

March 6, 2008

### **John Hancock Closed-End Funds Auction Preferred Shares (APS) Questions & Answers**

**In response to recent developments in the APS market, we would like to help you understand the reason for the disruptions, the impact on closed-end funds and how John Hancock is responding. The following Q&A is intended to explain how closed-end funds use APS and answer some questions you may have about the current market environment.**

## **Frequently Asked Questions:**

### **Q: What is the difference between open-end and closed-end funds?**

**A:** Closed-end investment companies differ from open-end mutual funds in several critical ways. Among other things, a closed-end fund generally issues a fixed number of common shares in a one-time underwritten public offering. The launch of a new closed-end fund is substantially similar to the initial public offering of an operating company in this regard.

Unlike open-end mutual funds, common shares of closed funds are not redeemable by shareholders. Like the common stock of a conventional public company, the common shares trade exclusively on a secondary market, most typically a national securities exchange. The common shares of John Hancock closed-end funds currently all trade on the New York Stock Exchange. Hence, an investor who wants to buy or sell closed-end fund common shares generally must place purchase and sale orders through a broker or other qualified intermediary who then executes the transaction on the open market at prices determined by the supply and demand in the market at that time.

### **Q: What is a leveraged closed-end fund?**

**A:** As described above, a closed-end fund raises its initial capital through the initial public offering of its common shares. The proceeds from this offering are then invested by the closed-end fund's management company in accordance with the fund's investment objective and policies. In the case of a leveraged closed-end fund, additional capital is raised by means of a second underwritten public offering of preferred shares of the fund.

### **Q: What are auction preferred shares (APS)?**

**A:** Auction preferred shares (APS) are preferred stock whose dividend resets at regular intervals at a "Dutch" auction. Dutch auctions are commonly used alternatives to traditional pricing mechanisms. Many other types of preferred stock and debt securities also trade in an auction process. Like common shares of closed-end funds, APS have no redemption rights, which would enable holders to sell them directly back to the fund either on demand or at periodic intervals. When auctions are used to determine APS dividend rates, existing shareholders declare whether they intend to sell or hold their shares, while buyers declare the dividend rate at which they wish to purchase shares and in what quantity. For an auction to be successful, the number of shares bid on must meet or exceed the number of shares being offered for sale.

It is important to note that neither the Funds nor John Hancock exercise control over the auction rate market. The market is mediated by the auction agent who is compensated for their services regardless of whether or not an auction is successful. However, the functioning of the market is entirely a product of investor interest (i.e., supply and demand) communicated through the brokers that have entered into agreements to participate in these markets, as well as the willingness and ability of such brokers to assist in supporting these markets by investment of their own capital.

**Q: What are the special risks considerations associated with APS?**

A: The risk associated with both preferred shares and auctions are outlined in your fund's prospectus.

*The following paragraphs are both excerpts from the John Hancock Tax-Advantaged Dividend Income Fund (HTD) closed-end prospectus:*

**Risks of investing in the Preferred Shares include:**

**THE PRIMARY RISKS**

- If an Auction fails you may not be able to sell some or all of your APS and the Fund is not obligated to redeem your APS if the Auction fails.
- Because of the nature of the market for APS, you may receive less than the price you paid for your shares if you sell them outside of the Auction, especially when market interest rates are rising.
- A rating agency could downgrade the rating assigned to the APS, which could affect liquidity.
- The Fund may be forced to redeem APS to meet regulatory or rating agency requirements or may voluntarily redeem the APS in certain circumstances.
- In certain circumstances, the Fund may not earn sufficient income from its investments to pay dividends on the APS.
- If interest rates rise, the value of the Fund's investment portfolio generally will decline, reducing the asset coverage for the APS.

**AUCTION RISK**

The dividend rate for the APS normally is set through an Auction process. In the Auction, Existing Holders of APS may indicate the dividend rate at which the Existing Holders would be willing to hold or sell their APS or purchase additional APS. The Auction also provides liquidity for the sale of APS. An Auction fails if there are more APS offered for sale than there are buyers. You may not be able to sell your APS at an Auction if the Auction fails. Also, if you place Bid Orders, orders to retain shares at an Auction only at a specified dividend rate and that rate exceeds the rate set at the Auction, you will not retain your APS. Additionally, if you buy APS or elect to retain APS without specifying a dividend rate below which you would not wish to buy or continue to hold those APS, you could receive a lower rate of return on your shares than the market rate. Finally, the Dividend Period for the APS may be changed by the Fund, subject to certain conditions with notice to the holders of APS, which could also affect the liquidity of your investment.

**Q: What has recently happened with APS?**

A: As a result of the recent issues with the credit markets, an imbalance of buyers and sellers of APS auctions (including those of several John Hancock closed-end funds) has resulted. This is an industry-wide issue impacting nearly all auction rate securities and impacting many leveraged closed-end funds. Recent auctions have failed because of liquidity issues (i.e., there were more shares offered for sale than there were bids to buy shares), not because of credit quality concerns. The liquidity problems may have arisen because some broker-dealers who customarily placed bids for their own accounts in auctions did not place bids in recent failed auctions. However, broker-dealers are not, and never have been, legally required to bid in an auction.

**Q: What happens when an auction fails?**

A: It is important to note that a "failed" auction for a closed-end fund's APS is not a "default" on the security. Preferred shareholders continue to receive dividends at the "maximum rate" as noted below. Any bids in the auction to newly purchased shares that are filled will be allocated on a pro rata basis among the shareholders who wished to sell. Preferred shareholders who sought to sell shares, to the extent they were unable to do so, will continue to hold their shares. They may offer their shares at the next scheduled auction, subject to the same risk that the subsequent auction may not attract sufficient demand for a successful auction to occur.

The auction process calls for the fund to pay a "maximum rate" for the entire series, not just the unsold shares. This rate is intended in part to compensate would-be sellers for the gap in liquidity. In the case of John Hancock's APS, the maximum rate is the higher of 125 bps over or 125% of the 30-day commercial paper benchmark rate, except in the case of the Patriot Premium Dividend II Fund, which has a maximum rate of the higher of 150 bps over or 150% of a two-month LIBOR.

**Q: Which JH closed-end funds have been affected?**

A: Tax-Advantaged Dividend Income (HTD)      Investors Trust (JHI)  
Preferred Income (HPI)                              Income Securities Trust (JHS)  
Preferred Income II (HPF)                          Patriot Premium Dividend II (PDT)  
Preferred Income III (HPS)

**Q: What is the impact on common shareholders of closed-end funds that use APS?**

A: There has been no immediate negative impact on common shareholders of John Hancock closed-end funds. Our leveraged closed-end fund common shareholders continue to benefit from an attractive spread between the short-term rates our funds are paying on APS and the returns our funds are earning on the securities they hold.

However, one potential implication of the auction failures for common shareholders is that the cost of financing a fund's leverage may be higher than it would have been if those costs were determined through a successful auction process.

This means that common shareholder earnings would be marginally lower than the earnings the common shares would have otherwise earned. If these difficulties persist for an extended period of time, the funds may need to find alternative methods of financing the funds' leverage or otherwise alter the funds' financing plan.

**Q: Was this due to any credit quality issues with the funds?**

A: No, each of our funds' preferred shares continue to have AAA/AA credit ratings from one or more nationally recognized statistical rating organizations: Moody's and/or Standard & Poors. The failed auctions involving closed-end funds do not appear to be a credit quality issue. These auction failures were across several asset classes and structures and involved numerous issuers, many of which have extremely strong credit quality. Please keep in mind that our closed-end funds' APS rely on their asset coverage and their underlying portfolio credit quality and diversification of the collateral for their credit ratings. They are evaluated by independent ratings agencies who have been reviewing such shares and their underlying asset coverage for nearly 20 years.

**Q: Will I be able to sell my shares in the secondary market?**

A: Broker-dealer auction desks may try to facilitate secondary market trades away from the auction process, though there is no obligation to make a market bid to furnish liquidity. Such a secondary market, if it does materialize, may be thin and may not provide shareholders the degree of liquidity they are seeking. Sellers in the secondary market may receive less than the par value share price.

**Q: What if I want to sell my APS shares at the next scheduled auction?**

A: We cannot predict what will happen with upcoming auctions. Current indications are that liquidity pressure and auction market displacements will continue for at least the near term. If a particular auction fails to attract sufficient demand, all investors in that fund's APS will receive the maximum rate dividend as allowed by each closed-end fund. This maximum rate is intended to be attractively above comparable rates for successful auctions of closed-end fund preferred shares, although the maximum rates have been only slightly higher than the reset rates for recent successful auctions.

Please [click here](#) to view the updated auction rates.

**Q: Can bids be placed for rates higher than the maximum rate?**

A: No, they are capped at the maximum rate, which is calculated on the day of the applicable auction. If that auction fails, the maximum rate determined on that date remains in effect until the next scheduled auction.

**Q: What is the industry doing to address this issue?**

A: Industry participants are considering a variety of options to respond to the needs of preferred and common shareholders, but the focus appears to currently be centered on two options:

- Restructuring APS with other forms of leverage, and/or
- Making them eligible for investment by money market funds.

Other options such as buying back and retiring APS (i.e. deleveraging) have been considered but may not be practical given that they favor one class of shareholder over another. Currently, industry members are consulting with the U.S. Securities and Exchange Commission (SEC), the Investment Company Institute (ICI) and Wall Street leaders for input on the most appropriate course of action.

**Q: I've read about statements posted in the *New York Times* made by Western Investment LLC that suggest a common share tender offer proposal could solve the APS liquidity issue for the Tax-Advantaged Dividend Income Fund (HTD), is this accurate?**

**A:** The suggestion being made by Western Investment LLC does not solve the auction shares liquidity problem. Western is interested in a short-term liquidity event that they can leverage to make a quick profit at the expense of long-term shareholders. They have a history of attempting to do this, moving from one closed-end fund to the next.

It is important that investors not be misled by these suggestions. The suggestion of a tender offer does not solve the liquidity problem for all APS shareholders and potentially does not provide a solution for any APS shareholders.

The Board of Directors for all John Hancock closed-end funds are actively reviewing solutions to the lack of liquidity in the APS auction market that are in the best interest of all APS and all common shareholders.

**Q: How is John Hancock responding to this issue?**

**A:** John Hancock continues to monitor overall developments and actively work to help restore liquidity to the APS holders. Along with other market participants, each of whom is facing exactly the same issue, we are focusing significant resources on the issue and we are having ongoing dialog with Wall Street. The funds' board of trustees have been informed of these on-going issues and continue to be actively involved in discussions regarding the options available. Any final decisions regarding the APS will be reviewed by the board prior to implementation. In the interim, those shareholders will continue to earn an attractive rate of interest on their APS holdings.

**Q: Who do I contact if I have any further questions?**

**A:** Please call 1-800-843-0090, Monday through Friday, between 8:00 A.M. and 7:00 P.M., Eastern Time.



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