,226

**SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:**

|  |            |
|--|------------|
| Interest paid during the year                              | \$ 858,536 |
| Reinvestment of dividends                                  | 1,134,328  |
| Increase in dividends payable to common stock shareholders | 2,062      |

The accompanying notes are an integral part of the financial statements.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**FINANCIAL HIGHLIGHTS****For a Common Stock share outstanding throughout each year**

Contained below is per share operating performance data, total investment returns, ratios to average net assets and other supplemental data. This information has been derived from information provided in the financial statements and market price data for the Fund's shares.

|  | Year Ended November 30, |            |            |            |            |
|--|-------------------------|------------|------------|------------|------------|
|  | 2012                    | 2011       | 2010       | 2009       | 2008       |
| <b>PER SHARE OPERATING PERFORMANCE:</b>  |                         |            |            |            |            |
| Net asset value, beginning of year   | \$ 11.45                | \$ 11.86   | \$ 9.82    | \$ 5.98    | \$ 12.85   |
| <b>INVESTMENT OPERATIONS:</b>  |                         |            |            |            |            |
| Net investment income  | 1.25                    | 1.14       | 1.07       | 0.92       | 1.27       |
| Net realized and unrealized gain/(loss) on investments   | 1.97                    | (0.43)     | 1.94       | 3.78       | (6.80)     |
| <b>DISTRIBUTIONS TO APS* SHAREHOLDERS:</b>   |                         |            |            |            |            |
| From net investment income   |                         |            | (0.01)     | (0.10)     | (0.42)     |
| Total from investment operations   | 3.22                    | 0.71       | 3.00       | 4.60       | (5.95)     |
| <b>DISTRIBUTIONS TO COMMON STOCK SHAREHOLDERS:</b>   |                         |            |            |            |            |
| From net investment income   | (1.16)                  | (1.12)     | (0.96)     | (0.76)     | (0.87)     |
| From return of capital   |                         |            |            |            | (0.05)     |
| Total distributions to Common Stock Shareholders   | (1.16)                  | (1.12)     | (0.96)     | (0.76)     | (0.92)     |
| Net asset value, end of year   | \$ 13.51                | \$ 11.45   | \$ 11.86   | \$ 9.82    | \$ 5.98    |
| Market value, end of year  | \$ 14.85                | \$ 13.63   | \$ 12.03   | \$ 9.12    | \$ 5.67    |
| Total investment return based on net asset value**   | 28.22%                  | 5.65%      | 31.52%     | 82.53%     | (48.39%)   |
| Total investment return based on market value**  | 18.40%                  | 23.99%     | 43.65%     | 78.78%     | (49.34%)   |
| <b>RATIOS TO AVERAGE NET ASSETS AVAILABLE TO COMMON STOCK SHAREHOLDERS:</b>                      |                         |            |            |            |            |
| Total net assets, end of year (in 000 s)   | \$ 147,522              | \$ 124,095 | \$ 127,561 | \$ 104,764 | \$ 63,277  |
| Operating expenses including interest expense <sup>(1)</sup>                                     | 2.02%                   | 2.08%      | 2.29%      | 2.44%      |            |
| Operating expenses excluding interest expense  | 1.38%                   | 1.46%      | 1.57%      | 2.04%      | 1.99%      |
| Net investment income  | 10.06%                  | 9.45%      | 9.72%      | 12.55%     |            |
| Net investment income, including payments to APS Shareholders                                    |                         |            | 9.66%      | 11.21%     | 8.38%      |
| <b>SUPPLEMENTAL DATA:</b>  |                         |            |            |            |            |
| Portfolio turnover rate  | 35%                     | 24%        | 37%        | 56%        | 67%        |
| Total managed assets, end of year (in 000 s)   | \$ 221,622              | \$ 192,395 | \$ 188,061 | \$ 156,564 | \$ 118,077 |
| Ratio of operating expenses including interest expense <sup>(1)(2)</sup> to total managed assets | 1.34%                   | 1.38%      | 1.54%      | 1.50%      |            |
| Ratio of operating expenses excluding interest expense <sup>(2)</sup> to total managed assets    | 0.92%                   | 0.97%      | 1.05%      | 1.25%      | 1.15%      |

\* Auction Preferred Stock.

\*\* Assumes reinvestment of distributions at the price obtained by the Fund's Dividend Reinvestment and Cash Purchase Plan. The net investment income ratios reflect income net of operating expenses, including interest expense.

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Information presented under heading Supplemental Data includes APS and loan principal balance.

- (1) See Note 8.
- (2) Does not include distributions to APS shareholders.

The accompanying notes are an integral part of the financial statements.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**FINANCIAL HIGHLIGHTS (Continued)****Per Share of Common Stock**

|                    |         | <b>Total<br/>Dividends<br/>Paid</b> | <b>Net Asset<br/>Value</b> | <b>NYSE<br/>Closing Price</b> | <b>Dividend<br/>Reinvestment<br/>Price<sup>(1)</sup></b> |
|--------------------|---------|-------------------------------------|----------------------------|-------------------------------|--|
| December 30, 2011  | Special | \$ 0.0470                           | \$ 11.56                   | \$ 14.14                      | \$ 13.43   |
| December 30, 2011  |         | 0.0930                              | 11.56                      | 14.14                         | 13.43  |
| January 31, 2012   |         | 0.0930                              | 12.10                      | 14.90                         | 14.16  |
| February 29, 2012  |         | 0.0930                              | 12.42                      | 15.60                         | 14.82  |
| March 30, 2012     |         | 0.0930                              | 12.43                      | 14.22                         | 13.51  |
| April 30, 2012     |         | 0.0930                              | 12.53                      | 14.43                         | 13.71  |
| May 31, 2012       |         | 0.0930                              | 12.42                      | 13.88                         | 13.19  |
| June 29, 2012      |         | 0.0930                              | 12.57                      | 14.20                         | 13.49  |
| July 31, 2012      |         | 0.0930                              | 12.94                      | 14.59                         | 13.86  |
| August 31, 2012    |         | 0.0930                              | 13.10                      | 15.21                         | 14.45  |
| September 28, 2012 |         | 0.0930                              | 13.28                      | 15.39                         | 14.62  |
| October 31, 2012   |         | 0.0930                              | 13.59                      | 15.10                         | 14.35  |
| November 30, 2012  |         | 0.0930                              | 13.51                      | 14.85                         | 14.11  |

<sup>(1)</sup> Whenever the net asset value per share of the Fund's Common Stock is less than or equal to the market price per share on the reinvestment date, new shares issued will be valued at the higher of net asset value or 95% of the then current market price. Otherwise, the reinvestment shares of Common Stock will be purchased in the open market.

The accompanying notes are an integral part of the financial statements.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**FINANCIAL HIGHLIGHTS (Continued)****Senior Securities**

| <b>Date</b> | <b>Total APS* Shares Outstanding (1)</b> | <b>Asset Coverage Per APS Share (2)</b> | <b>Involuntary Liquidation Preference Per APS Share (3)</b> | <b>Total Debt Outstanding End of Period (000s) (4)</b> | <b>Asset Coverage Per \$1,000 of Debt (5)</b> |
|-------------|--|---|---|--|---|
| 11/30/12    |  | N/A                                     | N/A   | \$74,100   | \$2,991                                       |
| 11/30/11    |  | N/A                                     | N/A   | 68,300   | 2,817   |
| 11/30/10    |  | N/A                                     | N/A   | 60,500   | 3,108   |
| 11/30/09    |  | N/A                                     | N/A   | 51,800   | 3,022   |
| 11/30/08    | 548                                      | \$216,717                               | \$100,000   | N/A  | N/A   |

(1) See note 7.

(2) Calculated by subtracting the Fund's total liabilities (excluding the APS and accumulated undeclared distributions to APS) from the Fund's total assets and dividing that amount by the number of APS shares outstanding.

(3) Excludes accumulated undeclared dividends.

(4) See note 8.

(5) Calculated by subtracting the Fund's total liabilities (excluding the loan) from the Fund's total assets and dividing that amount by the loan outstanding in 000's.

\* Auction Preferred Stock.

The accompanying notes are an integral part of the financial statements.

Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS

### 1. Organization

Flaherty & Crumrine Preferred Income Fund Incorporated (the Fund) was incorporated as a Maryland corporation on September 28, 1990, and commenced operations on January 31, 1991 as a diversified, closed-end management investment company under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund's investment objective is to provide its common shareholders with high current income consistent with the preservation of capital.

### 2. Significant Accounting Policies

The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of its financial statements. The preparation of the financial statements is in conformity with U.S. generally accepted accounting principles (US GAAP) and requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the financial statements and the reported amounts of increases and decreases in net assets from operations during the reporting period. Actual results could differ from those estimates.

*Portfolio valuation:* The net asset value of the Fund's Common Stock is determined by the Fund's Administrator no less frequently than on the last business day of each week and month in accordance with the policies and procedures approved by the Board of Directors of the Fund. It is determined by dividing the value of the Fund's net assets available to Common Stock by the number of shares of Common Stock outstanding. The value of the Fund's net assets available to Common Stock is deemed to equal the value of the Fund's total assets less (i) the Fund's liabilities and (ii) the aggregate liquidation value of any outstanding preferred stock.

The Fund's preferred and debt securities are valued on the basis of current market quotations provided by independent pricing services or dealers approved by the Board of Directors of the Fund. Each quotation is based on the mean of the bid and asked prices of a security. In determining the value of a particular preferred or debt security, a pricing service or dealer may use information with respect to transactions in such investments, quotations, market transactions in comparable investments, various relationships observed in the market between investments, and/or calculated yield measures based on valuation technology commonly employed in the market for such investments. Common stocks that are traded on stock exchanges are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available mean price. Futures contracts and option contracts on futures contracts are valued on the basis of the settlement price for such contracts on the primary exchange on which they trade. Investments in over-the-counter derivative instruments, such as interest rate swaps and options thereon (swaptions), are valued using prices supplied by a pricing service, or if such prices are unavailable, prices provided by a single broker or dealer that is not the counterparty or, if no such prices are available, at a price at which the counterparty to the contract would repurchase the instrument or terminate the contract. Investments for which market quotations are not readily available or for which management determines that the prices are not reflective of current market conditions are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including reference to valuations of other securities which are comparable in quality, maturity and type.



Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

Investments in money market instruments and all debt and preferred securities which mature in 60 days or less are valued at amortized cost. Investments in money market funds are valued at the net asset value of such funds.

*Fair Value Measurements:* The Fund has performed an analysis of all existing investments and derivative instruments to determine the significance and character of all inputs to their fair value determination. The levels of fair value inputs used to measure the Fund's investments are characterized into a fair value hierarchy. Where inputs for an asset or liability fall into more than one level in the fair value hierarchy, the investment is classified in its entirety based on the lowest level input that is significant to that investment's valuation. The three levels of the fair value hierarchy are described below:

Level 1      quoted prices in active markets for identical securities

Level 2      other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, etc.)

Level 3      significant unobservable inputs (including the Fund's own assumptions in determining the fair value of investments)

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities. Transfers in and out of levels are recognized at market value at the end of the period. A summary of the inputs used to value the Fund's investments as of November 30, 2012 is as follows:

|                                     | Total<br>Value at<br>November 30, 2012 | Level 1<br>Quoted<br>Price | Level 2<br>Significant<br>Observable<br>Inputs | Level 3<br>Significant<br>Unobservable<br>Inputs |
|-------------------------------------|--|----------------------------|--|--|
| <b>Preferred Securities</b>         |  |                            |  |  |
| Banking                             | \$ 77,488,565                          | \$ 59,991,798              | \$ 17,484,452                                  | \$ 12,315  |
| Financial Services                  | 2,123,464                              | 749,064                    | 1,374,400                                      |  |
| Insurance                           | 51,825,653                             | 34,385,314                 | 17,440,339                                     |  |
| Utilities                           | 40,431,229                             | 16,586,835                 | 23,844,394                                     |  |
| Energy                              | 13,731,243                             | 10,756,024                 | 2,975,219                                      |  |
| Real Estate Investment Trust (REIT) | 2,063,413                              | 2,063,413                  |  |  |
| Miscellaneous Industries            | 5,776,963                              | 493,903                    | 5,283,060                                      |  |
| Corporate Debt Securities           | 24,273,530                             | 12,836,635                 | 11,436,895                                     |  |
| <b>Common Stock</b>                 |  |                            |  |  |
| Banking                             | 134,121                                | 134,121                    |  |  |
| Insurance                           | 9,504                                  | 9,504                      |  |  |
| Utilities                           | 283,464                                | 283,464                    |  |  |
| Money Market Fund                   | 952,423                                | 952,423                    |  |  |
| <b>Total Investments</b>            | <b>\$ 219,093,572</b>                  | <b>\$ 139,242,498</b>      | <b>\$ 79,838,759</b>                           | <b>\$ 12,315</b>                                 |

Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

During the reporting period, there were no transfers into Level 1 from Level 2. During the reporting period, securities with an aggregate market value of \$5,718,764 were transferred into Level 2 from Level 1. The securities were transferred because of a reduction in the amount of observable market data, resulting from: a decrease in market activity for the securities, reduced availability of quoted prices for the securities, or de-listing of securities from a national securities exchange that resulted in a material decrease in activity.

The fair values of the Fund's investments are generally based on market information and quotes received from brokers or independent pricing services approved by the Board and unaffiliated with the Adviser. To assess the continuing appropriateness of security valuations, management, in consultation with the Adviser, regularly compares current prices to prior prices, prices across comparable securities, actual sale prices for securities in the Fund's portfolio, and market information obtained by the Adviser as a function of being an active participant in the markets.

Securities with quotes that are based on actual trades or actionable bids and offers with a sufficient level of activity on or near the measurement date are classified as Level 1. Securities that are priced using quotes derived from implied values, indicative bids and offers, or a limited number of actual trades or the same information for securities that are similar in many respects to those being valued are classified as Level 2. If market information is not available for securities being valued, or materially-comparable securities, then those securities are classified as Level 3. In considering market information, management evaluates changes in liquidity, willingness of a broker to execute at the quoted price, the depth and consistency of prices from pricing services, and the existence of observable trades in the market.

The following is a reconciliation of Level 3 investments for which significant unobservable inputs were used to determine fair value:

|  | Preferred Securities |            | Financial |
|--|----------------------|------------|-----------|
|  | Total Investments    | Banking    | Services  |
| <b>Balance as of 11/30/11</b>                    | \$ 161,245           | \$ 160,800 | \$ 445    |
| Accrued discounts/premiums                       |                      |            |           |
| Realized gain/(loss)                             |                      |            |           |
| Change in unrealized appreciation/(depreciation) | (148,485)            | (148,485)  |           |
| Purchases  |                      |            |           |
| Sales  | (445)                |            | (445)     |
| Transfer in                                      |                      |            |           |
| Transfer out                                     |                      |            |           |
| <b>Balance as of 11/30/12</b>                    | \$ 12,315            | \$ 12,315  | \$        |

For the year ended November 30, 2012, total change in unrealized gain/(loss) on Level 3 securities still held at period-end and included in the change in net assets was \$(148,485). Total unrealized gain/(loss) for all securities (including Level 1 and Level 2) can be found on the accompanying Statement of Operations.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

The following table summarizes the valuation techniques used and unobservable inputs developed to determine the fair value of Level 3 investments:

| Category             | Fair Value  |                     |                                    |                       |
|----------------------|-------------|---------------------|------------------------------------|-----------------------|
|                      | at 11/30/12 | Valuation Technique | Unobservable Input                 | Input Range (Wgt Avg) |
| Preferred Securities |             |                     |                                    |                       |
| Banking              | \$ 7,815    | Bankruptcy recovery | Credit/Structure-specific recovery | 0.00% - 0.50% (0.15%) |
|                      | 4,500       | Bankruptcy recovery | Credit/Structure-specific recovery | 0.00% - 0.50% (0.05%) |

The significant unobservable inputs used in the fair value measurement technique for bankruptcy recovery are based on recovery analysis that is specific to the security being valued, including the level of subordination and structural features of the security, and the current status of any bankruptcy or liquidation proceedings. Observable market trades in bankruptcy claims are utilized by management, when available, to assess the appropriateness of valuations, although the frequency of trading depends on the specific credit and seniority of the claim. Expected recoveries in bankruptcy by security type and industry do not tend to deviate much from historical recovery rates, which are very low (sometimes zero) for preferred securities and more moderate for senior debt. Significant changes in these inputs would result in a significantly higher or lower fair value measurement.

*Securities transactions and investment income:* Securities transactions are recorded as of the trade date. Realized gains and losses from securities sold are recorded on the specific identified cost basis. Dividend income is recorded on ex-dividend dates. Interest income is recorded on the accrual basis. The Fund also amortizes premiums and accretes discounts on fixed income securities using the effective yield method.

*Options:* Purchases of options are recorded as an investment, the value of which is marked-to-market at each valuation date. When the Fund enters into a closing sale transaction, the Fund will record a gain or loss depending on the difference between the purchase and sale price.

When the Fund writes an option, an amount equal to the premium received by the Fund is recorded as a liability, the value of which is marked-to-market at each valuation date. When a written option expires, the Fund realizes a gain equal to the amount of the premium originally received. When the Fund enters into a closing purchase transaction, the Fund realizes a gain (or loss if the cost of the closing purchase transaction exceeds the premium received when the option was written) without regard to any unrealized gain or loss on the underlying security, and the liability related to such option is eliminated. When a call option is exercised, the Fund realizes a gain or loss from the sale of the underlying security and the proceeds from such sale are increased by the amount of the premium originally received. When a put option is exercised, the amount of the premium originally received will reduce the cost of the security which the Fund purchased upon exercise.

*Repurchase agreements:* The Fund may engage in repurchase agreement transactions. The Fund's investment adviser reviews and approves the eligibility of the banks and dealers with which the Fund may enter into repurchase agreement transactions. The value of the collateral underlying such transactions is at

Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

least equal at all times to the total amount of the repurchase obligations, including interest. The Fund maintains possession of the collateral through its custodian and, in the event of counterparty default, the Fund has the right to use the collateral to offset losses incurred. There is the possibility of loss to the Fund in the event the Fund is delayed or prevented from exercising its rights to dispose of the collateral securities.

*Federal income taxes:* The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under subchapter M of the Internal Revenue Code of 1986, as amended, applicable to regulated investment companies and intends to distribute substantially all of its taxable net investment income to its shareholders. Therefore, no federal income tax provision is required.

Management has analyzed the Fund's tax positions taken on federal income tax returns for all open tax years (November 30, 2012, 2011, 2010 and 2009), and has concluded that no provision for federal income tax is required in the Fund's financial statements. The Fund's major tax jurisdictions are federal and California. The Fund's federal and state income and federal excise tax returns for tax years for which the applicable statutes of limitations have not expired are subject to examination by the Internal Revenue Service and state departments of revenue.

*Dividends and distributions to shareholders:* The Fund expects to declare dividends on a monthly basis to shareholders of Common Stock ( Shareholders ). Distributions to Shareholders are recorded on the ex-dividend date. Any net realized short-term capital gains will be distributed to Shareholders at least annually. Any net realized long-term capital gains may be distributed to Shareholders at least annually or may be retained by the Fund as determined by the Fund's Board of Directors. Capital gains retained by the Fund are subject to tax at the capital gains corporate tax rate. Subject to the Fund qualifying as a regulated investment company, any taxes paid by the Fund on such net realized long-term capital gains may be used by the Fund's Shareholders as a credit against their own tax liabilities. The Fund may pay distributions in excess of the Fund's net investment company taxable income and this excess would be a tax-free return of capital distributed from the Fund's assets.

Income and capital gain distributions are determined and characterized in accordance with income tax regulations which may differ from US GAAP. These differences are primarily due to (1) differing treatments of income and gains on various investment securities held by the Fund, including timing differences, (2) the attribution of expenses against certain components of taxable investment income, and (3) federal regulations requiring proportionate allocation of income and gains to all classes of shareholders.

Distributions from net realized gains for book purposes may include short-term capital gains, which are included as ordinary income for tax purposes, and may exclude amortization of premium and discount on certain fixed income securities, which are not reflected in ordinary income for tax purposes. The tax character of distributions paid during 2012 and 2011 was as follows:

|              | Distributions paid in fiscal year 2012 |                            | Distributions paid in fiscal year 2011 |                            |
|--------------|--|----------------------------|--|----------------------------|
|              | Ordinary<br>Income                     | Long-Term<br>Capital Gains | Ordinary<br>Income                     | Long-Term<br>Capital Gains |
| Common Stock | \$12,658,771                           | \$0                        | \$12,115,178                           | \$0                        |

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

As of November 30, 2012, the components of distributable earnings (i.e., ordinary income and capital gain/loss) available to Shareholders, on a tax basis, were as follows:

| Capital (Loss)<br>Carryforward | Undistributed<br>Ordinary Income | Undistributed<br>Long-Term Gain | Net Unrealized<br>Appreciation/(Depreciation) |
|--------------------------------|----------------------------------|---------------------------------|---|
| \$(21,414,377)                 | \$1,497,864                      | \$0                             | \$12,335,085                                  |

The composition of the Fund's accumulated realized capital losses are indicated below. These losses may be carried forward and offset against future capital gains through the dates listed below.

|             |              | No Expiration<br>Short Term* | No Expiration<br>Long Term* | Total        |
|-------------|--------------|------------------------------|-----------------------------|--------------|
| 2016        | 2017         |                              |                             |              |
| \$5,486,228 | \$15,928,149 | \$0                          | \$0                         | \$21,414,377 |

\* Under the Regulated Investment Company Modernization Act of 2010 ( Modernization Act ), the Fund will be permitted to carry forward capital losses incurred in taxable years beginning after December 22, 2010 indefinitely. However, any losses incurred during those future taxable years must be utilized prior to the losses incurred in pre-enactment taxable years. As a result, pre-enactment capital loss carryforwards may be more likely to expire unused.

Additionally, post-enactment capital losses that are carried forward will retain their character as either short-term or long-term capital losses rather than being considered all short-term under previous law.

During the year ended November 30, 2012, the Fund utilized \$2,409,958 of capital losses expiring in 2016.

*Reclassification of accounts:* During the year ended November 30, 2012, reclassifications were made in the Fund's capital accounts to report these balances on a tax basis, excluding temporary differences, as of November 30, 2012. Additional adjustments may be required in subsequent reporting periods. These reclassifications have no impact on the net asset value of the Fund. The calculation of net investment income per share in the financial highlights excludes these adjustments. Below are the reclassifications:

| Paid-in<br>Capital | Undistributed<br>Net Investment Income | Accumulated Net Realized<br>Gain on Investments |
|--------------------|--|---|
| \$(64,951)         | \$(163,585)                            | \$228,536                                       |

*Excise tax:* The Internal Revenue Code of 1986, as amended, imposes a 4% nondeductible excise tax on the Fund to the extent the Fund does not distribute by the end of any calendar year at least (1) 98% of the sum of its net investment income for that year and 98.2% of its capital gains (both long-term and short-term) for its fiscal year and (2) certain undistributed amounts from previous years. The Fund is subject to a payment of an estimated \$361 of federal excise taxes attributed to calendar year 2012. The Fund paid \$5,139 of federal excise taxes attributable to calendar year 2011 in March 2012.

**3. Derivative Instruments**

The Fund intends to use derivatives primarily to economically hedge against risks in the portfolio, namely interest rate risk and credit risk. Historically the Fund has used options on treasury futures contracts for the purpose of economically hedging against a significant increase in

long-term interest rates. When the strategy has been employed, the Fund would purchase put options on treasury futures contracts that would increase in value if long-term interest rates increased significantly, offsetting some of the related decline in

Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

portfolio asset values. The Fund has also purchased and written call options on treasury futures contracts to supplement the put option strategy and also to reduce the overall cost of the interest rate hedge (by earning premiums from the net sale of call options).

The Fund has the authority to use other derivatives for hedging or to increase expected return, but has not employed any of these derivatives to-date and does not anticipate broad use of these derivatives in the near future (although this may change without advance notice). Other approved derivatives strategies include: buying and selling credit default swaps, interest rate swaps and options thereon (swaptions), and options on securities. Accounting policies for specific derivatives, including the location of these items in the financial statements, are included in Note 2 as appropriate. No assurance can be given that such use of derivatives will achieve their desired purposes or, in the case of hedging, will result in an overall reduction of risk to the Fund.

The Fund did not use any derivatives during the fiscal years ended November 30, 2012 and November 30, 2011.

*Options on Financial Futures Contracts:* When the interest rate hedging strategy is employed, the Fund intends to use options on financial futures contracts in much the same way as described above. The risk associated with purchasing options, and therefore the maximum loss the Fund would incur, is limited to the purchase price originally paid. The risk in writing a call option is that the Fund may forego the opportunity for profit if the market price of the underlying security increases and the option is exercised. The risk in writing a put option is that the Fund may incur a loss if the market price of the underlying security decreases and the option is exercised.

#### **4. Investment Advisory Fee, Administration Fee, Transfer Agent Fee, Custodian Fee, Directors Fees and Chief Compliance Officer Fee**

Flaherty & Crumrine Incorporated (the Adviser) serves as the Fund's investment adviser. The Fund pays the Adviser a monthly fee at an annual rate of 0.625% of the Fund's average monthly total managed assets up to \$100 million and 0.50% of the Fund's average monthly total managed assets of \$100 million or more.

For purposes of calculating the fees payable to the Adviser, Administrator and Custodian, the Fund's total managed assets means the total assets of the Fund (including any assets attributable to the Fund's preferred stock that may be outstanding or otherwise attributable to the use of leverage) minus the sum of accrued liabilities (other than debt, if any, representing financial leverage). For purposes of determining total managed assets, the liquidation preference of any outstanding preferred shares issued by the Fund is not treated as a liability.

BNY Mellon Investment Servicing (US) Inc. (BNY Mellon) serves as the Fund's administrator (the Administrator). As Administrator, BNY Mellon calculates the net asset value of the Fund's shares attributable to Common Stock and generally assists in all aspects of the Fund's administration and operation. As compensation for BNY Mellon's services as Administrator, the Fund pays BNY Mellon a monthly fee at an annual rate of 0.10% of the first \$200 million of the Fund's average weekly total managed

Flaherty & Crumrine Preferred Income Fund Incorporated

**NOTES TO FINANCIAL STATEMENTS (Continued)**

assets, 0.04% of the next \$300 million of the Fund's average weekly total managed assets, 0.03% of the next \$500 million of the Fund's average weekly total managed assets and 0.02% of the Fund's average weekly total managed assets above \$1 billion.

BNY Mellon also serves as the Fund's Common Stock dividend-paying agent and registrar (the Transfer Agent). As compensation for BNY Mellon's services as Transfer Agent, the Fund pays BNY Mellon a fee at an annual rate of 0.02% of the first \$150 million of the Fund's average weekly net assets attributable to Common Stock, 0.0075% of the next \$350 million of the Fund's average weekly net assets attributable to Common Stock, and 0.0025% of the Fund's average weekly net assets attributable to Common Stock above \$500 million, plus certain out of pocket expenses. For the purpose of calculating such fee, the Fund's average weekly net assets attributable to Common Stock are deemed to be the average weekly value of the Fund's total assets minus the sum of the Fund's liabilities. For this calculation, the Fund's liabilities are deemed to include the aggregate liquidation preference of any outstanding preferred shares and the loan principal balance.

The Bank of New York Mellon (the Custodian) serves as the Fund's Custodian. As compensation for the Custodian's services as custodian, the Fund pays the Custodian a monthly fee at the annual rate of 0.01% of the first \$200 million of the Fund's average weekly total managed assets, 0.008% of the next \$300 million of the Fund's average weekly total managed assets, 0.006% of the next \$500 million of the Fund's average weekly total managed assets and 0.005% of the Fund's average weekly total managed assets above \$1 billion.

The Fund currently pays each Director who is not a director, officer or employee of the Adviser a fee of \$9,000 per annum, plus \$750 for each in-person meeting of the Board of Directors or Audit Committee, \$500 for each in-person meeting of the Nominating Committee, and \$250 for each telephone meeting. The Audit Committee Chairman receives an additional annual fee of \$3,000. The Fund also reimburses all Directors for travel and out-of-pocket expenses incurred in connection with such meetings.

The Fund currently pays the Adviser a fee of \$37,500 per annum for Chief Compliance Officer services and reimburses out-of-pocket expenses incurred in connection with providing services in this role.

**5. Purchases and Sales of Securities**

For the year ended November 30, 2012, the cost of purchases and proceeds from sales of securities, excluding short-term investments, aggregated \$79,811,228 and \$70,891,019, respectively.

At November 30, 2012, the aggregate cost of securities for federal income tax purposes was \$206,758,487, the aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost was \$28,853,506 and the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value was \$16,518,421.



Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

### 6. Common Stock

At November 30, 2012, 240,000,000 shares of \$0.01 par value Common Stock were authorized.

Common Stock transactions were as follows:

|  | Year Ended<br>11/30/12 |              | Year Ended<br>11/30/11 |              |
|--|------------------------|--------------|------------------------|--------------|
|  | Shares                 | Amount       | Shares                 | Amount       |
| Shares issued under the Dividend Reinvestment and Cash Purchase Plan | 81,922                 | \$ 1,134,328 | 81,040                 | \$ 1,008,897 |

### 7. Preferred Stock

The Fund's Articles of Incorporation authorize the issuance of up to 10,000,000 shares of \$0.01 par value preferred stock. The Fund does not currently have any issued and outstanding shares of preferred stock.

### 8. Committed Financing Agreement

The Fund has entered into a committed financing agreement ( Financing Agreement ) that allows the Fund to borrow on a secured basis, which the Fund uses in the normal course of business as financial leverage. Such leveraging tends to magnify both the risks and opportunities to Shareholders. The Financing Agreement has been amended from time to time to allow for changes in the committed amount. As of November 30, 2012, the committed amount, and amount borrowed, under the Financing Agreement was \$74.1 million.

Effective August 23, 2011, the lender charges an annualized rate of 0.65% on the undrawn (committed) balance, and three-month LIBOR (reset quarterly) plus 0.75% on the drawn (borrowed) balance. From January 1, 2011 to August 22, 2011, the lender charged an annualized rate of 0.80% on the undrawn balance and three-month LIBOR (reset quarterly) plus 0.95% on the drawn balance. Prior to January 1, 2011, the lender charged an annualized rate of 1.00% on the undrawn balance and three-month LIBOR (reset quarterly) plus 1.10% on the drawn balance. For the year ended November 30, 2012, the daily weighted average annualized interest rate on the drawn balance was 1.21% and the average daily loan balance was \$69,640,984. LIBOR rates may vary in a manner unrelated to the income received on the Fund's assets, which could have either a beneficial or detrimental impact on net investment income and gains available to Shareholders.

The Fund is required to meet certain asset coverage requirements under the Financing Agreement and under the 1940 Act. In accordance with the asset coverage requirements, at least two-thirds of the Fund's assets are expected to be pledged as collateral assuming the full committed amount is drawn. Securities pledged as collateral are identified in the portfolio of investments. If the Fund fails to meet these requirements, or maintain other financial covenants required under the Financing Agreement, the Fund may be required to repay immediately, in part or in full, the amount borrowed under the Financing Agreement. Additionally, failure to meet the foregoing requirements or covenants could restrict the Fund's ability to pay

Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

dividends to Shareholders and could necessitate sales of portfolio securities at inopportune times. The Financing Agreement has no stated maturity, but may be terminated by either party without cause with six months' advance notice.

Under the terms of the Financing Agreement, the lender has the ability to borrow a portion of the securities pledged as collateral against the loan (Rehypothecated Securities), subject to certain limits. The Fund receives a fee from the lender in connection with any Rehypothecated Securities. The Fund may recall any Rehypothecated Security at any time and the lender is required to return the security in a timely fashion. In the event the lender does not return the security, the Fund will have the right to, among other things, apply and set off an amount equal to 100% of the then-current fair market value of such Rehypothecated Securities against any loan amounts owed to the lender under the Financing Agreement. Rehypothecated Securities are marked-to-market daily and adjusted as necessary so the value of all Rehypothecated Securities does not exceed 100% of the loan amount under the Financing Agreement. The Fund will continue to earn and receive all dividends, interest, and other distributions on Rehypothecated Securities. Rehypothecated Securities are identified in the Portfolio of Investments listing and fees earned from rehypothecation are included in the Statement of Operations.

### 9. Portfolio Investments, Concentration and Investment Quality

The Fund invests primarily in a diversified portfolio of preferred securities. This includes traditional preferred stocks eligible for the inter-corporate dividends received deduction (DRD) and fully taxable preferred securities. Under normal market conditions, at least 80% of the Fund's net assets will be invested in preferred securities. Also, under normal market conditions, the Fund invests at least 25% of its total assets in the financials sector, which for this purpose is comprised of the bank, thrifts & mortgage finance, diversified financial services, finance, consumer finance, capital markets, asset management & custody, investment banking & brokerage, insurance, insurance brokers, and real estate investment trusts (REIT) industries. From time to time, the Fund may have 25% or more of its total assets invested in any one of these industries. The Fund's portfolio may therefore be subject to greater risk and market fluctuation than a portfolio of securities representing a broader range of investment alternatives.

The Fund may invest up to 25% of its assets at the time of purchase in securities rated below investment grade by all of Moody's, S&P and Fitch, provided that (a) such securities are rated at least Ba3 by Moody's, BB- by S&P, or BB- by Fitch or (b) such securities are issued by an issuer having an outstanding class of senior debt rated investment grade by any one of Moody's, S&P, or Fitch at the time of purchase. Thus, the Fund may invest in securities rated below Ba3 by Moody's, BB- by S&P and BB- by Fitch if the issuer has investment grade senior debt outstanding. In addition, the Fund may invest in unrated securities that the Fund's investment adviser deems to be comparable in quality to rated issues in which the Fund is authorized to invest.

The Fund may invest up to 15% of its assets in common stocks and, under normal market conditions, up to 20% of its assets in debt securities. Certain of its investments in hybrid, i.e., fully taxable, preferred securities will be subject to the foregoing 20% limitation to the extent that, in the opinion of the Adviser, such investments are deemed to be debt-like in key characteristics. Typically, a security will not be considered

Flaherty & Crumrine Preferred Income Fund Incorporated

## NOTES TO FINANCIAL STATEMENTS (Continued)

debt-like (a) if an issuer can defer payment of income for eighteen months or more without triggering an event of default and (b) if such issue is a junior and fully subordinated liability of an issuer or its ultimate guarantor.

In addition to foreign money market securities, the Fund may invest up to 30% of its total assets in the securities of companies organized or having their principal place of business outside the United States. All foreign securities held by the Fund will be denominated in U.S. dollars.

The Fund may employ certain investment techniques in accordance with its fundamental investment policies. These may include the use of when-issued and delayed delivery transactions. Securities purchased or sold on a when-issued or delayed delivery basis may be settled within 45 days after the date of the transaction. The Fund may also enter into transactions, in accordance with its investment policies, involving short sales of securities and purchases of securities on margin. Such transactions may expose the Fund to credit and market valuation risk greater than that associated with regular trade settlement procedures.

### 10. Subsequent Events

Management has evaluated the impact of all subsequent events on the Fund through the date the financial statements were issued, and has determined that there were no subsequent events requiring recognition or disclosure in the financial statements.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Shareholders and Board of Directors of

Flaherty & Crumrine Preferred Income Fund Incorporated

We have audited the accompanying statement of assets and liabilities, including the portfolio of investments, of Flaherty & Crumrine Preferred Income Fund Incorporated, as of November 30, 2012, and the related statement of operations for the year then ended, the statements of changes in net assets for each of the years in the two-year period then ended, the statement of cash flows for the year then ended, and the financial highlights for each of the years in the five-year period then ended. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of November 30, 2012, by correspondence with the custodian, and brokers, or by other appropriate auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Flaherty & Crumrine Preferred Income Fund as of November 30, 2012, and the results of its operations, the changes in its net assets, its cash flows, and the financial highlights for the periods specified in the first paragraph above, in conformity with U.S. generally accepted accounting principles.

Boston, Massachusetts

January 23, 2013

Flaherty & Crumrine Preferred Income Fund Incorporated

## **ADDITIONAL INFORMATION (Unaudited)**

### **Dividend Reinvestment and Cash Purchase Plan**

Under the Fund's Dividend Reinvestment and Cash Purchase Plan (the Plan), a shareholder whose Common Stock is registered in his or her own name will have all distributions reinvested automatically by BNY Mellon as agent under the Plan, unless the shareholder elects to receive cash. Registered shareholders may elect to receive cash by contacting BNY Mellon at the number provided below. If shares are registered in the name of a broker-dealer or other nominee (that is, in street name) and the broker or nominee participates in the Plan, distributions may be reinvested by the broker or nominee in additional shares under the Plan, unless the shareholder elects to receive distributions in cash. Shareholders may elect to receive cash by contacting their broker or nominee. A shareholder who holds Common Stock registered in the name of a broker or other nominee may not be able to transfer the Common Stock to another broker or nominee and continue to participate in the Plan. Investors who own Common Stock registered in street name should consult their broker or nominee for details regarding reinvestment.

The number of shares of Common Stock distributed to participants in the Plan in lieu of a cash dividend is determined in the following manner. Whenever the market price per share of the Fund's Common Stock is equal to or exceeds the net asset value per share on the valuation date, participants in the Plan will be issued new shares valued at the higher of net asset value or 95% of the then current market value. Otherwise, BNY Mellon will buy shares of the Fund's Common Stock in the open market, on the New York Stock Exchange (NYSE) or elsewhere, on or shortly after the payment date of the dividend or distribution and continuing until the ex-dividend date of the Fund's next distribution to holders of the Common Stock or until it has expended for such purchases all of the cash that would otherwise be payable to the participants. The number of purchased shares that will then be credited to the participants' accounts will be based on the average per share purchase price of the shares so purchased, including brokerage commissions. If BNY Mellon commences purchases in the open market and the then current market price of the shares (plus any estimated brokerage commissions) subsequently exceeds their net asset value most recently determined before the completion of the purchases, BNY Mellon will attempt to terminate purchases in the open market and cause the Fund to issue the remaining dividend or distribution in shares. In this case, the number of shares received by the participant will be based on the weighted average of prices paid for shares purchased in the open market and the price at which the Fund issues the remaining shares. These remaining shares will be issued by the Fund at the higher of net asset value or 95% of the then current market value.

Plan participants are not subject to any charge for reinvesting dividends or capital gains distributions. Each Plan participant will, however, bear a proportionate share of brokerage commissions incurred with respect to BNY Mellon's open market purchases in connection with the reinvestment of dividends or capital gains distributions. For the year ended November 30, 2012, no brokerage commissions were incurred.

The automatic reinvestment of dividends and capital gains distributions will not relieve Plan participants of any income tax that may be payable on the dividends or capital gains distributions. A participant in the Plan will be treated for Federal income tax purposes as having received, on the dividend payment date, a dividend or distribution in an amount equal to the cash that the participant could have received instead of shares.

Flaherty & Crumrine Preferred Income Fund Incorporated

### **ADDITIONAL INFORMATION (Unaudited) (Continued)**

In addition to acquiring shares of Common Stock through the reinvestment of cash dividends and distributions, a shareholder may invest any further amounts from \$100 to \$3,000 semi-annually at the then current market price in shares purchased through the Plan. Such semi-annual investments are subject to any brokerage commission charges incurred by BNY Mellon under the Plan.

A shareholder whose Common Stock is registered in his or her own name may terminate participation in the Plan at any time by notifying BNY Mellon in writing, by completing the form on the back of the Plan account statement and forwarding it to BNY Mellon, or by calling BNY Mellon directly. A termination will be effective immediately if notice is received by BNY Mellon not less than 10 days before any dividend or distribution record date. Otherwise, the termination will be effective, and only with respect to any subsequent dividends or distributions, on the first day after the dividend or distribution has been credited to the participant's account in additional shares of the Fund. Upon termination and according to a participant's instructions, BNY Mellon will either (a) issue certificates for the whole shares credited to the shareholder's Plan account and a check representing any fractional shares or (b) sell the shares in the market. Shareholders who hold Common Stock registered in the name of a broker or other nominee should consult their broker or nominee to terminate participation.

The Plan is described in more detail in the Fund's Plan brochure. Information concerning the Plan may be obtained from BNY Mellon at 1-866-351-7446.

#### **Proxy Voting Policies and Proxy Voting Record on Form N-PX**

The Fund files Form N-PX with its complete proxy voting record for the 12 months ended June 30<sup>th</sup> no later than August 31<sup>st</sup> of each year. The Fund filed its latest Form N-PX with the Securities and Exchange Commission (SEC) on July 25, 2012. This filing, as well as the Fund's proxy voting policies and procedures, are available (i) without charge, upon request, by calling the Fund's transfer agent at 1-866-351-7446 and (ii) on the SEC's website at [www.sec.gov](http://www.sec.gov). In addition, the Fund's proxy voting policies and procedures are available on the Fund's website at [www.preferredincome.com](http://www.preferredincome.com).

#### **Portfolio Schedule on Form N-Q**

The Fund files a complete schedule of portfolio holdings with the SEC for the first and third fiscal quarters on Form N-Q, the latest of which was filed for the quarter ended August 31, 2012. The Fund's Form N-Q is available on the SEC's website at [www.sec.gov](http://www.sec.gov) or may be viewed and obtained from the SEC's Public Reference Room in Washington D.C. Information on the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330.

#### **Portfolio Management Team**

In managing the day-to-day operations of the Fund, the Adviser relies on the expertise of its team of money management professionals, consisting of Messrs. Crumrine, Ettinger, Stone and Chadwick. The professional backgrounds of each member of the management team are included in the "Information about Fund Directors and Officers" section of this report.

Flaherty & Crumrine Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

**Supplementary Tax Information**

Distributions to Common Stock Shareholders are characterized as follows for purposes of Federal income taxes (as a percentage of total distributions). Individual Shareholders will receive a Form 1099-DIV in 2013 with information about the tax character of distributions they received in calendar year 2012.

|                    | Individual Shareholder |                 | Corporate Shareholder |                 |
|--------------------|------------------------|-----------------|-----------------------|-----------------|
|                    | QDI                    | Ordinary Income | DRD                   | Ordinary Income |
| Fiscal Year 2012   | 49.60%                 | 50.40%          | 20.72%                | 79.28%          |
| Calendar Year 2012 | 49.13%                 | 50.87%          | 20.46%                | 79.54%          |

Flaherty & Crumrine Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

**Information about Fund Directors and Officers**

The business and affairs of the Fund are managed under the direction of the Fund's Board of Directors. Information pertaining to the Directors and officers of the Fund is set forth below.

| Name, Address,<br>and Age  | Current  | Term of Office                              | Principal  | Number of Funds | Other   |
|--|--|---|--|-----------------|---|
|  | Position(s)  | and Length of                               | Occupation(s)  | in Fund Complex | Public Company  |
| NON-INTERESTED DIRECTORS:  | Held with Fund   | Time Served*                                | During Past  | Overseen        | Board Memberships   |
|  |  |   | Five Years   | by Director**   | During Past Five Years  |
| <b>David Gale</b><br>Delta Dividend Group, Inc. 220<br>Montgomery Street Suite 426<br><br>San Francisco, CA 94104<br><br>Age: 63 | Director   | Class I Director<br>since<br>January 1997   | President of Delta<br>Dividend Group, Inc.<br>(investments)  | 4               | Metromedia International<br>Group, Inc. and Emmis<br><br>Communications |
| <b>Morgan Gust</b><br>301 E. Colorado Boulevard<br><br>Suite 720<br><br>Pasadena, CA 91101<br><br>Age: 65                        | Director and<br>Nominating<br><br>and<br>Governance<br><br>Committee<br><br>Chairman | Class III Director<br>since<br>January 1991 | Owner and operator of various<br>entities engaged in agriculture<br>and real estate.   | 4               | CoBiz, Financial, Inc.<br>(financial services)                          |
| <b>Karen H. Hogan</b><br>301 E. Colorado Boulevard<br><br>Suite 720<br><br>Pasadena, CA 91101<br><br>Age: 51                     | Director   | Class I Director<br>since<br>April 2005     | Board Member, IKAR, a<br>non-profit organization;<br>Active Member, Committee<br>Member and Volunteer to<br>several non-profit<br>organizations. | 4               | None  |

\*



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The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

**Class I Directors** three year term expires at the Fund's 2014 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class II Directors** three year term expires at the Fund's 2015 Annual Meeting of Shareholders; directors may continue in office until their successors are duly elected and qualified.

**Class III Director** three year term expires at the Fund's 2013 Annual Meeting of Shareholders; director may continue in office until his successor is duly elected and qualified.

\*\* Each Director also serves as a Director for Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund, and Flaherty & Crumrine/Claymore Total Return Fund.

Flaherty & Crumrine Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

| Name, Address,<br>and Age<br>NON-INTERESTED | Current                       | Term of Office                | Principal                                  | Number of Funds                              | Other   |
|---|-------------------------------|-------------------------------|--|--|---|
|   | Position(s)<br>Held with Fund | and Length of<br>Time Served* | Occupation(s)<br>During Past<br>Five Years | in Fund Complex<br>Overseen<br>by Director** | Public Company<br>Board Memberships<br>During Past Five Years |

**DIRECTORS:**

|   |                              |                                      |   |   |      |
|---|------------------------------|--------------------------------------|---|---|------|
| <b>Robert F. Wulf</b>                                       | Director and Audit Committee | Class II Director since January 1991 | Financial Consultant; Trustee, University of Oregon Foundation; Trustee, San Francisco Theological Seminary | 4 | None |
| 1000 SW Vista Ave, Apt 314<br>Portland, OR 97205<br>Age: 75 | Chairman                     |                                      |   |   |      |

**INTERESTED**

**DIRECTOR:**

|   |   |                                      |  |   |      |
|---|---|--------------------------------------|--|---|------|
| <b>Donald F. Crumrine</b>   | Director, Chairman of the Board and Chief Executive Officer | Class II Director since January 1991 | Chairman of the Board and Director of Flaherty & Crumrine Incorporated | 4 | None |
| 301 E. Colorado Boulevard<br>Suite 720<br>Pasadena, CA 91101<br>Age: 65 |   |                                      |  |   |      |

\* The Fund's Board of Directors is divided into three classes, each class having a term of three years. Each year the term of office of one class expires and the successor or successors elected to such class serve for a three year term. The three year term for each class expires as follows:

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\*\* Each Director also serves as a Director for Flaherty & Crumrine Preferred Income Opportunity Fund, Flaherty & Crumrine/Claymore Preferred Securities Income Fund, and Flaherty & Crumrine/Claymore Total Return Fund.

Interested person of the Fund as defined in the 1940 Act. Mr. Crumrine is considered an interested person because of his affiliation with Flaherty & Crumrine Incorporated, which acts as the Fund's investment adviser.

Flaherty &amp; Crumrine Preferred Income Fund Incorporated

**ADDITIONAL INFORMATION (Unaudited) (Continued)**

| Name, Address,<br>and Age  | Current<br>Position(s)<br>Held with Fund   | Term of Office<br>and Length of<br>Time Served | Principal   |
|--|--|--|---|
|  |  |  | Occupation(s)<br>During Past<br>Five Years  |
| <b>OFFICERS</b>  |  |  |   |
| <b>Robert M. Ettinger</b><br><br>301 E. Colorado Boulevard<br>Suite 720<br><br>Pasadena, CA 91101<br><br>Age: 54 | President  | Since<br>October 2002                          | President and Director of Flaherty & Crumrine Incorporated  |
| <b>R. Eric Chadwick</b><br><br>301 E. Colorado Boulevard<br>Suite 720<br><br>Pasadena, CA 91101<br><br>Age: 37   | Chief Financial<br><br>Officer, Vice<br><br>President and<br><br>Treasurer         | Since<br>July 2004                             | Vice President and Director of Flaherty & Crumrine Incorporated   |
| <b>Chad C. Conwell</b><br><br>301 E. Colorado Boulevard<br>Suite 720<br><br>Pasadena, CA 91101<br><br>Age: 40    | Chief Compliance<br><br>Officer, Vice<br><br>President and<br><br>Secretary        | Since<br>July 2005                             | Chief Compliance Officer & Vice<br><br>President of Flaherty & Crumrine<br><br>Incorporated; Director of Flaherty & Crumrine Incorporated since<br><br>January 2011 |
| <b>Bradford S. Stone</b><br><br>47 Maple Street<br><br>Suite 403<br><br>Summit, NJ 07901<br><br>Age: 53          | Vice President<br><br>and Assistant<br>Treasurer                                   | Since<br>July 2003                             | Vice President and Director of Flaherty & Crumrine Incorporated   |
| <b>Laurie C. Lodolo</b><br><br>301 E. Colorado Boulevard<br>Suite 720  | Assistant Compliance<br>Officer, Assistant<br>Treasurer and<br>Assistant Secretary | Since<br>July 2004                             | Assistant Compliance Officer and<br>Secretary of Flaherty & Crumrine<br><br>Incorporated  |

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Pasadena, CA 91101

Age: 49

**Linda M. Puchalski**

Assistant Treasurer

Since  
August 2010

Administrator of Flaherty & Crumrine

301 E. Colorado Boulevard  
Suite 720

Incorporated

Pasadena, CA 91101

Age: 56

**Directors**

Donald F. Crumrine, CFA

Chairman of the Board

David Gale

Morgan Gust

Karen H. Hogan

Robert F. Wulf, CFA

**Officers**

Donald F. Crumrine, CFA

Chief Executive Officer

Robert M. Ettinger, CFA

President

R. Eric Chadwick, CFA

Chief Financial Officer,

Vice President and Treasurer

Chad C. Conwell

Chief Compliance Officer,

Vice President and Secretary

Bradford S. Stone

Vice President and

Assistant Treasurer

Laurie C. Lodolo

Assistant Compliance Officer,

Assistant Treasurer and

Assistant Secretary

Linda M. Puchalski

Assistant Treasurer

**Investment Adviser**

Flaherty & Crumrine Incorporated

e-mail: flaherty@pfdincome.com

**Questions concerning your shares of Flaherty & Crumrine Preferred Income Fund?**

If your shares are held in a Brokerage Account, contact your Broker.

If you have physical possession of your shares in certificate form, contact the Fund's Transfer Agent & Shareholder Servicing Agent  
BNY Mellon Investment Servicing

P.O. Box 358035

Pittsburgh, PA 15252-8035

1-866-351-7446

**This report is sent to shareholders of Flaherty & Crumrine Preferred Income Fund Incorporated for their information. It is not a Prospectus, circular or representation intended for use in the purchase or sale of shares of the Fund or of any securities mentioned in this report.**

Annual

Report

November 30, 2012

[www.preferredincome.com](http://www.preferredincome.com)

**Item 2. Code of Ethics.**

- (a) The registrant, as of the end of the period covered by this report, has adopted a code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party.
- (c) There have been no amendments, during the period covered by this report, to a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, and that relates to any element of the code of ethics description.
- (d) The registrant has not granted any waivers, including an implicit waiver, from a provision of the code of ethics that applies to the registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the registrant or a third party, that relates to one or more of the items set forth in paragraph (b) of this item's instructions.

**Item 3. Audit Committee Financial Expert.**

As of the end of the period covered by the report, the registrant's board of directors has determined that David Gale, Karen H. Hogan and Robert F. Wulf are each qualified to serve as an audit committee financial expert serving on its audit committee and that they all are independent, as defined by the Securities and Exchange Commission.

**Item 4. Principal Accountant Fees and Services.**

Audit Fees

- (a) The aggregate fees billed for each of the last two fiscal years for professional services rendered by the principal accountant for the audit of the registrant's annual financial statements or services that are normally provided by the accountant in connection with statutory and regulatory filings or engagements for those fiscal years are \$45,000 for 2012 and \$45,000 for 2011.

Audit-Related Fees

- (b) The aggregate fees billed in each of the last two fiscal years for assurance and related services by the principal accountant that are reasonably related to the performance of the audit of the registrant's financial statements and are not reported under paragraph (a) of this Item are \$0 for 2012 and \$0 for 2011.



Tax Fees

- (c) The aggregate fees billed in each of the last two fiscal years for professional services rendered by the principal accountant for tax compliance, tax advice, and tax planning are \$8,650 for 2012 and \$8,270 for 2011.

All Other Fees

- (d) The aggregate fees billed in each of the last two fiscal years for products and services provided by the principal accountant, other than the services reported in paragraphs (a) through (c) of this Item are \$0 for 2012 and \$0 for 2011.

- (e)(1) The Fund's Audit Committee Charter states that the Audit Committee shall have the duty and power to pre-approve all audit and non-audit services to be provided by the auditors to the Fund, and all non-audit services to be provided by the auditors to the Fund's investment adviser and any service providers controlling, controlled by or under common control with the Fund's investment adviser that provide ongoing services to the Fund, if the engagement relates directly to the operations and financial reporting of the Fund.

- (e)(2) The percentage of services described in each of paragraphs (b) through (d) of this Item that were approved by the audit committee pursuant to paragraph (c)(7)(i)(C) of Rule 2-01 of Regulation S-X are as follows:

(b) N/A

(c) N/A

(d) N/A

- (f) The percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees was zero percent.

- (g) The aggregate non-audit fees billed by the registrant's accountant for services rendered to the registrant, and rendered to the registrant's investment adviser (not including any sub-adviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser), and any entity controlling, controlled by, or under common control with the adviser that provides ongoing services to the registrant for each of the last two fiscal years of the registrant was \$0 for 2012 and \$0 for 2011.

- (h) Not applicable.

**Item 5. Audit Committee of Listed registrants.**

- (a) The registrant has a separately designated audit committee consisting of all the independent directors of the registrant. The members of the audit committee are: David Gale, Morgan Gust, Karen H. Hogan, and Robert F. Wulf.

**Item 6. Investments.**

- (a) Schedule of Investments in securities of unaffiliated issuers as of the close of the reporting period is included as part of the report to shareholders filed under Item 1 of this form.
- (b) Not applicable.

**Item 7. Disclosure of Proxy Voting Policies and Procedures for Closed-End Management**

**Investment Companies.**

The Proxy Voting Policies are attached herewith.

**ADVISER PROXY VOTING POLICIES AND PROCEDURES**

Flaherty & Crumrine Incorporated ( FCI ) acts as discretionary investment adviser for various clients, including the following six pooled investment vehicles (the Funds ):

As adviser to the U.S. Funds

|   |
|---|
| Flaherty & Crumrine Preferred Income Fund                     |
| Flaherty & Crumrine Preferred Income Opportunity Fund         |
| Flaherty & Crumrine/Claymore Preferred Securities Income Fund |
| Flaherty & Crumrine/Claymore Total Return Fund                |

As sub-adviser

to the Canadian Fund

|  |
|--|
| Flaherty & Crumrine Investment Grade Fixed Income Fund |
|--|

As sub-adviser

to the Mutual Fund

|   |
|---|
| Destra Preferred and Income Securities Fund |
|---|

FCI's authority to vote proxies for its clients is established through the delegation of discretionary authority under its investment advisory contracts and the U.S. Funds have adopted these policies and procedures for themselves

**Purpose**

These policies and procedures are designed to satisfy FCI's duties of care and loyalty to its clients with respect to monitoring corporate events and exercising proxy authority in the best interests of such clients.

In connection with this objective, these policies and procedures are designed to deal with potential complexities which may arise in cases where FCI's interests conflict or appear to conflict with the interests of its clients.

These policies and procedures are also designed to communicate with clients the methods and rationale whereby FCI exercises proxy voting authority.

This document is available to any client or Fund shareholder upon request and FCI will make available to such clients and Fund shareholders the record of FCI's votes promptly upon request and to the extent required by Federal law and regulations.

### **Fundamental Standard**

FCI will be guided by the principle that, in those cases where it has proxy voting authority, it will vote proxies, and take such other corporate actions, consistent with the interest of its clients in a manner free of conflicts of interest with the objective of client wealth maximization.

### **General**

FCI has divided its discussion in this document into two major categories: voting with respect to common stock and voting with respect to senior equity, e.g., preferred stock and similar securities. In those events where FCI may have to take action with respect to debt, such as in the case of amendments of covenants or in the case of default, bankruptcy, reorganization, etc., FCI will apply the same principles as would apply to common or preferred stock, *mutatis mutandis*.

These policies and procedures apply only where the client has granted discretionary authority with respect to proxy voting. Where FCI does not have authority, it will keep appropriate written records evidencing that such discretionary authority has not been granted.

FCI may choose not to keep written copies of proxy materials that are subject to SEC regulation and maintained in the SEC's EDGAR database. In other instances, FCI will keep appropriate written records in its files or in reasonably accessible storage.

Similarly, FCI will keep in its files, or reasonably accessible storage, work papers and other materials that were significant to FCI in making a decision how to vote.

For purposes of decision making, FCI will assume that each ballot for which it casts votes is the only security of an issuer held by the client. Thus, when casting votes where FCI may have discretionary authority with regard to several different securities of the same issuer, it may vote securities in favor for those securities or classes where FCI has determined the matter in question to be beneficial while, at the same time, voting against for those securities or classes where FCI has determined the matter to be adverse. Such cases occasionally arise, for example, in those instances where a vote is required by both common and preferred shareholders, voting as separate classes, for a change in the terms regarding preferred stock issuance.

FCI will reach its voting decisions independently, after appropriate investigation. It does not generally intend to delegate its decision making or to rely on the recommendations of any third party, although it may take such recommendations into consideration. FCI may consult with such other experts, such as CPAs, investment bankers, attorneys, etc., as it regards necessary to help it reach informed decisions.

Absent good reason to the contrary, FCI will generally give substantial weight to management recommendations regarding voting. This is based on the view that management is usually in the best position to know which corporate actions are in the best interests of common shareholders as a whole.

With regard to those shareholder-originated proposals which are typically described as social, environmental, and corporate responsibility matters, FCI will typically give weight to management's recommendations and vote against such shareholder proposals, particularly if the adoption of such proposals would bring about burdens or costs not borne by those of the issuer's competitors.

In cases where the voting of proxies would not justify the time and costs involved, FCI may refrain from voting. From the individual client's perspective, this would most typically come about in the case of small holdings, such as might arise in connection with spin-offs or other corporate reorganizations. From the perspective of FCI's institutional clients, this envisions cases (1) as more fully described below where preferred and common shareholders vote together as a class or (2) other similar or analogous instances.

Ultimately, all voting decisions are made on a case-by-case basis, taking relevant considerations into account.

### **Voting of Common Stock Proxies**

FCI categorizes matters as either routine or non-routine, which definition may or may not precisely conform to the definitions set forth by securities exchanges or other bodies categorizing such matters. Routine matters would include such things as the voting for directors and the ratification of auditors and most shareholder proposals regarding social, environmental, and corporate responsibility matters. Absent good reason to the contrary, FCI normally will vote in favor of management's recommendations on these routine matters.

Non-routine matters might include, without limitation, such things as (1) amendments to management incentive plans, (2) the authorization of additional common or preferred stock, (3) initiation or termination of barriers to takeover or acquisition, (4) mergers or acquisitions, (5) changes in the state of incorporation, (6) corporate reorganizations, and (7) contested director slates. In non-routine matters, FCI, as a matter of policy, will attempt to be generally familiar with the questions at issue. This will include, without limitation, studying news in the popular press, regulatory filings, and competing proxy solicitation materials, if any. Non-routine matters will be voted on a case-by-case basis, given the complexity of many of these issues.

### **Voting of Preferred Stock Proxies**

Preferred stock, which is defined to include any form of equity senior to common stock, generally has voting rights only in the event that the issuer has not made timely payments of income and principal to shareholders or in the event that a corporation desires to effectuate some change in its articles of incorporation which might modify the rights of preferred stockholders. These are non-routine in both form and substance.

In the case of non-routine matters having to do with the modification of the rights or protections accorded preferred stock shareholders, FCI will attempt, wherever possible, to assess the costs and benefits of such modifications and will vote in favor of such modifications only if they are in the best interests of preferred shareholders or if the issuer has offered sufficient compensation to preferred stock shareholders to offset the reasonably foreseeable adverse consequences of such modifications. A similar type of analysis would be made in the case where preferred shares, as a class, are entitled to vote on a merger or other substantial transaction.

In the case of the election of directors when timely payments to preferred shareholders have not been made (contingent voting), FCI will cast its votes on a case-by-case basis after investigation of the qualifications and independence of the persons standing for election.

Routine matters regarding preferred stock are the exception, rather than the rule, and typically arise when the preferred and common shareholders vote together as a class on such matters as election of directors. FCI will vote on a case-by-case basis, reflecting the principles set forth elsewhere in this

document. However, in those instances (1) where the common shares of an issuer are held by a parent company and (2) where, because of that, the election outcome is not in doubt, FCI does not intend to vote such proxies since the time and costs would outweigh the benefits.

### **Actual and Apparent Conflicts of Interest**

Potential conflicts of interest between FCI and FCI's clients may arise when FCI's relationships with an issuer or with a related third party conflict or appear to conflict with the best interests of FCI's clients.

FCI will indicate in its voting records available to clients whether or not a material conflict exists or appears to exist. In addition, FCI will communicate with the client (which means the independent Directors or Director(s) they may so designate in the case of the U.S. Funds and the investment adviser in the case of the Canadian Fund or the Mutual Fund) in instances when a material conflict of interest may be apparent. FCI must describe the conflict to the client and state FCI's voting recommendation and the basis therefor. If the client considers there to be a reasonable basis for the proposed vote notwithstanding the conflict or, in the case of the Funds, that the recommendation was not affected by the conflict (without considering the merits of the proposal), FCI will vote in accordance with the recommendation it had made to the client.

In all such instances, FCI will keep reasonable documentation supporting its voting decisions and/or recommendations to clients.

### **Amendment of the Policies and Procedures**

These policies and procedures may be modified at any time by action of the Board of Directors of FCI but will not become effective, in the case of the U.S. Funds, unless they are approved by majority vote of the non-interested directors of the U.S. Funds. Any such modifications will be sent to FCI's clients by mail and/or other electronic means in a timely manner. These policies and procedures, and any amendments hereto, will be posted on the U.S. Funds websites and will be disclosed in reports to shareholders as required by law.

### **Item 8. Portfolio Managers of Closed-End Management Investment Companies.**

The following paragraphs provide certain information with respect to the portfolio managers of the Fund and the material conflicts of interest that may arise in connection with their management of the investments of the Fund, on the one hand, and the investments of other client accounts for which they have responsibility, on the other hand. Certain other potential conflicts of interest with respect to personal trading and proxy voting are discussed above under Item 2 - Codes of Ethics and Item 7 - Proxy Voting Policies.

#### **(a)(1) Portfolio Managers**

R. Eric Chadwick, Donald F. Crumrine, Robert M. Ettinger and Bradford S. Stone jointly serve as the Portfolio Managers of the Fund. Additional biographical information about the portfolio managers is available in the Annual Report included in Response to Item 1 above.

**(a)(2) Other Accounts Managed By Portfolio Managers**

The tables below illustrate other accounts where each of the above-mentioned four portfolio managers has significant day-to-day management responsibilities as of November 30, 2012:

| Name of Portfolio <u>Manager</u><br>or <u>Team Member</u> | <u>Type of Accounts</u>           | Total                            |                              | # of Accounts<br>Managed for which<br>Advisory Fee is<br>Based on<br><u>Performance</u> |
|---|-----------------------------------|----------------------------------|------------------------------|---|
|   |                                   | <u># of Accounts<br/>Managed</u> | <u>Total Assets<br/>(mm)</u> |   |
| 1. Donald F. Crumrine                                     | Other Registered Investment       |                                  |                              |   |
|   | Companies:                        | 4                                | 1,766                        | 0   |
|   | Other Pooled Investment Vehicles: | 1                                | 184                          | 0   |
|   | Other Accounts:                   | 12                               | 2,818                        | 0   |
| 2. Robert M. Ettinger                                     | Other Registered Investment       |                                  |                              |   |
|   | Companies:                        | 4                                | 1,766                        | 0   |
|   | Other Pooled Investment Vehicles: | 1                                | 184                          | 0   |
|   | Other Accounts:                   | 12                               | 2,818                        | 0   |
| 3. R. Eric Chadwick                                       | Other Registered Investment       |                                  |                              |   |
|   | Companies:                        | 4                                | 1,766                        | 0   |
|   | Other Pooled Investment Vehicles: | 1                                | 184                          | 0   |
|   | Other Accounts:                   | 12                               | 2,818                        | 0   |
| 4. Bradford S. Stone                                      | Other Registered Investment       |                                  |                              |   |
|   | Companies:                        | 4                                | 1,766                        | 0   |
|   | Other Pooled Investment Vehicles: | 1                                | 184                          | 0   |
|   | Other Accounts:                   | 12                               | 2,818                        | 0   |

**Potential Conflicts of Interest**

In addition to the Fund, the Portfolio Managers jointly manage accounts for three other closed-end funds, one mutual fund, one Canadian fund and other institutional clients. As a result, potential conflicts of interest may arise as follows:

*Allocation of Limited Time and Attention.* The Portfolio Managers may devote unequal time and attention to the management of all accounts. As a result, the Portfolio Managers may not be able to formulate as complete a strategy or identify equally attractive investment opportunities for each of those accounts as might be the case if they were to devote substantially more attention to the management of one account.

*Allocation of Limited Investment Opportunities.* If the Portfolio Managers identify an investment opportunity that may be suitable for multiple accounts, the Fund may not be able to take full advantage of that opportunity because the opportunity may need to be allocated among other accounts.

*Pursuit of Differing Strategies.* At times, the Portfolio Managers may determine that an investment

opportunity may be appropriate for only some accounts or may decide that certain of these accounts should take differing positions (i.e., may buy or sell the particular security at different times or the same time or in differing amounts) with respect to a particular security. In these cases, the Portfolio Manager may place separate transactions for one or more accounts which may affect the market price of the security or the execution of the transaction, or both, to the detriment of one or more other accounts.

*Variation in Compensation.* A conflict of interest may arise where the financial or other benefits available to the Portfolio Manager differ among accounts. While the Adviser only charges fees based on assets under management and does not receive a performance fee from any of its accounts, and while it strives to maintain uniform fee schedules, it does have different fee schedules based on the differing advisory services required by some accounts. Consequently, though the differences in such fee rates are slight, the Portfolio Managers may be motivated to favor certain accounts over others. In addition, the desire to maintain assets under management or to derive other rewards, financial or otherwise, could influence the Portfolio Managers in affording preferential treatment to those accounts that could most significantly benefit the Adviser.



The Adviser and the Fund have adopted compliance policies and procedures that are designed to address the various conflicts of interest that may arise for the Adviser and its staff members. However, there is no guarantee that such policies and procedures will be able to detect and prevent every situation in which an actual or potential conflict may arise.

**(a)(3) Portfolio Manager Compensation**

Compensation is paid solely by the Adviser. Each Portfolio Manager receives the same fixed salary. In addition, each Portfolio Manager receives a bonus based on peer reviews of his performance and the total net investment advisory fees received by Flaherty & Crumrine (which are in turn based on the value of its assets under management). The Portfolio Managers do not receive deferred compensation, but participate in a profit-sharing plan available to all employees of the Adviser; amounts are determined as a percentage of the employee's eligible compensation for a calendar year based on IRS limitations. Each Portfolio Manager is also a shareholder of Flaherty & Crumrine and receives quarterly dividends based on his equity interest in the company.

**(a)(4) Disclosure of Securities Ownership**

The following indicates the dollar range of beneficial ownership of shares by each Portfolio Manager as of November 30, 2012:

| Name               | Dollar Range of Fund Shares<br>Beneficially Owned* |
|--------------------|--|
| R. Eric Chadwick   | \$100,001 - \$500,000                              |
| Donald F. Crumrine | \$100,001 - \$500,000                              |
| Robert M. Ettinger | \$100,001 - \$500,000                              |
| Bradford S. Stone  | \$100,001 - \$500,000                              |

*\*Includes 7,169 shares held by Flaherty & Crumrine Incorporated of which each portfolio manager has beneficial ownership.*

**(b)** Not applicable.

**Item 9. Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers.**

Not applicable.

**Item 10. Submission of Matters to a Vote of Security Holders.**

There have been no material changes to the procedures by which the shareholders may recommend nominees to the registrant's board of directors, where those changes were implemented after the registrant last provided disclosure in response to the requirements of Item 407(c)(2)(iv) of Regulation S-K (17 CFR 229.407) (as required by Item 22(b)(15) of Schedule 14A (17 CFR 240.14a-101)), or this Item.

**Item 11. Controls and Procedures.**

- (a) The registrant's principal executive and principal financial officers, or persons performing similar functions, have concluded that the registrant's disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act of 1940, as amended (the "1940 Act") (17 CFR 270.30a-3(c))) are effective, as of a date within 90 days of the filing date of the report that includes the disclosure required by this paragraph, based on their evaluation of these controls and procedures required by Rule 30a-3(b) under the 1940 Act (17 CFR 270.30a-3(b)) and Rules 13a-15(b) or 15d-15(b) under the Securities Exchange Act of 1934, as amended (17 CFR 240.13a-15(b) or 240.15d-15(b)).
- (b) There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the 1940 Act (17 CFR 270.30a-3(d))) that occurred during the registrant's second fiscal quarter of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

**Item 12. Exhibits.**

- (a)(1) Code of ethics, or any amendment thereto, that is the subject of disclosure required by Item 2 is attached hereto.
- (a)(2) Certifications pursuant to Rule 30a-2(a) under the 1940 Act and Section 302 of the Sarbanes-Oxley Act of 2002 are attached hereto.
- (a)(3) Not applicable.
- (b) Certifications pursuant to Rule 30a-2(b) under the 1940 Act and Section 906 of the Sarbanes-Oxley Act of 2002 are attached hereto.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

(registrant) Flaherty & Crumrine Preferred Income Fund Incorporated

By (Signature and Title) \* /s/ Donald F. Crumrine  
Donald F. Crumrine, Director, Chairman of the Board and Chief  
Executive Officer  
(principal executive officer)

Date 01/28/13

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By (Signature and Title) \* /s/ Donald F. Crumrine  
Donald F. Crumrine, Director, Chairman of the Board and Chief  
Executive Officer  
(principal executive officer)

Date 01/28/13

By (Signature and Title) \* /s/ R. Eric Chadwick  
R. Eric Chadwick, Chief Financial Officer, Treasurer and  
Vice President  
(principal financial officer)

Date 01/29/13

\* Print the name and title of each signing officer under his or her signature.