

# Update on Auction Preferred Shares

**Insured Municipal Income Fund Inc. (NYSE: PIF)**

**Investment Grade Municipal Income Fund Inc. (NYSE: PPM)**

**March 27, 2008**

Investors in auction preferred shares (APS) issued by many closed-end funds, including **Insured Municipal Income Fund Inc.** and **Investment Grade Municipal Income Fund Inc.** (collectively, “the Funds”), have experienced a lack of liquidity. The following provides some additional details about the Funds and their APS.

## **Q. What are auction preferred shares?**

**A.** APS are preferred stock issued by closed-end funds. APS generally pay dividends based on a rate that is set by a detailed process. Historically, dividend rates for the APS issued by the Funds have been periodically reset through auctions run by an auction agent. An auction is governed by a set of procedures established by a closed-end fund and its auction agent. Typically, investors submit bids through a broker-dealer, who, in turn, submits them to an auction agent. Auctions may have a single broker-dealer or multiple broker-dealers, who may submit bids for their own account and on behalf of customers. Most recently, APS auctions have “failed” and interest rates have reset to a maximum rate as explained later in this update. After APS are issued, there is no guarantee that the auction process will attract sufficient buyers and that the APS will remain liquid at all times.

## **Q. Why would a fund issue APS?**

**A.** Assets obtained by the Funds through issuance of APS are used to leverage the Funds’ investments—thus providing the potential for higher yields and returns to common stock shareholders.

## **Q. Why did the Funds’ auctions fail?**

**A.** An auction can fail for a number of reasons, but it occurs primarily because more investors wish to sell their shares than there are buyers willing to purchase the shares. Auctions for the Funds’ APS first failed beginning on February 12, 2008, around the same time that auctions began to fail for many other closed-end funds. We believe that numerous closed-end funds that are leveraged via auction rate preferred stock have had similar issues. The possibility of a failed auction is inherent to the auction process and was explained in the APS offering documents.

## **Q. How do auction failures impact closed-end fund shareholders?**

**A.** Closed-end funds that issue APS usually have two types of shareholders: 1) shareholders who own auction preferred shares, and 2) shareholders who own common stock.

Failed auctions impact them differently. In the event of a failed auction, holders of preferred shares are not able to sell all (or some) of the APS they hold, and they become entitled to dividends calculated at a maximum rate, based upon a formula in the Funds’ governing documents. The maximum rate is reset on a periodic basis; in the case of the Funds, it is reset currently on a weekly basis. This maximum rate continues until a successful auction occurs.

Holders of preferred shares have experienced a loss of liquidity because the auctions have failed starting on February 12, 2008. It is possible that other avenues of liquidity may develop, such as secondary markets; however, the success of any such market is uncertain. The APS offering documents did not indicate that other avenues of liquidity would exist in case of auction failures. Prolonged auction failures would result in a Fund continuing to make preferred share dividend payments at the maximum rate. This may increase the cost of leverage for a Fund and could impact the dividends that are paid to common stock shareholders. Currently, the Funds' common shareholders continue to benefit from the leverage provided by the APS because the Funds' borrowing costs are less than the long-term earnings generated by the Funds' portfolio investments. If the cost of leverage begins to exceed a Fund's long-term earnings from its portfolio investments, it would further lower the level of dividend payments to common stock shareholders and would make the Fund's leverage more expensive than its intended benefits.

**Q. If an auction fails, does a closed-end fund default?**

**A.** No. A failed auction is not a credit event for a Fund; rather, it is a liquidity event for holders of the APS who lose the ability to trade their APS through the auction process. Failed auctions do not mean default or loss of capital. Instead, dividends are potentially affected because, as mentioned above, if auctions fail, the APS dividend rates are set at the maximum rates until the next successful auctions. Failed auctions also have not affected the credit quality of the Funds. The APS issued by both Funds currently continue to have a "AAA" rating from Standard & Poor's<sup>1</sup> and "Aaa" from Moody's Investors Services.

**Q. What are the details of the Funds' preferred shares?**

**A.** Insured Municipal Income Fund Inc. and Investment Grade Municipal Income Fund Inc. commenced operations in the early 1990s, and both have outstanding common shares and APS. The table below details the Funds' various classes of shares, number of shares outstanding for each class and date of the initial issuance for each class.

Fund	Class of Shares	Number of Shares Outstanding	Date of Issuance
Insured Municipal Income Fund Inc.	Common Shares	20,628,363	1993
	APS Series A	800	1993
	APS Series B	800	1993
	APS Series C	800	1993
	APS Series D	600	1994
	APS Series E	600	2003
Investment Grade Municipal Income Fund Inc.	Common Shares	10,356,667	1992
	APS Series A	800	1993
	APS Series B	800	1993
	APS Series C	600	2003

**Q. When an auction fails, how is the maximum rate determined?**

**A.** The maximum rate, should an auction fail, is determined based on the principles set forth in the APS governing documents. In effect, the maximum rate currently is the higher of 110% of (1) the Federal Reserve's 30 Day CP AA Financial Rate adjusted or (2) the S&P Weekly High Grade Index adjusted.

<sup>1</sup> Standard & Poor's is a division of The McGraw-Hill Companies, Inc.

**Q. Do the Funds currently have an obligation to redeem APS as a result of the failed auctions?**

**A.** No. Closed-end funds that issue APS generally have no legal obligation to repurchase or redeem APS, except under certain circumstances set forth in the governing documents. Under the Funds' governing documents, mandatory redemption is only required if certain asset coverage requirements (imposed by the Investment Company Act of 1940 and the rating agencies rating the APS) are not maintained. UBS Global Asset Management monitors these requirements for each Fund on a periodic basis, and each Fund currently has asset levels well in excess of those that would result in the need for a mandatory redemption. Consequently, APS may continue to be illiquid for an undetermined (and potentially extended) period of time.

**Q. What is UBS Global Asset Management doing in light of the lack of liquidity for APS holders?**

**A.** Currently, as auctions fail, the Funds are compensating APS shareholders by paying them dividends at the maximum rate, as required pursuant to their respective offering documents. As investment adviser to the Funds, UBS Global Asset Management is carefully monitoring the situation, including the level of reset rates. It cannot predict when (or even if) the next successful auction will occur, as this depends on factors outside its control, including the supply and demand for APS and general economic conditions.

Although the APS governing documents address what happens in the event of failed auctions, the Funds and their investment adviser are keenly aware of concerns relating to the loss of liquidity. At this time, taking into consideration the best interests of each Fund and both its preferred and common stock shareholders, UBS Global Asset Management is evaluating a number of options to deal with the current lack of liquidity.

Each Fund's Board of Directors has discussed the auction failures with the Funds' investment adviser and would be involved in any actions taken to effect a resolution of this situation.

For more information about the Funds, such as copies of recent shareholder reports, call the **UBS Global Asset Management Closed-End Funds Desk** at 888-793 8637.

Investors should carefully consider the investment objectives, risks and expenses of the funds in which they invest prior to investing.

**Forward-looking statements**

Certain statements made above are forward-looking statements. Actual future results or occurrences may differ significantly from those anticipated in any forward-looking statements due to numerous factors. These include, but are not limited to: the ability of the adviser and the Funds to develop and finalize any fund-by-fund specific proposals to restructure the leverage of such Funds; the need for the leveraged Funds to obtain formal fund-by-fund board approval of any specific proposals if they are developed and finalized; the ability of the Funds to negotiate and obtain from third parties any necessary debt facilities and other commitments and agreements necessary, should the Funds decide to refinance all or a portion their leverage, on terms and conditions acceptable to the Funds and in a timely manner; the effects of changes in market and economic conditions; other legal and regulatory developments; and other additional risks and uncertainties. The adviser and the Funds, and their affiliates, undertake no responsibility to update publicly or revise any forward-looking statements.