

**FIRST TRUST/HIGHLAND CAPITAL
FLOATING RATE INCOME FUND II**

ANNUAL INFORMATION FORM

March 19, 2010

TABLE OF CONTENTS

	Page
NAME, FORMATION AND HISTORY OF THE FUND	1
INVESTMENT RESTRICTIONS AND PRACTICES OF THE FUND.....	1
Investment Objectives	1
Investment Strategy.....	2
Independent Review Committee Approvals	4
DESCRIPTION OF THE UNITS	4
Non-Resident Unitholders	5
Acts Requiring Unitholder Approval	5
Amendments to the Declaration of Trust.....	6
Distributions	6
Repurchase of Units	7
VALUATION OF PORTFOLIO.....	7
Net Asset Value	8
Senior Loans	9
PURCHASES AND REDEMPTIONS.....	10
Purchases 10	
Redemptions	10
RESPONSIBILITY FOR FUND OPERATIONS	12
Trustee/Manager	12
Advisor	15
Investment Advisory Agreement	16
Sub-Advisor.....	17
Investment Sub-Advisory Agreement	17
Portfolio Manager of the Sub-Advisor	18
Brokerage Arrangements.....	18
Custodian	19
Registrar, Transfer Agent and Distribution Agent	19
Auditor	19
CONFLICTS OF INTEREST.....	19
GOVERNANCE OF THE FUND	19
Fund Governance	19
Proxy Voting Policy	20
CANADIAN INCOME TAX CONSIDERATIONS FOR INVESTORS.....	22
Status of the Fund	22
Taxation of the Fund	23
Taxation of Unitholders.....	24
U.S. INCOME TAX CONSIDERATIONS.....	25
Characterization of the Fund for U.S. Tax Purposes.....	25

TABLE OF CONTENTS
(continued)

	Page
Fund Not Subject to Tax on Net Income Basis.....	26
Withholding Tax on Interest Generally Not Applicable to Fund.....	26
MATERIAL CONTRACTS	28

Name, Formation and History of the Fund

This is the Annual Information Form for First Trust/Highland Capital Floating Rate Income Fund II (the “Fund”).

The Fund was established under the laws of the Province of Ontario by a declaration of trust dated May 16, 2005 (the “Original Declaration of Trust”) of FT (NSI) Management Inc. (the “Manager”), a wholly-owned subsidiary of First Defined Portfolio Management Inc. (“FDPM”). The units of the Fund (the “Units”) are listed on the Toronto Stock Exchange (“TSX”) under the symbol FHM.UN.

The Original Declaration of Trust was amended and restated on August 18, 2009 (the “Declaration of Trust”) to, among other things, amend the investment objectives, strategy and restrictions of the Fund, allow for certain additional securities offerings, limit redemptions of Units in 2010 and 2011 and amend the termination provisions of the Fund.

In addition, on August 18, 2009, the Fund merged (the “Merger”) with First Trust/Highland Capital Floating Rate Income Fund (the “Terminating Fund”) by acquiring all of the assets of the Terminating Fund in consideration for the issuance of 3,576,733 Units. These Units were distributed to the unitholders of the Terminating Fund. The Manager presented the terms of the Merger to the Independent Review Committee (the “IRC”) of the Fund. The IRC reviewed the conflict of interest matters raised by the proposed Merger and associated matters and having regard to, among other things, the process proposed for the completion of the Merger including the requirement to obtain unitholder approval, the IRC resolved that the conflict of interest matters raised by the Merger and associated matters achieved a fair and reasonable result for the Fund. The Terminating Fund was terminated after the Merger.

The head office and principal place of business of the Fund and the Manager is the head office of the Manager at Suite 1300, 330 Bay Street, Toronto, Ontario, M5H 2S8. The Manager may be contacted toll free at 1-877-622-5552 or by e-mail at info@firsttrust.ca. Information about the Fund is also available at www.firsttrust.ca or at www.sedar.com.

First Trust Advisors L.P. (the “Advisor”), an affiliate of the Manager, acts as investment advisor to the Fund and Highland Capital Management, L.P. (the “Sub-Advisor”) is the sub-advisor in respect of the Senior Loan Portfolio (as defined below) of the Fund. The Sub-Advisor was appointed at the time of the Merger.

Investment Restrictions and Practices of the Fund

Investment Objectives

The Fund’s investment objectives are to:

- provide holders of Units (“Unitholders”) with monthly distributions which will fluctuate with changes in U.S. short-term interest rates; and
- preserve and potentially enhance the net asset value (“NAV”) of the Fund.

There can be no assurance that the Fund will achieve its investment objectives.

Investment Strategy

The Fund's assets will be invested in a common share portfolio (the "Common Share Portfolio") and/or a senior loan portfolio (the "Senior Loan Portfolio") in accordance with the Common Share Portfolio Investment Strategy and Senior Loan Portfolio Investment Strategy set out below. The Advisor allocates the assets of the Fund between the two investment strategies in its discretion. Prior to the Merger, the Fund only invested pursuant to the Common Share Portfolio Investment Strategy.

For temporary defensive purposes, including to fund redemptions, the Fund may depart from the investment strategies and investment restrictions by investing part or all of its assets in cash and cash equivalents.

Common Share Portfolio Investment Strategy

Pursuant to the Fund's Common Share Portfolio Investment Strategy:

- (a) the Fund's Common Share Portfolio will be invested in a portfolio of common shares of Canadian public companies and the Fund will enter into one or more purchase and sale agreements (or forward or other derivative transaction having the same economic effect) (a "Forward Agreement") between the Fund and a counterparty (the "Counterparty") pursuant to which the Fund will gain exposure to First Trust/Highland Capital Senior Loan Trust (the "Senior Loan Trust") in respect thereof; and
- (b) the Fund may partially settle the Forward Agreement prior to the termination date of the Fund in order to fund monthly distributions, redemptions of Units by Unitholders from time to time, payments for purchases of Units in the market and expenses of the Fund, and the Fund may partially settle or terminate the Forward Agreement when determined appropriate in the discretion of the Manager.

The returns of the Common Share Portfolio are intended to correlate with an investment in the Senior Loan Trust, subject to any expenses incurred by the Fund. The Senior Loan Trust is an investment trust established under the laws of Ontario and a reporting issuer under the laws of Quebec. The portfolio of the Senior Loan Trust consists primarily of senior secured floating rate interest loans ("Senior Loans") issued by debtors that are primarily U.S. issuers. Senior Loans generally hold the most senior position in the capital structure of a business entity, are typically secured with specific collateral and have a claim on the assets of the borrower that is senior to that held by subordinated debtholders and shareholders of the borrower. For information with respect to the Senior Loan Trust, please refer to its Annual Information Form dated March 19, 2010 available at www.firsttrust.ca or at www.sedar.com.

In addition to holding cash, the Fund also may invest excess cash of the Common Share Portfolio in (i) any Canadian or U.S. dollar denominated debt security considered investment grade, at the time of the investment, by Standard & Poor's or another equivalent credit rating agency, and (ii) cash equivalents.

Senior Loan Portfolio Investment Strategy

Pursuant to the Fund's Senior Loan Portfolio Investment Strategy:

- (a) the Fund's Senior Loan Portfolio shall be invested primarily in a portfolio of Senior Loans issued by debtors that are primarily United States issuers. The Fund may also invest, to a limited extent, in U.S. dollar denominated Senior Loans of non-US issuers. The Fund's investments in Senior Loans may take different forms including (i)

purchasing an assignment of a portion of a Senior Loan from a third party or (ii) acquiring a participation in a Senior Loan;

- (b) the Fund also may invest in:
 - (i) Special Situation Investments (as defined below);
 - (ii) Senior Loans of firms, prior to an event of default, whose acute operating and/or financial problems have resulted in the markets valuing their respective securities and debt at discounted prices that may yield, should they not default, a premium over comparable duration U.S. Treasury bonds;
 - (iii) participation interests in loans secured by high credit tenant leases; and
 - (iv) cash and cash equivalents.

“Special Situation Investments” means securities and debt of distressed issuers, Senior Loans of firms that, at the time of acquisition, have defaulted on their debt obligations and/or filed for protection under Chapter 11 of the U.S. Bankruptcy Code, or have entered into a voluntary reorganization in conjunction with their creditors and stakeholders in order to avoid a bankruptcy filing, second lien loans, sub-performing real estate loans and mortgages, public and privately placed senior, mezzanine, subordinated and junior debt, convertible bonds and preferred and common stock received in debt restructurings.

As the Fund is not a “mutual fund” as defined under applicable Canadian securities law, the Fund is not subject to certain investment restrictions and practices contained in securities legislation applicable to mutual funds, including National Instrument 81-102.

The Fund is a mutual fund trust under the *Income Tax Act* (Canada) (the “Tax Act”) and has been from the date of inception. The investment restrictions of the Fund require the Fund, among other things, to manage its investments and affairs to ensure that it will at all times be a “mutual fund trust” for purposes of the Tax Act.

In conjunction with the changes to its investment strategy, the Fund amended its investment restrictions to add restrictions relating to the Senior Loan Portfolio including with respect to asset class weightings, concentration in issuers or industries and related party investments as set out in the Declaration of Trust. In addition, the Fund is now permitted to borrow an amount representing not more than 100% of the value of the net assets of the Senior Loan Portfolio. Currently, the Fund is not employing leverage.

Unitholder approval is required before the investment objectives and restrictions of the Fund are changed. See “Description of the Units - Acts Requiring Unitholder Approval” below.

Independent Review Committee Approvals

Subject to certain conditions set out in National Instrument 81-107 – Independent Review Committee for Investment Funds (*NI 81-107*), the Fund may:

- (i) invest in securities of related issuers; and
- (ii) purchase securities of an issuer from or sell securities of an issuer to another investment fund managed by the Manager or an affiliate thereof ((i) and (ii) collectively referred to as *Related-Party Trading Activities*).

The Independent Review Committee of the Fund has, as permitted by Canadian securities laws, approved standing instructions in respect of Related-Party Trading Activities. In accordance with the conditions of the applicable standing instructions, the Independent Review Committee reviews Related-Party Trading Activities at least quarterly. In its review, the Independent Review Committee considers whether investment decisions in respect of Related-Party Trading Activities:

- were made by the Manager or Advisor in the best interests of the fund and were free from any influence of the Manager and/or Advisor and without taking into account any consideration relevant to those entities;
- were in compliance with the conditions of the policies and procedures of the Manager;
- were in compliance with the applicable standing instructions of the Independent Review Committee; and
- achieved a fair and reasonable result for the Fund.

The Fund did not conduct any Related Party Trading Activities during the period between January 1, 2009 and December 31, 2009.

Description of the Units

The Fund's capital consists of an unlimited number of a single class of transferable, redeemable Units, each of which represents an equal, undivided beneficial interest in the net assets of the Fund. Each Unit entitles the holder to the same rights and obligations as a holder of any other Unit and no holder of Units is entitled to any privilege, priority or preference in relation to any other holder of Units except as provided in the Declaration of Trust or required by law. Each holder of Units is entitled to one vote for each whole Unit held and is entitled to participate equally with respect to any and all distributions made by the Fund.

The termination date of the Fund is May 31, 2015 or such other date as determined in accordance with the Declaration of Trust (the "Termination Date"). On termination or liquidation of the Fund, the holders of outstanding Units of record are entitled to receive on a pro rata basis all of the assets of the Fund remaining after payment of all debts, liabilities and liquidation expenses of the Fund. The Fund may be terminated at any time (i) upon not less than 90 days' written notice by the Manager with the approval of the Unitholders by extraordinary resolution (provided that Unitholders holding at least 10% of Units outstanding on the record date of the meeting called to consider the matter vote in favour of the resolution); or (ii) without the approval of Unitholders but upon not less than 30 days' written notice by the Manager to the Unitholders at the discretion of the Manager if, in the opinion of the independent directors of the Manager, (A) it is no longer economically feasible to continue the Fund (including if the total net assets of the Fund are less than \$20 million or the expenses of the Fund exceed the income of the Fund such that the Fund is no longer profitable); or (B) it is in the best interests of Unitholders to do so. Furthermore, the Manager may, under certain conditions, extend the date of termination for a period of up to one year.

Non-Resident Unitholders

At no time may (i) non-residents of Canada, (ii) partnerships that are not Canadian partnerships or (iii) a combination of non-residents of Canada and such partnerships (all as defined in the Tax Act) (collectively, "Non-Residents"), be the beneficial owners of a majority of the Units. The Manager may

require declarations as to the jurisdictions in which beneficial owners of Units are resident and if a partnership, its status as a Canadian partnership. If the Manager becomes aware, as a result of requiring such declarations as to beneficial ownership or otherwise, that the beneficial owners of 40% of the Units then outstanding are, or may be, Non-Residents, or that such a situation is imminent, the Manager may make a public announcement thereof and send a notice to the Unitholders that are not Non-Residents, chosen in inverse order to the order of acquisition or in such manner as the Manager may consider equitable and practicable, requiring them to sell their Units or a portion thereof within a specified period of not less than 30 days. If a Unitholder that receives such notice has not sold the specified number of Units or provided the Manager with satisfactory evidence that they are not Non-Residents within such period, the Manager may on behalf of such Unitholders sell such Units and, in the interim, shall suspend the voting and distribution rights attached to such Units. Upon such sale, the affected holders shall cease to be beneficial holders of Units and their rights shall be limited to receiving the net proceeds of sale of such Units.

Acts Requiring Unitholder Approval

The holder of each whole Unit is entitled to one vote per Unit at any meeting of Unitholders.

The following may only be undertaken with the approval of Unitholders provided by affirmative vote of at least 66^{2/3}% of the votes cast, either in person or by proxy, at a meeting of Unitholders called to approve such resolution (an “Extraordinary Resolution”):

- any change in the investment objectives or restrictions of the Trust unless such changes are necessary to ensure compliance with applicable laws, regulations or other requirements imposed by applicable regulatory authorities from time to time;
- the liquidation, dissolution or termination of the Fund prior to May 31, 2015 unless otherwise permitted (see “Description of the Units” above);
- the sale of all or substantially all of the assets of the Fund other than in the ordinary course;
- any increase in the fees payable to the Manager;
- any amendment, modification or variation in the provisions or rights attaching to the Units other than as provided under the terms of the Declaration of Trust (see “Amendments to the Declaration of Trust” below);
- subject to certain exceptions, any issue of Units for net proceeds per Unit less than the NAV per Unit calculated prior to the entering into of the commitment by one or more subscribers to purchase such Units or prior to the pricing of the offering, as the case may be, other than pursuant to an offering of rights, warrants or options to existing Unitholders to acquire Units from treasury;
- any change in the frequency of calculating NAV per Unit to less often than weekly; and
- the removal of the Manager (other than if replaced by an affiliate thereof).

Amendments to the Declaration of Trust

Except for changes to the Declaration of Trust that require the approval of Unitholders or a change discussed below, the Declaration of Trust may be amended from time to time by the Manager upon not less than 30 days' prior written notice to Unitholders.

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

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

Distributions

In accordance with the Fund's investment objectives, the Fund will endeavour to make monthly distributions to Unitholders of record on the last Business Day of each month (the “Record Date”). Distributions will be paid no later than the tenth Business Day of the subsequent month (the “Distribution Payment Date”). Currently, the Fund is not making distributions to Unitholders. There can be no assurance that the Fund will be able to achieve its monthly distribution objective or make such payments on any Distribution Payment Date. Distributions of the Fund generated through its Common Share Portfolio Investment Strategy are expected to consist primarily of return of capital and will correspond to the monthly distributions of the Senior Loan Trust (less any expenses of the Fund) which will be derived primarily from net income earned on the Senior Loan Portfolio and, in certain circumstances, from net gains from dispositions of investments in the Senior Loan Portfolio and, as a result, will fluctuate from month to month. Under the Forward Agreement, if the Senior Loan Trust suspends redemptions or fails to pay distributions on its units corresponding to the Fund's targeted distributions, the Counterparty will suspend payment in respect of a partial settlement until such time as such redemptions and distributions are reinstated. Any distributions generated through the Senior Loan Portfolio Investment Strategy are expected to be comprised primarily of ordinary income but also may be comprised of capital gains or return of capital.

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

The amount of distributions in any particular calendar month will be determined by the Manager, having regard to the investment objectives of the Fund, the net realized capital gains and net income of the Fund and the Senior Loan Trust, if any, during the calendar month and in the year to date, the net realized capital gains and net income of the Fund and the Senior Loan Trust anticipated in the balance of the year and distributions made in previous months.

Because the Fund and the Senior Loan Trust invest primarily in Senior Loans whose interest rates are typically reset on average every 120 days, the distributions paid by the Fund will typically move up and down based on movement in prevailing U.S. short-term interest rates. Unitholders may expect the reset rate of the Fund or the Senior Loan Trust to be longer than average during periods of rising short-term interest rates and shorter than average during periods of falling interest rates. The average reset rate of the Senior Loans in the Senior Loan Investment Portfolio as at December 31, 2009 was 40 days and the average reset rate of the Senior Loans in the Senior Loan Trust as at December 31, 2009 was 31 days.

Repurchase of Units

To enhance liquidity and to provide market support for the Units, the Fund has a mandatory market purchase program under which the Fund is, subject to certain exceptions and conditions contained in the Declaration of Trust and in compliance with any applicable regulatory requirements, obligated to purchase for cancellation any Units offered in the market at the then prevailing market price if the price at which Units are then offered for sale is less than 95% of the NAV per Unit determined as at the close of business on the immediately preceding Business Day. The maximum number of Units to be purchased in any three month period will be 1.25% of the number of Units outstanding at the beginning of such period. The Declaration of Trust provides that the Fund is not obligated to make such purchases if, among other things, (i) the Fund lacks the cash, debt capacity or other resources to make such purchases, or (ii) in the opinion of the Manager, such market purchases would adversely affect the on-going activities of the Fund.

The Declaration of Trust provides that, subject to applicable law, the Fund may, in its sole discretion, from time to time purchase (in the open market or by invitation for tenders) Units for cancellation up to a maximum in any 12-month period of 10% of the number of Units outstanding at the commencement of such period, in all cases at a price per Unit not exceeding the NAV per Unit on the Valuation Date immediately prior to the date of any such purchase of Units. It is expected that these purchases will be made as normal course issuer bids through the facilities and under the rules of the TSX or such other exchange or market on which the Units are then listed.

Valuation of Portfolio

CIBC Mellon Global Securities Services Company (the “Valuation Agent”) will, on the close of business on each Valuation Date (as defined below), calculate the value of the assets of the Fund pursuant to the terms of a fund administration services agreement (the “Fund Administration Services Agreement”) dated May 16, 2005. Since the value of the Fund’s rights and obligations under the Forward Agreement is determined by reference to the value of the Senior Loan Portfolio, the NAV of the Fund is linked to the value of the Senior Loan Portfolio.

“Valuation Date” means the date upon which NAV per Unit is calculated and which currently is Friday of each week, or if any Friday is not a Business Day, the immediately preceding Business Day, and the last Business Day of each month, and includes any other date on which the Manager elects, in its discretion, to calculate the NAV per Unit. “Business Day” means any day except Saturday, Sunday or statutory holiday in Toronto, Ontario or any other day on which the TSX or the New York Stock Exchange is not open for trading.

The Manager, together with the Advisor, will review and, if satisfactory, approve the valuation and will, from time to time, consider the appropriateness of the valuation policies adopted by the Fund and the Senior Loan Trust.

Net Asset Value

NAV is calculated by the Valuation Agent on each Valuation Date by subtracting the aggregate amount of the liabilities of the Fund from the total assets of the Fund.

The assets and liabilities of the Fund and the Senior Loan Trust, other than Senior Loans, will be valued as follows:

- the value of any security which is listed or traded upon a stock exchange shall be determined by taking the latest available sale price of recent date, or lacking any recent sales or any record thereof, the simple average of the latest available offer price and the latest available bid price (unless, in the opinion of the Valuation Agent, such value does not reflect the value thereof and in which case the latest offer price or bid price should be used), as at the Valuation Date, all as reported by any means in common use;
- the value of any cash on hand or on deposit, prepaid expenses, cash dividends received (or distributions declared to Unitholders of record on a date before the Valuation Date as of which the NAV is being determined and to be received) and interest accrued and not yet received, shall be deemed to be the face amount thereof unless the Valuation Agent has determined that any such asset is not otherwise worth the face amount thereof, in which case the value thereof shall be deemed to be such value as the Advisor determines to be the fair value thereof;
- the value of a forward contract shall be the gain or loss with respect thereto that would be realized if, on the Valuation Date, the position in the forward contract were to be closed out in accordance with its terms;
- the value of any bonds, debentures and other debt obligations will be valued by taking the average of the bid and ask prices on the Valuation Date at such times as the Valuation Agent, in its discretion, deems appropriate. Leverage borrowings will be valued at par. Short term investments, including notes and money market instruments, will be valued at cost plus accrued interest; and
- if an investment cannot be valued under the foregoing rules or if the foregoing rules are at any time considered by the Valuation Agent to be inappropriate under the circumstances, then notwithstanding the foregoing rules, the Valuation Agent and/or the Advisor shall make such valuation as it considers fair and reasonable. This discretion has not been exercised in the past three years.

The NAV of the Fund will be calculated in accordance with the rules and policies of the Canadian Securities Administrators or in accordance with any exemption therefrom that the fund may rely upon (which rules and policies may differ from Canadian generally accepted accounting principles (“Canadian GAAP”)). The NAV of the Fund is calculated using the bid and ask prices of securities of the Fund which are listed or traded upon a stock exchange. Under GAAP, the net asset value is calculated using the closing price of such securities.

Financial statements of the Fund will contain a reconciliation of the NAV per unit that is reported in such financial statements in accordance with Canadian GAAP to the NAV per unit used by the Fund for other purposes.

The value of all assets quoted or valued in terms of foreign currency, the value of all funds on deposit and the value of all liabilities and contractual obligations payable in foreign currency shall be determined using the applicable rate of exchange current at, or as nearly as practicable to, the date on which the NAV is computed.

The NAV per Unit is the amount obtained by dividing the NAV of the Fund as of a particular date by the total number of Units outstanding on that date. The NAV per Unit is calculated on a weekly basis by the Valuation Agent. The NAV of the Fund or NAV per Unit is provided by the Manager to Unitholders through the Internet at www.firsttrust.ca.

The process of valuing investments for which no published market exists is based on inherent uncertainties and the resulting values may differ from values that would have been used had a ready market existed for the investments and may differ from the prices at which the investments may be sold.

Senior Loans

The Senior Loans in which the Fund and the Senior Loan Trust will invest are not listed on any securities exchange or board of trade. Senior Loans are typically bought and sold by institutional investors in individually negotiated private transactions that function in many respects like an over-the-counter secondary market, although typically no formal market-makers exist. This market, while having grown substantially in the past several years, generally has fewer trades and less liquidity than the secondary market for other types of securities. Some Senior Loans have few or no trades, or trade infrequently, and information regarding a specific Senior Loan may not be widely available or may be incomplete. Accordingly, determinations of the market value of Senior Loans may be based on infrequent and dated information. Because there is less reliable, objective data available, elements of judgment may play a greater role in valuation of Senior Loans than for other types of securities.

Senior Loans with readily available quotations shall be valued using the current quotations provided by Loan Pricing Corporation or another prominent pricing service. Senior Loans for which current quotations are not readily available shall be valued at fair value. When applicable, fair value will be determined by the Advisor. In valuing an investment in Senior Loans, consideration is given to several factors, which may include, among others, the following:

- the fundamental business data relating to the borrower;
- an evaluation of the forces which influence the market in which these securities are purchased and sold;
- the type, size and cost of holding;
- the financial statements of the borrower;
- the credit quality and cash flow of the issuer, based on the Advisor's or external analysis;
- the information as to any transactions in or offers for the holding;
- the price and extent of public trading in similar securities (or equity securities) of the borrower, or comparable companies;
- the coupon payments;

- the quality, value and saleability of collateral securing the loan;
- the business prospects of the borrower, including any ability to obtain money or resources from a parent or affiliate and an assessment of the borrower's management; and
- the prospects for the borrower's industry and multiples (of earnings and/or cash flow) being paid for similar businesses in that industry.

Purchases And Redemptions

Purchases

Registration of interests in, and transfers of, the Units will be made only through the book-entry only system administered by The Canadian Depository for Securities Limited ("CDS"). Units must be purchased, transferred and surrendered for redemption through a participant in CDS. All rights of Unitholders must be exercised through, and all payments or other property to which such Unitholders are entitled will be made or delivered by, CDS or the CDS participant through which the Unitholder holds such Units. Upon purchase of any Units, the Unitholders will receive only a customer confirmation (and not a Unit certificate) from the CDS participant from or through which the Units are purchased.

Redemptions

Subject to the Trust's rights to suspend redemptions and the limit on redemptions (as described below), Units may be surrendered for redemption during the period (the "Annual Notice Period") not more than 60 days, and not later than 5:00 p.m. (Toronto time) on the 30th day, prior to the second last Business Day of June in each year (the "Annual Redemption Date"), to CIBC Mellon Trust Company (the "Transfer Agent and Registrar"). In addition to the annual redemption right, Units may be surrendered for redemption not later than 5:00 p.m. (Toronto time) on the 20th Business Day prior to the second last Business Day of each month (the "Monthly Redemption Date"). Units surrendered for redemption by a Unitholder will be redeemed as at such redemption date and the Unitholder will receive payment in respect of any Units surrendered for redemption on or before the Redemption Payment Date. "Redemption Payment Date" means in relation to an Annual Redemption Date or Monthly Redemption Date, the later of (i) the date on or before the tenth Business Day after the Annual Redemption Date or Monthly Redemption Date, as applicable and (ii) the Business Day on which the Fund receives payment from the Counterparty in respect of a pre-settlement made under the Forward Agreement on or about such Annual Redemption Date or Monthly Redemption Date.

The maximum number of units that can be redeemed on an Annual Redemption Date in 2010 and 2011 is 10% of the Units outstanding on that date (the "Permitted Amount"). In the event that Unitholders of the Fund surrender for redemption in each of 2010 and 2011 more than the Permitted Amount of Units, the entitlement of a redeeming Unitholder to have its Units redeemed for the applicable redemption price will be determined by the Manager on a pro rata basis. Any Units surrendered for redemption but not redeemed because they exceed the Permitted Amount will not be redeemed unless the redeeming Unitholder has indicated that such Units shall be redeemed at the Monthly Redemption Price in lieu thereof in accordance with the Declaration of Trust.

Unitholders whose Units are redeemed on the Annual Redemption Date in any year will be entitled to receive a redemption price per Unit (the "Annual Redemption Price") equal to the NAV per Unit determined on the Annual Redemption Date less any expenses incurred by the Fund including those incurred to partially settle the Forward Agreement and any brokerage costs. The NAV per Unit will vary

depending on the performance of the Fund, which depends on a number of factors, including the market value of the Senior Loans and other securities in the Fund and the Senior Loan Trust where sufficient liquidity exists for such a determination, market perceptions of the issuers of the Senior Loans and other securities in the Fund and the Senior Loan Trust, the performance of the Senior Loan and high yield debt markets generally and interest rates.

Unitholders whose Units are redeemed on any Monthly Redemption Date will receive a redemption price per Unit (the "Monthly Redemption Price") equal to the lesser of (i) 95% of the Market Price of the Units, and (ii) 100% of the Closing Market Price of the Units on the applicable Monthly Redemption Date less, in each case, any costs associated with the redemption, including those incurred to partially settle the Forward Agreement and brokerage costs. "Market Price" means the weighted average trading price on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX) for the ten trading days immediately preceding the relevant Monthly Redemption Date. "Closing Market Price" means the closing price of the Units on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX) or, if there was no trade on the relevant Monthly Redemption Date, the average of the last bid and the last asking prices of the Units on the TSX (or such other stock exchange on which the Units are listed, if the Units are no longer listed on the TSX).

The Manager may, without the approval of Unitholders (but subject to regulatory approval), change the redemption rights attached to the Units on not less than 30 days' notice to Unitholders, provided that no such change may be made without Unitholder approval if it would eliminate the rights of Unitholders to redeem their Units on the Annual Redemption Date in any year at an Annual Redemption Price equal to the NAV per Unit or if it would result in the Fund being a mutual fund for securities law purposes.

A Unitholder who desires to exercise Unit redemption privileges must do so by causing a CDS Participant, which includes securities brokers and dealers, banks and trust companies, to deliver to CDS (at its office in the City of Toronto) on behalf of the Unitholder a written notice of the Unitholder's intention to redeem Units, no later than 5:00 p.m. (Toronto time) on the relevant notice date. A Unitholder who desires to redeem Units should ensure that the CDS Participant is provided with notice of his or her intention to exercise his or her redemption right sufficiently in advance of the relevant notice date so as to permit the CDS Participant to deliver a notice to CDS by the required time. By causing a CDS Participant to deliver to CDS a notice of a Unitholder's intention to redeem Units, the Unitholder shall be deemed to have irrevocably surrendered his or her Units for redemption and appointed such CDS Participant to act as his or her exclusive settlement agent with respect to the exercise of such redemption privilege and the receipt of payment in connection with the settlement of obligations arising from such exercise. Any redemption notice that CDS determines to be incomplete, not in proper form or not duly executed shall, for all purposes, be void and of no effect, and the redemption privilege to which it relates shall be considered, for all purposes, not to have been exercised thereby. A failure by a CDS Participant to exercise redemption privileges or to give effect to the settlement thereof in accordance with a Unitholder's instructions will not give rise to any obligations or liability on the part of the Fund or the Manager to the CDS Participant or the Unitholder.

Trust Units surrendered on a date that falls within both an Annual Notice Period and a Monthly Notice Period will be deemed to be surrendered for the Annual Redemption Price. A Redemption Notice submitted during the Annual Notice Period in 2010 and 2011 shall indicate whether any Units that cannot be redeemed on an Annual Redemption Date (the "Excess Units") because the number of Units surrendered for redemption exceeds the Permitted Amount shall be (i) returned to the holder thereof or (ii) redeemed at the applicable Monthly Redemption Price.

The Manager may suspend the redemption of Units or payment of redemption proceeds or the mandatory market purchase of Units of the Fund for any period not exceeding 120 days during which the Manager determines that conditions exist which render impractical the sale of assets of the Fund or the Senior Loan Trust or which impair the ability of the Manager to determine the value of the assets of the Fund or the Senior Loan Trust. The suspension may, at the sole discretion of the Manager, apply to all requests for redemption received prior to the suspension but as for which payment has not been made, as well as to all requests received while the suspension is in effect. All Unitholders making such requests shall be advised of the suspension and of their right to withdraw their request for redemption. Redemptions so suspended and not withdrawn will be effected at a price determined on the first Valuation Date following the termination of the suspension. The suspension shall terminate on the first day on which the condition giving rise to the suspension has ceased to exist provided that no other condition under which a suspension is authorized then exists. To the extent not inconsistent with applicable law or the official rules and regulations promulgated by any stock exchange having jurisdiction over the Fund, any declaration of suspension made by the Manager shall be conclusive.

Under the Forward Agreement, if the Senior Loan Trust suspends redemptions or otherwise does not pay redemption proceeds in the event a unitholder provides notice of redemption, the Counterparty will suspend payment in respect of a settlement of the Forward Agreement until such time as such redemptions are reinstated. In such circumstances, the Fund may be unable to pay the redemption proceeds in respect of any Units tendered for redemption. If the Counterparty or one of its affiliates subscribes for units of the Senior Loan Trust, it will waive its right to enforce payment of redemption proceeds by the Senior Loan Trust. In addition, any eligible assignee of such units will be subject to the same waiver. The Fund cannot compel the Senior Loan Trust to pay the Counterparty in respect of redemption proceeds and cannot compel a unitholder of the Senior Loan Trust (including the Counterparty, if applicable) to enforce payment by the Senior Loan Trust of redemption proceeds.

Responsibility for Fund Operations

Trustee/Manager

FT (NSI) Management Co. is the trustee and manager of the Fund. The Declaration of Trust sets out the responsibilities of the Manager with respect to the Fund. Under the Declaration of Trust, the Manager provides or arranges for all management, administrative and other services required by the Fund.

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

In consideration for the services provided to the Fund, the Manager will be entitled to a management fee ("Management Fee") of 0.75% of Managed Assets (calculated and payable monthly in arrears plus an

amount equal to the Service Fee, plus applicable taxes). “Managed Assets” means, in respect of any particular month, the average daily gross asset value of the Fund during such month (including assets attributable to the principal amount of borrowings) minus the sum of the accrued liabilities of the Fund as at the end of such month (other than the principal amount of any borrowings incurred and minus the value of the Common Share Portfolio and the fair market value of the Forward Agreement).

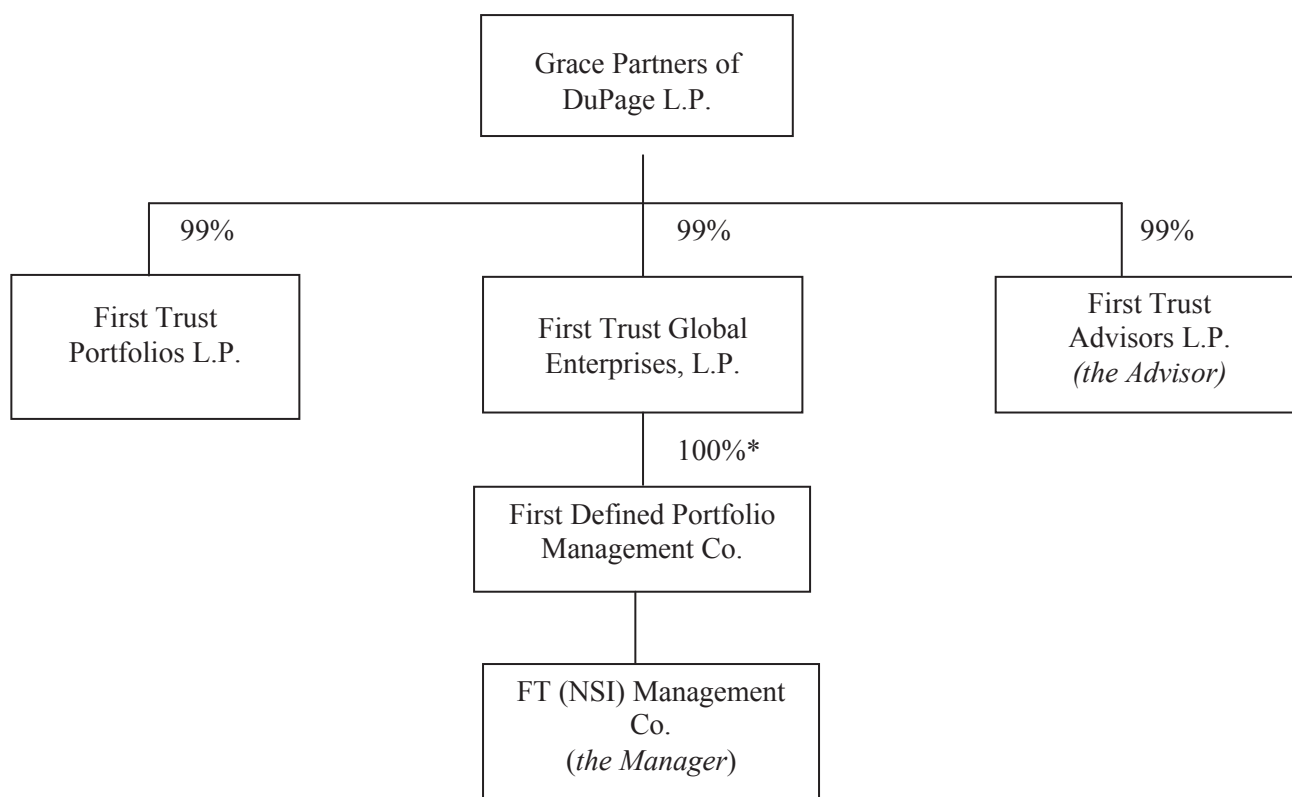
The Manager, the Advisor and each of their directors, officers, employees, consultants and agents will be indemnified and will be reimbursed by the Fund to the fullest extent permitted by law against all liabilities and expenses (including judgments, fines, penalties, interest, amounts paid in settlement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

The Manager may be removed as manager of the Fund with the approval of the Unitholders by an Extraordinary Resolution passed at a duly convened meeting of Unitholders called for the purpose of considering such resolution. The Manager may resign upon 120 days’ notice to the Fund. If no new trustee is appointed within such 120-day period, the Fund will be terminated. The appointment of a new trustee (other than an affiliate of the Manager) requires the approval of the Unitholders by an Ordinary Resolution. “Ordinary Resolution” means a resolution passed by the affirmative vote of at least a majority of the votes cast, either in person or by proxy, at a meeting of Unitholders called for the purpose of approving such resolution.

The Manager is also the trustee of the Fund. In its capacity as the trustee, the Manager is not entitled to receive fees from the Fund but is entitled to be reimbursed by the Fund for all expenses which it reasonably incurs as trustee in connection with the activities of the Fund.

The services of the Manager and the officers, directors and employees of the Manager are not exclusive to the Fund. The Manager and its affiliates and associates may, at any time, engage in any other activity including the administration of any other fund or trust.

The following diagram illustrates the current relationship between the Manager, the Advisor and their affiliated entities. The amount of fees received from the Fund by each such person, if applicable, is set out in the audited financial statements of the Fund.



*This is an indirect 100% interest.

The Charger Corporation is the general partner of each of Grace Partners of DuPage L.P., First Trust Portfolios L.P., First Trust Global Enterprises, L.P. and First Trust Advisors L.P. As general partner, the Charger Corporation has control over the operations of each of the limited partnerships.

The following table sets out information regarding the directors and senior officers of the Manager.

Name and Municipality of Residence	Position with the Manager	Principal Occupation
Ronald McAlister (Wayne, Illinois)	Director, Chairman of the Board and Chief Executive Officer	Managing Director of First Trust Portfolios L.P. and President of First Trust Global Enterprises L.P.
Mark Bradley (Wheaton, Illinois)	Director and Chief Financial Officer	Chief Financial Officer of First Trust Portfolios L.P. and the Chief Financial Officer of the Advisor
James T. Rager (Oakville, Ontario)	Director	Retired/Company Director

Name and Municipality of Residence	Position with the Manager	Principal Occupation
John Szucs (Toronto, Ontario)	Director	Vice President, Institutional Trading, Macquarie Capital Markets Canada Ltd. (an investment bank)
Robert Turner (Toronto, Ontario)	Director	Vice President, Human Relations/Shared Services for Rogers Communications Inc. (a communications and media company)
Fraser Howell (Toronto, Ontario)	President, Chief Financial Officer and Director	President and Chief Financial Officer of FDPM
M. Craig Brown (Toronto, Ontario)	Secretary	Partner, Fasken Martineau DuMoulin LLP (a law firm)
Liberty Rivera (Toronto, Ontario)	Vice President	Vice President of FDPM

Other than the following, each of the persons listed in the table above has had as his/her principal occupation the position set out opposite his/her name for the past five years.

Mr. Rager has been a company director since 2005. From 1999 to 2004, Mr. Rager was Vice-Chairman of RBC Financial Group.

Mr. Szucs has been Vice President, Institutional Trading, Macquarie Capital Markets Canada Ltd. since October 2007. Prior thereto, he was a Portfolio Manager with Blumont Capital Corporation from July 2004 to July 2007.

Mr. Turner is Vice President, IT Services for Rogers Communications Inc. Prior to joining Rogers Communications Inc. in April 2006, Mr. Turner had been with Bell Canada Inc since May 2000 where he was most recently Senior Director of Shared Services.

Mr. Howell joined FDPM in April 2007. From December 1998 to April 2007, he was Director of Finance at Grant Forest Products Inc.

As the table illustrates, Ronald McAlister and Mark Bradley are senior officers of the Advisor. Ronald McAlister has less than 7% ownership interest in Grace Partners of DuPage L.P. Mark Bradley has less than 2.5% interest in Grace Partners of DuPage L.P.

Advisor

First Trust Advisors L.P. is the investment advisor to the Fund. The Advisor is an affiliate of the Manager located in Wheaton, Illinois. The Advisor provides asset management, investment advisory and unit trust portfolio supervision services to its clients and had approximately US\$27 billion in assets under management or supervision as of January 31, 2010. The Advisor is a non-Canadian advisor registered with the Ontario Securities Commission as a portfolio manager. As a result, it may be difficult to enforce any legal rights against the Advisor since all or substantially all of its assets are situated outside Canada.

The name and address of the agent for service of process of the Advisor in Ontario is Torys LLP, Maritime Life Tower, Suite 3000, 79 Wellington Street West, Box 270, Toronto-Dominion Centre, Toronto, ON M5K 1N2.

Investment Advisory Agreement

The investment advisory agreement (the “Investment Advisory Agreement”) dated May 16, 2005 between the Manager, the Advisor and the Fund sets out the duties of the Advisor. Under the Investment Advisory Agreement, the Advisor is responsible for the implementation of the Fund’s overall investment strategy which includes the acquisition of the Common Share Portfolio and the entering into the Forward Agreement. The portfolio management oversight group of the Advisor oversees these services. In addition, the Advisor has entered into an investment advisory agreement with the Manager and the Senior Loan Trust pursuant to which the Advisor has agreed to provide investment advisory services to the Senior Loan Trust.

Under the Investment Advisory Agreement with the Fund, the Advisor is required to act at all times on a basis which is fair and reasonable to the Fund, to act honestly and in good faith with a view to the best interests of the unitholders of the applicable trust and, in connection therewith, to exercise the degree of care, diligence and skill that a reasonably prudent investment manager would exercise in comparable circumstances. The Investment Advisory Agreement provides that the Advisor shall not be liable to the Manager, the Fund, a unitholder thereof or any other person for any loss in respect of an investment decision if such decision shall have been made with due care and in good faith, provided the Advisor has satisfied the duties and standard of care, diligence and skill set forth above and further provided the Advisor has not acted with wilful misconduct, bad faith, reckless disregard or negligence in the performance of its obligations and duties under the Investment Advisory Agreement or materially breached the terms of the Investment Advisory Agreement. The Fund shall indemnify the Advisor and its directors, officers, employees and agents and save them harmless in respect of all losses, liabilities, damages, expenses and costs incurred in connection with any action, suit or proceeding or other claim that is made against such Advisor or any of its directors, officers, employees or agents in the exercise of their duties under the Investment Advisory Agreement, except those resulting from the Advisor’s wilful misconduct, bad faith, reckless disregard, negligence or material breach of its obligations and duties under such agreement.

The Investment Advisory Agreement, unless terminated in accordance with its terms, will continue in effect until the termination of the Manager as trustee of the Fund. The Manager can terminate the Investment Advisory Agreement at any time on 30 days’ notice for breach thereof by the Advisor. The Advisor’s appointment under the Investment Advisory Agreement may be immediately terminated by the Manager if (i) the Advisor shall cease to carry on business, become bankrupt or insolvent, resolve to wind up, dissolve or liquidate, if a receiver of any of the assets of the Advisor is appointed or if the Advisor makes a general assignment for the benefit of its creditors, (ii) the Manager establishes that the Advisor has committed any fraud or material wrongdoing in conducting its business, generally or under the Investment Advisory Agreement, or (iii) the Advisor has lost any registration, license or other authorization required of it to perform its services under the Investment Advisory Agreement or is not otherwise in compliance with any other law or regulation applicable to it. The Investment Advisory Agreement may be terminated by either party on 60 days’ notice to the other party. The Investment Advisory Agreement may be assigned by the Advisor to an affiliate thereof. In addition, pursuant to the terms of the Investment Advisory Agreements, the Advisor may retain a sub-advisor to provide investment advisory and portfolio management services.

The Advisor is entitled to fees for providing investment management services. All such fees will be paid to the Advisor by the Manager.

Sub-Advisor

At the time of the Merger, the Advisor appointed Highland Capital Management, L.P. (the “Sub-Advisor”) to act as sub-advisor of the Senior Loan Portfolio. Pursuant to the terms of an investment sub-advisory agreement (the “Investment Sub-Advisory Agreement”) between the Advisor and Highland Capital Management L.P. (the “Sub-Advisor”) dated August 18, 2009, the Sub-Advisor is responsible for the selection and on-going monitoring of the assets in the Senior Loan Portfolio and leverage.

The Sub-Advisor is a Delaware limited partnership founded in 1993 and is 100% owned by its employees. The Sub-Advisor has one general partner, Strand Advisors, Inc., a Delaware corporation. The principal office of the Sub-Advisor is located at 13455 Noel Road, 8th Floor, and Dallas, Texas 75240.

The Sub-Advisor’s expertise in managing portfolios of Senior Loans and structured finance assets is particularly suited to the Fund’s focus on Senior Loans. As of December 31, 2009, the Sub-Advisor had approximately U.S.\$24.3 billion of assets under management which consisted of U.S.\$20 billion in leveraged loans, U.S.\$2.2 billion in high yield bonds, U.S.\$1.6 billion in equity and U.S.\$0.5 billion in asset backed securities.

Investment Sub-Advisory Agreement

Under the Investment Sub-Advisory Agreement, the Sub-Advisor is required to act at all times on a basis which is fair and reasonable to the Fund, to act honestly and in good faith with a view to the best interests of the Unitholders of the Fund and, in connection therewith, to exercise the degree of care, diligence and skill that a reasonably prudent investment manager would exercise in comparable circumstances. The Investment Sub-Advisory Agreement provides that the Sub-Advisor shall not be liable in any way for any error of judgment or mistake of law or for any loss suffered by the Senior Loan Portfolio in connection with the performance of the Sub-Advisor’s duties except for a loss resulting from wilful misconduct, bad faith or negligence on the part of the Sub-Advisor in the performance of its duties under the Investment Sub-Advisory Agreement or by reason of its reckless disregard or material breach of its obligations and duties under the Investment Sub-Advisory Agreement. In addition, the Sub-Advisor shall not be liable for any determination of the value of any securities or property held by the Senior Loan Portfolio in connection with the determination of the price or NAV of Units of the Fund or any determination of the price or net asset value of Units of the Fund.

The Investment Sub-Advisory Agreement, unless terminated in accordance with its terms, will continue in effect until the termination of the Fund or the Investment Advisory Agreement (in which case the Investment Sub-Advisory Agreement shall automatically terminate). The Investment Sub-Advisory Agreement may be immediately terminated by the Advisor in the event of (i) a material breach of any of the covenants of the Sub-Advisor by the Sub-Advisor or any of its officers or directors; (ii) a material violation by the Sub-Advisor of the Fund’s investment objectives or the Fund’s or Sub-Advisor’s policies or procedures that, in the opinion of the Advisor, would have a material adverse effect on the Fund, provided that the Sub-Advisor is first given a reasonable period of time to cure such violation; (iii) the failure by the Sub-Advisor to maintain the registration necessary to legally perform its duties under the Investment Sub-Advisory Agreement; (iv) any disqualification of the Sub-Advisor to act as investment sub-advisor for the Fund by a regulatory authority or court of competent jurisdiction; (v) not less than six (6) quarters of significant underperformance of the Fund when compared to the performance of an appropriate peer group; (vi) the insolvency or liquidation of the Sub-Advisor or if the Sub-Advisor becomes bankrupt or passes a resolution approving its winding-up or dissolution or deemed dissolution or makes a general assignment for the benefit of its creditors; or (vii) the Sub-Advisor becomes sub-advisor for another distinct Canadian fund with similar objectives, policies and restrictions as the Fund, for which

the Advisor is not the investment advisor, but only if the Sub-Advisor did not offer the Advisor the opportunity to act as investment advisor to such fund on substantially similar terms. For the purposes of clause (v) above, (a) significant underperformance shall mean that the Fund' performance, calculated gross of fees and expenses, is in the fourth (bottom) quartile of the performance of the peer group also calculated gross of fees and expenses, and as adjusted for the effects and costs of currency hedges; and (b) the peer group shall initially consist of certain closed-end funds agreed to by the Advisor and Sub-Advisor. In addition, the Advisor may terminate the Investment Sub-Advisory Agreement upon not less than 30 days' notice in the event that the Sub-Advisor engaged in conduct as a result of which the Sub-Advisor shall have become subject to a legal or disciplinary event involving the Sub-Advisor or a management person of the Sub-Advisor that is material to the Sub-Advisor within the meaning of Rule 206(4)-4(b) under the U.S. Investment Advisers Act of 1940.

The Investment Sub-Advisory Agreement may be terminated by the Sub-Advisor upon not less than 90 days' written notice to the Advisor in the event there are any significant changes to the investment objectives, policies and restrictions of the Fund that relate to the Senior Loan Portfolio. The Investment Sub-Advisory Agreement may also be terminated by the Sub-Advisor upon not less than 60 days' written notice to the Advisor in the event any of the following occur: (i) the Advisor ceases to be investment advisor to the Fund, (ii) the Sub-Advisor ceases to provide investment advisory services to any other portfolios which contain Senior Loans, or (iii) the Advisor becomes investment adviser for another distinct Canadian fund with similar investment objectives, policies and restrictions as the Fund, with a sub-advisor other than the Sub-Advisor, but only if the Advisor did not offer the Sub-Advisor the opportunity to act as sub-advisor to such fund on substantially the same terms. The Investment Sub-Advisory Agreement may also be terminated by the Sub-Advisor upon not less than 120 days' written notice to the Advisor in the event the Advisor shall have engaged in conduct as a result of which the Advisor shall have become subject to a legal or disciplinary event involving the Advisor or a management person of the Advisor that is material to the Advisor. In addition, the Investment Sub-Advisory Agreement may be terminated by the Advisor upon not less than 120 days' written notice in the event the Sub-Advisor shall have engaged in conduct as a result of which the Sub-Advisor shall have become subject to a legal or disciplinary event involving the Sub-Advisor or a management person of the Sub-Advisor that is material to the Sub-Advisor.

Portfolio Manager of the Sub-Advisor

Joe Dougherty is the portfolio manager of the Fund.

Joe Dougherty, CFA, CPA – Mr. Dougherty is a Partner and the Head of Retail Products at Highland Capital Management, L.P. In this capacity, Mr. Dougherty manages the team dedicated to the day-to-day operations of the Retail Products. He serves as President and Director of the Firm's NYSE-listed and 1940 Act registered funds. He also serves as a Portfolio Manager for the Firm's sub-advised closed-end and mutual funds. Prior to his current duties, Mr. Dougherty served as a Portfolio Manager for the Firm's registered products, alongside several other Portfolio Managers. Mr. Dougherty served as Portfolio Analyst for Highland from 1998 to 1999. As a Portfolio Analyst, Mr. Dougherty followed companies within the chemical, retail, supermarket, wireless and restaurant sectors. Prior to joining Highland in March 1998, Mr. Dougherty served as an Investment Analyst with Sandera Capital Management from 1997 to 1998. Formerly, he was a Business Development Manager at Akzo Nobel from 1994 to 1996 and a Senior Accountant at Deloitte & Touche, LLP from 1992 to 1994. He received an MBA from Southern Methodist University, and a BS in Accounting from Villanova University. Mr. Dougherty is a Certified Public Accountant and has earned the right to use the Chartered Financial Analyst designation.

Brokerage Arrangements

The purchase and sale of portfolio securities by the Fund is arranged through brokers on the basis of an assessment, by the Advisor, of the ability of the broker to execute transactions promptly and on favourable terms to the Fund. The Advisor will negotiate with brokers for the Fund and other products of the Manager as well as products of other affiliates of the Advisor, in an attempt to obtain favourable prices and other favourable terms.

Custodian

Canadian Imperial Bank of Commerce is the custodian (the “Custodian”) of the Fund pursuant to the terms of a custodial services agreement dated May 16, 2005 between the Fund, the Custodian, CIBC Mellon Global Securities Services Company and Mellon Bank, N.A. The head office of the Custodian is located in Toronto, Ontario. The Custodian is generally responsible for holding and maintaining information regarding all securities held by the Fund. The Custodian holds the Fund’s securities and other portfolio assets, including cash on deposit with financial institutions, on behalf of the Fund.

The Custodian may appoint sub-custodians to provide for the safekeeping of portfolio securities located outside Canada. Such sub-custodians, if needed, would enter into sub-custodianship agreements with the Custodian on terms and conditions substantially consistent with the terms and conditions in the custodian agreement.

Registrar, Transfer Agent and Distribution Agent

CIBC Mellon Trust Company has been appointed the registrar, transfer agent and distribution agent of the Fund pursuant to a transfer agent, registrar and distribution disbursing agent agreement dated May 31, 2005. The Transfer Agent and Registrar is responsible for maintaining the register of the owners of Units of the Fund and for distribution services. The register of Units of the Fund is kept in Toronto, Ontario, at the head office of the Transfer Agent and Registrar. The appointment of the Transfer Agent and Registrar shall continue until terminated by 90 days’ notice by either party to the other.

Auditor

Deloitte & Touche LLP is the auditor (the “Auditor”) of the Fund. The head office of the Auditor is located in Toronto, Ontario.

Conflicts of Interest

As at March 19, 2010, CDS held directly 5,310,821 Units of record, being 100% of the Units. As at March 19, 2010 other than as set out herein, the directors and senior officers of the Manager and members of the IRC of the Fund individually and in the aggregate beneficially own, directly or indirectly, an inconsequential number (being less than 0.1%) of any class or series of voting or equity securities of any person or company that provides services to the Fund or the Manager.

Governance of the Fund

Fund Governance

Currently, the board of directors of the Manager (the “Board”) is responsible for fund governance matters. Three of the six members of the Board are independent of the Manager, the Advisor and their affiliates

(the “Independent Directors”). In the event of a conflict between the Fund and such persons, the non-independent members of the Board abstain from voting.

The Independent Directors collectively provide the Manager with independent advice and assist the Manager in carrying out its obligations under the Declaration of Trust in the event of any conflicts of interest, potential conflicts of interest or related party transactions (each a “Conflict” and collectively “Conflicts”) identified by the Manager. The Manager will notify the Independent Directors in writing of any Conflicts identified by the Manager concerning the Manager, the Fund or the Senior Loan Trust (other than Conflicts which require approval of Unitholders in accordance with the terms of the Declaration of Trust) and will consult with the Independent Directors in respect of any Conflicts. In the event of a dispute between the Independent Directors and the Manager with respect to a Conflict, the Manager shall, upon written direction from the Independent Directors, call a meeting of Unitholders to consider the Conflict. The Manager will report to the Independent Directors on the operation and performance of the Senior Loan Trust on a quarterly basis including with respect to compliance with the Investment Guidelines and material contracts of the Fund in force from time to time. The Fund’s annual report to Unitholders will include a report of the Independent Directors disclosing any recommendations made by the Independent Directors, including recommendations made and not followed by the Manager, and any other matter the Independent Directors deem appropriate. The Independent Directors will be indemnified by the Fund, except in cases of wilful misconduct, bad faith, negligence or breach of their duty of care. The Independent Directors may serve in a similar capacity in respect of other entities managed by the Manager.

The Fund has established an Independent Review Committee (“IRC”) to oversee decisions involving actual or perceived conflicts of interest. The IRC was formed on May 1, 2007 and became effective on November 1, 2007. The members of the IRC are: Peter Copestake (Chair), George Anderson and Jacqueline Orange. As required by National Instrument 81-107 – *Independent Review Committee for Investment Funds*, the Manager has established written policies and procedures to follow in making decisions involving actual or perceived conflicts of interest and will refer such matters to the IRC for review. The members of the IRC are paid an annual fee and fees for each meeting attended. In addition, members of the IRC are reimbursed for expenses associated with their responsibilities. The aggregate compensation paid in 2009 by the Fund and the Senior Loan Trust to the IRC was \$2,893 as well as a nominal amount as reimbursement for expenses incurred in connection with the performance of their duties.

The Manager has a policies and procedures manual (the “Manual”) that governs the policies and practices of the Manager in connection with its business practices, sales practices, risk management controls and internal conflicts of interest. The Manual includes employee policies such as the code of ethics and the personal trading policy as well as policies addressing allocation of investments, allocation of costs, inter-fund trades, trades in related issuers, best execution/soft dollars, correction of NAV errors and trades in underwritten securities by dealer-managed mutual funds. It also prescribes procedures for sales communications and practices and timely and continuous disclosure requirements. As the Fund is a non-redeemable investment fund the securities of which are listed on the TSX, the Manager does not have policies and procedures in place in respect of short-term trading for the Fund. The policies and procedures described in the Manual are reviewed on an annual basis.

In addition, the Manager is responsible for monitoring third party service providers including the Custodian, Valuation Agent and Advisor.

The Fund currently does not use derivatives to hedge against currency fluctuations. The Manager is seeking commercially reasonable alternatives to hedge its foreign currency exposure but there can be no assurance that arrangements will be made on substantially similar terms to the prior arrangements or at

all. As it is expected that any currency hedging strategy will not require active trading, the Fund does not have any written policies and procedures in place with respect to derivatives trading; however, the Manager and the Advisor will monitor the currency hedging program.

Proxy Voting Policy

The Advisor has full responsibility for proxy voting and related duties in respect of the Fund. In fulfilling these duties, the Advisor and the Fund have adopted proxy policies and procedures (the “Proxy Policies”) to ensure that proxies for securities held by the Fund are voted consistently and solely in the best economic interests of the Fund. The Proxy Policies are more fully summarized below.

- The Advisor is responsible for the oversight of the Fund’s proxy voting process and has assigned a senior member of its staff to be responsible for this oversight.
- Pursuant to the Proxy Policies, the Advisor has engaged the services of Institutional Shareholder Services, Inc. (“ISS”) to make recommendations to the Advisor on the voting of proxies related to securities held by the Fund on both routine and non-routine matters. Such voting recommendations are based on established guidelines and practices developed by ISS.
- The Advisor will review and consider the ISS recommendations and generally will vote the proxies in accordance with such recommendations when dealing with routine matters on which the Fund may vote. Routine matters include: election of directors; appointment of auditors and auditor compensation; changes in capitalization; and management compensation.
- The Fund will typically vote in favour of routine matters unless there are specific circumstances for voting against. For example, the Advisor may not vote in accordance with the ISS recommendations on routine matters if the Advisor believes that the specific ISS recommendation is not in the best interests of the Fund. As an example, the Advisor will typically vote the proxies in support of management’s recommendations regarding the appointment of an auditor, but may vote against such a recommendation if the fees for services are excessive or if there are other reasons to question the independence or quality of the company’s auditors.
- The Advisor will also consider ISS recommendations on non-routine matters and generally will vote the proxies in accordance with those recommendations when dealing with such matters. Non-routine matters include: corporate reorganization; mergers and acquisitions; proposals affecting shareholder rights; corporate governance; and social and environmental issues.
- How the Advisor actually votes the proxies or refrains from voting on non-routine matters will vary depending on the specific matter involved. For example, with respect to shareholders rights, the Fund will typically vote in favour of proposals that give shareholders a greater voice in the affairs of the company and oppose any measure that seeks to limit those rights.
- Deviations from the standing policy may occur on routine and non-routine matters where there is a conflict of interest. For example, if the Advisor has actual knowledge of a material conflict of interest between itself and the Fund with respect to the voting of a proxy, the Advisor shall vote the applicable proxy to avoid such conflict of interest.
- The Proxy Policies also include procedures to ensure that portfolio securities held by the Fund are voted in accordance with the instructions of the Manager. The Advisor will report to the

Manager on a quarterly basis the voting results and confirm that it has voted all securities held by the Fund it manages in accordance with the Manager's policies and procedures.

- If the Manager requests the Advisor to follow specific voting guidelines or additional guidelines, the Advisor shall review the request and follow such guidelines, unless the Advisor determines that it is unable to follow such guidelines, in which case the Portfolio Advisor shall inform the Manager that it is not able to follow the Manager's request.

The Manager will compile and maintain annual proxy voting records for the Fund for the annual periods beginning July 1 in a year and ending June 30 of the following year. After completion of an annual period, the proxy voting record will be made available on the Manager's website (www.firsttrust.ca) on August 31 following the annual period. Copies of the complete proxy voting procedures for the Fund are available to investors free of charge upon request. Requests can be made by calling toll-free 1-877-622-5552 or sending an email to info@firsttrust.ca. Investors may also send a request by mail addressed to the attention of the Manager at 330 Bay Street, Suite 1300, Toronto Ontario M5H 2S8.

Canadian Income Tax Considerations For Investors

The following is a general summary, as of the date hereof, of the principal Canadian federal income tax consequences to Unitholders who hold and dispose of Units.

This summary applies only to a Unitholder who is an individual (other than a trust) and who, for the purposes of the Tax Act, is resident in Canada, deals at arm's length with the Fund and holds Units as capital property. Generally, Units will be considered to be capital property to a Unitholder provided the Unitholder does not hold the Units in the course of carrying on a business of trading or dealing in securities and has not acquired them in one or more transactions considered to be an adventure or concern in the nature of trade. Certain Unitholders who might not otherwise be considered to hold their Units as capital property may, in certain circumstances, be entitled to have them (and every other "Canadian security" owned by such investor) treated as capital property by making an irrevocable election in accordance with the Tax Act.

This summary is based on the assumptions that the Common Share Portfolio will consist of "Canadian securities" for the purposes of the Tax Act and that the Fund has elected in accordance with the Tax Act to have each of its "Canadian securities" treated as capital property. This summary is based on the current provisions of the Tax Act, the regulations to the Tax Act, the Manager's understanding of the current publicly available published administrative policies and assessing practices of the CRA and all specific amendments to the Tax Act and its regulations publicly announced by, or on behalf of, the Minister of Finance (Canada) (the "Tax Proposals"). This summary does not otherwise take into account or anticipate any changes in law, whether by legislative, governmental or judicial action, nor does it take into account provincial or foreign income tax legislation or considerations. There can be no assurance that the Tax Proposals will be enacted in the form publicly announced or at all.

This summary is not exhaustive of all possible Canadian federal tax considerations applicable to an investment in Units. Moreover, the income and other tax consequences of acquiring, holding or disposing of Units will vary depending on the investor's particular circumstances including the province or provinces in which the investor resides or carries on business. No view is expressed herein in respect of the deductibility of interest on any funds borrowed by a Unitholder to purchase Units. Accordingly, this summary is of a general nature only and is not intended to be legal or tax advice to any investor. Investors should consult their own tax advisors for advice with respect to the income tax consequences of an investment in Units, based on their particular circumstances.

Status of the Fund

This summary assumes that the Fund will qualify at all relevant times as a “mutual fund trust” within the meaning of the Tax Act. In the event the Fund was not to qualify as a mutual fund trust at all times, the income tax consequences as described below would in some respects be materially different.

The Tax Act contains rules which impose a tax on certain publicly traded trusts and partnerships (“SIFTs”). In the case of a SIFT trust, in general, these rules impose a tax on the SIFT trust's non-portfolio earnings that are distributed to beneficiaries. These rules apply in the case of a SIFT the units of which were already publicly traded on October 31, 2006, beginning with the 2011 taxation year of such SIFT, subject to earlier application where certain growth guidelines are exceeded. These changes may reduce the after-tax returns to investors in SIFT trust's, in particular non-residents and tax-exempt investors. In order to be a SIFT trust, the trust must hold “non-portfolio property.” In simplified terms, non-portfolio property includes property used in carrying on a business in Canada, direct or indirect holdings of Canadian real estate or resource property if such holdings are worth more than 50% of the value of the units of the trust, and securities of Canadian entities (or non-Canadian entities whose principal source of income is in Canada) if either securities of such a particular entity represent more than 50% of the value of the units of the trust or if the trust holds more than 10% of the value of the securities of such a particular entity. The Fund currently does not hold any non-portfolio property. As long as the Fund does not hold any non-portfolio property it will not be a SIFT trust.

Taxation of the Fund

The Fund will be subject to tax in each taxation year under Part I of the Tax Act on the amount of its income for the year, including net realized taxable capital gains, less the portion thereof that it deducts in respect of the amount paid or payable to Unitholders in the year. The Fund intends to deduct, in computing its income in each taxation year, the full amount available for deduction in each year and, therefore, provided the Fund makes distributions in each year of its net income and net realized capital gains as described under “Distributions”, it will generally not be liable in such year for income tax under Part I of the Tax Act.

The Fund will be entitled for each taxation year throughout which it is a mutual fund trust to reduce (or receive a refund in respect of) its liability, if any, for tax on its net realized capital gains by an amount determined under the Tax Act based on the redemptions of Units during the year (“Capital Gains Refund”). The Capital Gains Refund in a particular taxation year may not completely offset the tax liability of the Fund for such taxation year which may arise, for example, upon the sale of Common Share Portfolio securities pursuant to the Forward Agreement in connection with redemptions of Units.

In computing its income for tax purposes, the Fund may deduct reasonable administrative and other expenses incurred to earn income. The Fund may deduct the costs and expenses of the offering of its Units paid by the Fund and not reimbursed at a rate of 20% per year, pro-rated where the Fund's taxation year is less than 365 days.

The Fund did not realize any income, gain or loss as a result of entering into the initial Forward Agreement. The Fund has elected in accordance with the Tax Act to have each of its Canadian securities treated as capital property; consequently gains or losses realized by the Fund on the sale of the Common Share Portfolio will be taxed as capital gains or capital losses. If the obligations of the Fund and the Counterparty under the Forward Agreement are settled by making cash payments, a payment made or received by the Fund may be treated as an income outlay or receipt, as applicable. If the Fund delivers securities in the Common Share Portfolio to the Counterparty in satisfaction of its obligations under the initial Forward Agreement and receives a payment from the Counterparty equal to the price stipulated in

the initial Forward Agreement, the Fund will realize capital gains (losses) equal to the amount by which such purchase price (less reasonable costs of disposition) exceeds (or is less than) the aggregate adjusted cost base of such securities.

On October 31, 2003 the Department of Finance announced a Tax Proposal relating to the deductibility of losses under the Tax Act, applicable to taxation years beginning after 2004. Under this Tax Proposal, a taxpayer will be considered to have a loss from a business or property for a taxation year only if, in that year, it is reasonable to expect that the taxpayer will realize a cumulative profit from the business or property during the time that the taxpayer has carried on, or can reasonably be expected to carry on, the business or has held, or can reasonably be expected to hold, the property. Profit, for this purpose, does not include capital gains or capital losses. If this Tax Proposal were to apply to the Fund, deductions that would otherwise reduce the Fund's taxable income could be denied, with after-tax returns to the Unitholders reduced as a result. On February 23, 2005, the Minister of Finance (Canada) announced that an alternative proposal to replace the Tax Proposal of October 31, 2003 would be released for comment at an early opportunity, although none has been released to date. It will be necessary for the Fund to monitor its activities having regard to the October 31, 2003 Tax Proposal and any alternative proposal.

Taxation of Unitholders

A Unitholder will generally be required to include in computing income for a taxation year the amount of the Fund's net income for the taxation year, including net realized taxable capital gains, paid or payable to the Unitholder in the taxation year. The non-taxable portion of the Fund's net realized capital gains paid or payable (whether in cash or in Units) to a Unitholder in a taxation year will not be included in the Unitholder's income for the year. Any other amount in excess of the Fund's net income for a taxation year paid or payable to the Unitholder in the year will not generally be included in the Unitholder's income. Such amount, however, will generally reduce the adjusted cost base of the Unitholder's Units. To the extent that the adjusted cost base of a Unit would otherwise be less than zero, the negative amount will be deemed to be a capital gain realized by the Unitholder from the disposition of the Unit and the Unitholder's adjusted cost base will be increased by the amount of such deemed gain.

Provided that appropriate designations are made by the Fund, such portion of (i) the net realized taxable capital gains of the Fund, and (ii) the taxable dividends received or deemed to be received by the Fund on shares of taxable Canadian corporations, as is paid or payable to a Unitholder, will effectively retain its character and be treated as such in the hands of the Unitholder for purposes of the Tax Act. To the extent that amounts are designated as taxable dividends from taxable Canadian corporations, the gross-up and dividend tax credit rules will apply.

Under the Tax Act, the Fund is permitted to deduct in computing its income for a taxation year an amount which is less than the amount of its distributions for the year. This will enable the Fund to use, in a taxation year, losses from prior years without affecting the ability of the Fund to distribute its income annually. The amount distributed to a Unitholder but not deducted by the Fund will not be included in the Unitholder's income. However, the adjusted cost base of the Unitholder's Units will be reduced by such amount.

The NAV per Unit will reflect any income and gains of the Fund that have accrued at the time Units are acquired. Accordingly, a Unitholder who acquires Units may become taxable on the Unitholder's share of income and gains of the Fund that accrued before the Units were acquired. The purchase price for the Common Share Portfolio under the Forward Agreement from time to time may significantly exceed the aggregate adjusted cost base of the securities comprising the Common Share Portfolio. Therefore, there may be significant accrued gains in the Fund prior to the settlement of the Forward Agreement on or about the Termination Date.

On the disposition or deemed disposition of a Unit (including on a redemption), the Unitholder will realize a capital gain (or capital loss) to the extent that the Unitholder's proceeds of disposition (other than any amount payable by the Fund which represents an amount that is otherwise required to be included in the Unitholder's income as described above and net of any reasonable costs of disposition) exceed (or are less than) the adjusted cost base of Units. For the purpose of determining the adjusted cost base to a Unitholder, when a Unit is acquired, the cost of the newly acquired Units will be averaged with the adjusted cost base of all Units owned by the Unitholder as capital property before that time. For this purpose the cost of Units that have been issued as a distribution as contemplated under "Distributions" will generally be equal to the amount of the net income or capital gain distributed to the Unitholder in Units. A consolidation of Units following a distribution paid in the form of additional Units will not be regarded as a disposition of Units and will not affect the aggregate adjusted cost base to a Unitholder of Units.

One-half of any capital gain ("taxable capital gain") realized on the disposition of Units will be included in the Unitholder's income and one-half of any capital loss realized may be deducted from taxable capital gains in accordance with the provisions of the Tax Act.

In computing a Unitholder's income for purposes of the Tax Act, any taxable capital gain designated to the Unitholder in accordance with the provisions of the Tax Act may be netted against any allowable capital loss realized by the Unitholder, including any allowable capital loss realized on the disposition of Units to the Fund on redemption.

In general terms, net income of the Fund paid or payable to a Unitholder that is designated as net realized taxable capital gains or dividends from taxable Canadian corporations or taxable capital gains realized on the disposition of Units may increase the Unitholder's liability for alternative minimum tax.

U.S. Income Tax Considerations

The following is, as of the date hereof, a summary of the principal U.S. federal income tax considerations under the U.S. Internal Revenue Code of 1986, as amended (the "U.S. Tax Code") and the regulations thereto ("U.S. Regulations") generally applicable to the Fund with respect to its investments in debt instruments issued by U.S. issuers. It does not address all U.S. federal income tax consequences that may apply to the Fund or to investors in the Fund, some of which may be subject to special rules. These authorities are subject to change and to differing interpretations, which could apply retroactively. The Fund is likely to be a passive foreign investment company from a U.S. tax perspective, and so the following comments assume investors are not U.S. persons.

This summary is based upon the following assumptions: (a) the Fund will be treated as a non-U.S. corporation for U.S. federal income tax purposes; (b) the Fund will not engage in any activities in the U.S. other than making investments in debt instruments issued by U.S. issuers and (c) any obligations (including, without limitation, collateralized mortgage obligations) in which the Fund invests are properly characterized as indebtedness, and not as equity, for U.S. federal income tax purposes.

If one or more of the preceding assumptions proves to be inaccurate, the conclusions reached in this summary may not apply and the Fund may experience material adverse U.S. federal income tax consequences. The conclusions provided in this section were not written, and cannot be used by the recipient for, the purposes of avoiding penalties relating to a substantial understatement of income tax under U.S. Tax Code § 6662(d).

This summary is not intended or written by a practitioner to be used, and it cannot be used, by any taxpayer for the purpose of avoiding tax penalties that may be imposed on the taxpayer. This summary is

to be used to support the promotion or marketing of the matter discussed herein. The taxpayer should seek advice from an independent tax advisor regarding the matter set forth herein based on the taxpayer's particular circumstances.

Characterization of the Fund for U.S. Tax Purposes

An investment trust is generally treated as a business entity for U.S. tax purposes if there is a power to vary the investment of the owners in the trust, including a power to invest and reinvest the proceeds from the sale of the assets of the trust. It is intended that the Fund will have a power to vary the investment of the owners of the Fund including a power to invest and reinvest the proceeds from the sale of the assets of the trust. Thus, the Fund will be treated as a business entity for U.S. tax purposes. Because the Fund is not a U.S. entity, it will constitute a non-U.S. business entity for U.S. tax purposes.

A non-U.S. business entity has a default classification as an association taxable as a corporation for U.S. tax purposes, unless the liability of at least one owner of the entity is not limited. It is not intended that any owner of the Fund will have unlimited liability, and so the Fund will have a default classification of being taxable as a corporation for U.S. tax purposes. However, to ensure this result, the Fund has made a protective election to be classified as a corporation for U.S. tax purposes.

Fund Not Subject to Tax on Net Income Basis

The Fund does not intend to engage in a U.S. trade or business for U.S. tax purposes. If the Fund does not engage in a U.S. trade or business, it will not be subject to a U.S. tax on its net income.

In general, a non-U.S. corporation that is engaged in a trade or business within the U.S. will be subject to U.S. federal income tax on a net income basis with respect to its earnings that are effectively connected with such U.S. trade or business (and also generally will be subject to a branch profits tax of 30 percent, or lower applicable treaty rate). However, a non-U.S. corporation will not be considered to be engaged in a trade or business within the U.S. if (a) such corporation limits its activities within the United States to investing and trading in stocks or securities for its own account (and engaging in other activities closely related thereto) and (b) the corporation is not a dealer in stocks or securities (the "Trading Exemption"). It is the intention of the Fund to only engage in activities related to investing in securities for its own account.

A dealer in stocks or securities is defined as a merchant of stock or securities with an established place of business that regularly is engaged as a merchant in purchasing stock or securities and selling them to customers with a view to the gains and profits that may be derived therefrom. The Fund does not intend to operate as a dealer in stocks or securities. In addition, based upon its investment guidelines and restrictions, the Fund does not intend to purchase or hold securities that are properly characterized as equity for U.S. federal income tax purposes. Accordingly, the Fund should be eligible for the Trading Exemption and not subject to U.S. federal income tax on a net income basis, assuming the Fund operates according to its present intentions.

Withholding Tax on Interest Generally Not Applicable to Fund

The Fund intends to make investments that qualify for certain available exceptions from U.S. withholding tax. This intent is reflected in the investment restrictions of the Fund, which permit the Fund to only make investments that qualify for the portfolio interest exception. If the Fund follows its intent to only make investments that qualify for the portfolio interest exception and to provide the necessary documentation to the U.S. withholding agent, the U.S. will not impose a withholding tax on the interest received by the Fund.

In general, the United States imposes a tax of 30 percent on payments of interest from U.S. sources to non-residents who are not citizens of the United States. This rate is reduced to zero (0%) percent on payments to Canadian resident trusts qualifying under the U.S. - Canada Income Tax Treaty. However, the United States does not tax portfolio interest received by non-U.S. corporations.

“Portfolio interest” means any interest (including original issue discount) which, but for the portfolio interest exception would be subject to withholding tax on the interest under the U.S. Tax Code and which is:

- (i) paid in respect of an obligation in registered form; and
- (ii) in respect of which the withholding agent has received a Form W-8BEN.

Registered form means that the obligation states on its face that “the right to principal and interest may be transferred only through a book entry system maintained by the issuer or its agent.” If a book entry system is maintained by a person holding an obligation in street name or safekeeping for another, the obligation will be considered to be in registered form only if the ultimate beneficial owner of the obligation and its interest is determinable by way of the system.

Portfolio interest does not include any interest if the amount of such interest is determined by reference to any receipts, sales or other cash flow of the debtor or a related person, any income or profits of the debtor or a related person, any change in value of any property of the debtor or a related person, or any dividend, partnership distributions, or similar payments made by the debtor or a related person. The Fund does not intend to invest in instruments with such contingent interest.

Portfolio interest does not include any payment of interest to a 10 percent shareholder or partner in the issuer of the obligation. For the purposes of determining whether the recipient of the interest is a 10 percent shareholder, stock held by partnerships, trusts, and corporations are attributed to the ultimate beneficial owners. Attribution rules may also attribute stock held by owners of a corporation to a corporation. Stock held by spouses, parents, children, and grandchildren are also attributed to a single holder.

The Fund does not intend to invest in issuers to which it is related as a 10% shareholder or partner. However, if the owners of the Fund hold 10 percent or more of an issuer in which the Fund invests, the Fund may be deemed to be a 10-percent shareholder of an issuer for the purposes of the portfolio interest tests. To mitigate this issue, the Fund intends to ask all investors who own more than 1 percent of the Fund to provide the Fund with a list of the U.S. entities in which the investor holds an equity interest and the percentage of such U.S. entity owned.

Portfolio interest does not include certain payments of interest to controlled foreign corporations by related parties and most interest received by banks on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its business.

It is not anticipated that the Fund will be a controlled foreign corporation (owned more than 50 percent by U.S. persons) from a U.S. tax perspective. The Fund is not classified as a bank for Canadian or U.S. regulatory purposes. The Fund does not intend to directly (or through its agents) actively participate in the negotiation of the terms of the instruments into which it invests. However, the Fund may acquire interests in a loan from and appoint as its agent a person who has previously negotiated the terms of the instrument.

Unless the obligation is in bearer form, to qualify for the portfolio interest exception the U.S. withholding agent must receive a statement that the beneficial owner of the instrument is not a U.S. person. Normally, this statement is provided on I.R.S. Form W-8BEN. The Fund intends to provide the U.S. withholding agents the appropriate forms as is necessary to qualify for the portfolio interest exception.

As stated above, if the Fund follows its intention to only make investments that qualify for the portfolio interest exception and to provide the necessary documentation to the U.S. withholding agent, the U.S. will not impose a withholding tax on the interest received by the Fund.

However, whether U.S. withholding will, in fact, be imposed is dependent upon the actual facts that exist with respect to a particular investment by the Fund. If the Fund does not invest in loans eligible for the portfolio debt exception, it will be subject to U.S. withholding tax if it is not eligible for the treaty.

Recent U.S. legislation would impose a 30% withholding tax on all payments to non-U.S. financial institutions without regard to the recipient's treaty qualification or qualification of the payments under the portfolio interest exception described above, unless the financial institution agrees to certain U.S. reporting requirements. Under the language of the legislation, the Fund would be a non-U.S. financial institution. Thus, unless the Fund undertakes to comply with certain U.S. reporting requirements, payments received from the United States may be subject to withholding after December 31, 2012, in respect of securities that are not outstanding on March 17, 2012. The Fund will review the U.S. reporting requirements as details are released, but it has not yet been determined whether the Fund will (or is capable of) complying with the new U.S. reporting requirements.

Material Contracts

The following are the material contracts of the Fund. These contracts may be inspected by you, either as a prospective investor or as an existing Unitholder, at the offices of the Manager during normal business hours. They are also available on www.SEDAR.com.

- Declaration of Trust;
- Investment Advisory Agreement;
- Investment Sub-Advisory Agreement;
- Forward Agreement;
- Custodial Services Agreement;
- Fund Administration Services Agreement; and
- Registrar, Transfer Agency & Distribution Agency Agreement.

ANNUAL INFORMATION FORM

First Trust/Highland Capital Floating Rate Income Fund II

Additional information about the Fund is available in the Fund's management reports of fund performance and financial statements.

You can get a copy of these documents at your request, and at no cost, by calling toll-free 1-877-622-5552, or from your dealer or broker or by e-mail at info@firsttrust.ca.

These documents and other information about the Fund, such as information circulars and material contracts, are also available either at www.firsttrust.ca or at www.sedar.com.

Managed by:

**FT (NSI) MANAGEMENT CO., an affiliate of
FIRST DEFINED PORTFOLIO MANAGEMENT CO.**

330 Bay Street, Suite 1300
Toronto, Ontario M5H 2S8

1-877-622-5552

www.firsttrust.ca