

PROCEDURES FOR AUCTION RATE SECURITY LOTTERIES IN THE EVENT OF A PARTIAL CALL

Increase in Volume of Issuer Redemptions of ARS

Continued dislocation in the Auction Rate Securities (ARS) market has resulted in elevated interest costs for many issuers, especially those with auctions that fail to produce a clearing rate. A “failed auction” often results in the establishment of a maximum rate for the rate period as described in each issue’s offering documents. As issuers seek to reduce the interest rate paid for ARS, there has been an increase in the volume of early redemptions of ARS.

Issuers May Elect Full or Partial Calls

Issuer options may be exercised as “full calls” that result in the complete redemption of the entire par value of the specific security. In such cases, all investors receive the full face value of their respective ARS position.

In addition, issuers can elect to exercise “partial calls” in which only a portion of the outstanding par value of the affected security is redeemed while other investors may not have any ARS redeemed.

Brief Description of ARS Partial Call Allocation Process

When an ARS issuer initiates a partial call, it notifies the appropriate securities depository institution of the specific security and the amount to be redeemed. Most commonly this is the Depository Trust Corporation (DTC). DTC then conducts an impartial lottery to determine the allocation of redemptions among broker dealers for which it holds securities. After receiving notice of the number of securities to be called, DTC’s process assigns an identification number to each tradable unit held by each firm holding bonds with DTC. DTC’s lottery then randomly allocates the call across the units as designated by the unit’s identification number. Because this process is random, it is possible that some DTC participants may not receive an allocation from a partial call.

Once Morgan Keegan receives notice of any allocation from a partial call of an ARS issue, it conducts a computer-generated lottery to allocate the partial call in a fair and impartial manner among customers who hold ARS in “street name.”

After allocations are made, the firm notifies clients if a partial call results in a redemption of some portion of an ARS position.

Morgan Keegan’s Positions are Liquidated Last, if At All.

NYSE Rule 402.30 concerns the responsibilities of member firms when bonds or preferreds securities are subject to a partial call. Among the rule's provisions, is a requirement that when a partial call is offered on terms favorable to owners of the security, that the member firm take measures to prohibit allocation of the call to its “proprietary accounts, or those of an affiliate or an employee, before all of its customers’ shares have been redeemed. Therefore, Morgan Keegan’s accounts, as well as those of its employees and employees’ immediate relatives, are excluded from the lottery process until all customer accounts have been liquidated.

How ARS Units are Entered in a Partial Redemption Lottery

First, in order to offer liquidity to all of Morgan Keegan's customers who own an ARS for which there is a partial call, if enough shares have been called from Morgan Keegan's position at DTC, one share is called from each customer account before a lottery is run. If there are not enough shares to liquidate one unit from each customer account, then the lottery proceeds without the adjusted lottery and share quantities as the total lottery number and total shares outstanding are used in determining lottery picks and customer positions.

Once each account has been assigned a share to be called, the lottery is run in the following manner:

Morgan Keegan starts by identifying the number of shares held by each customer of the affected ARS. Each share is assigned a number, 1 through the total number of remaining, outstanding shares held by Morgan Keegan. Then, using the Microsoft Xcel Random Number Generator, a random number spreadsheet is created by assigning integers from 1 through the total number of outstanding shares. By reading the random numbers selected for the spreadsheet in the order generated, the corresponding customer positions which were previously assigned numbers are then chosen for the call.

For example, if a customer owns \$50,000 in affected ARS and the unit of trade for the partial call is \$25,000, that customer will have two numbers entered into the lottery while a customer with a \$250,000 position in the affected ARS will have ten numbers entered into the lottery. Each number has equal odds of redemption in a random lottery. However, the odds of a client receiving a partial redemption is dependent on the number of integers a client has in the lottery.

PARTIAL CALL LOTTERY EXAMPLES

Customer Position	Unit of Trade for Call	Integers Assigned
\$1,000,000	\$25,000	1-40
\$250,000	\$25,000	41-50
\$100,000	\$25,000	51-54
\$50,000	\$25,000	55-56
\$25,000	\$25,000	57

ARS Partial Redemption Process Designed to Assure Impartiality

Morgan Keegan has designed this process to assure that lotteries are conducted in a fair and impartial fashion. The probability of a customer having units redeemed through the lottery process is proportional to the holdings of all clients holding the security in street name at the firm.

INVESTMENT PRODUCTS OFFERED BY MORGAN KEEGAN:
NOT FDIC INSURED ~ NOT BANK GUARANTEED ~ MAY LOSE VALUE