Flaherty & Crumrine
Preferred
Income
Opportunity
FUND

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February 23, 2004

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S7-03-03

The Honorable William H. Donaldson
Chairman
The Honorable Cynthia A. Glassman
The Honorable Harvey J. Goldschmid
The Honorable Paul S. Atkins
The Honorable Roel C. Campos
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

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OFFICE OF THE SECRETARY

Dear Sir or Madam:

Flaherty & Crumrine Preferred Income Opportunity Fund Incorporated ("PFO") is a relatively small ($218 million in total net assets) closed-end fund investing in preferred securities. Over its twelve-year history, the Fund has delivered excellent results to shareholders[1], while maintaining expense ratios well below those of similarly situated funds investing in the same types of fixed income securities. Over the life of the Fund, the Board of Directors and fund management have endeavored to control expenses, and have largely accomplished this, with the exception of expenses directly or indirectly impacted by regulation. We understand the necessity of regulation, but it is important to remember that its cost is ultimately borne by the shareholders. This letter quantifies the *actual increase* in the regulatory expenses *over the past five years* to PFO shareholders, and estimates the *impact on expenses* of the SEC's recently adopted and proposed regulations.

We believe that PFO's experience provides a useful proxy for the recent increase in regulatory related expenses for many small to mid-sized funds over the past five years. Because PFO is a closed-end fund, its size is not affected by the large issuance and redemption of shares that an open-end mutual fund might experience. Further, PFO at all times has had hedging strategies in place to dampen NAV volatility. As a result, the Fund's total net assets have been relatively stable, allowing valid expense comparisons over time. In addition, PFO's business hasn't changed since its inception in 1992. The Fund's investment objective and strategies, investment adviser and capital structure have remained constant over the time period analyzed.

To quantify the impact of rising regulatory related expenses, we have compared the change in several expense categories from the Fund's audited financial statements between 1998 and 2003 as listed below. (Prior to 1998, these various expenses increased only slightly since the Fund's inception.) While non-regulatory factors may be responsible for a portion of the increase in some of these categories, we believe that additional regulation certainly was the primary underlying cause.

[1] PFO is rated "5 Star" by Morningstar for the 3-year, 5-year, 10-year and Overall periods.

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It's no surprise that the increased regulatory burden significantly impacted legal expenses and audit fees. Director's fees and expenses increased because of greater frequency of Board and committee meetings. The most significant increase was the cost of insurance. Of these expense categories, insurance may be the least directly impacted by the level of regulation, but some portion of its increase must be attributed to greater regulation.

Flaherty & Crumrine Preferred Income Opportunity Fund
Regulatory Related Expense Analysis

	1998	**2003**	**% Change**
Legal & Audit	**$70,174**	**$111,677**	**59%**
Director's fees & expenses	**58,474**	**72,993**	**25%**
Insurance	**77,922**	**149,369**	**92%**
Total	**$206,570**	**$334,039**	**62%**

From 1998 to 2003, regulatory related expenses (as identified above) increased by 62%, growing from 9.4% of total expenses to 15.8%. (Excluding the cost of insurance, these expenses rose 44%.) Stated relative to total net assets available to common shareholders, *the regulatory related expense ratio increased from 13.6 basis points in 1998 to 24.4 basis points last year.* As a result, *in 2003 alone our shareholders had to absorb approximately $130,000 in additional regulatory related expenses compared with 1998.*

In the future, the regulatory burden appears likely to continue to increase. Two of the SEC's recent proposals and one new rule arising out of the *open-end mutual fund* trading scandal disproportionally impact PFO, along with other small to mid-sized funds.

One proposal currently under consideration is for all investment companies to have at least a 75% majority of independent directors. PFO has always had a supermajority of independent directors. Meeting a 75% requirement would require the addition of two new independent director positions, at an additional cost to our shareholders exceeding $20,000 per year. (Because of the small existing Board size and other circumstances, it would not be appropriate for either of the two interested directors to step down to increase the independent director percentage.) One has to wonder what a 75% majority of independent directors could accomplish that the Fund's existing $66^2/_3$% cannot?

A second proposal under consideration is for all investment companies to divide the roles of Board Chair and CEO. We estimate that doing so would increase PFO's expenses by at least $10,000 per year. However, the value to shareholders of such separation is open to question. As you are aware, a significant number of the fund complexes implicated in the *open-end mutual fund* trading scandal had Board Chairs independent of the CEO and the fund adviser.

A recently adopted rule mandates that each investment company have a Chief Compliance Officer. While it is difficult to estimate the cost of staffing such a position and the allocation of that cost, it undoubtedly will further increase the expense borne by shareholders.

If you combine the estimated financial impact of the proposals and rule described above with the actual increase experienced since 1998, *the Fund's annual regulatory burden next year compared with 1998 will increase by an amount approaching $200,000.* Stated relative to total net assets available to common shareholders, *the regulatory expense ratio will have more than doubled to approximately 30 basis points since 1998.* This is a substantial sum for the shareholders of a relatively small fund to absorb. Over the next ten years, the *increase in regulatory costs since 1998* for a shareholder investing $100,000 in the Fund will total approximately $1,100, but only assuming no further increases in regulatory related expenses.

Unfortunately, since much of the regulatory burden is denominated as fixed costs, the impact on small to mid-sized fund shareholders adds up quickly. In addition, PFO and its sister funds are all *closed-end investment companies*, structures under the 1940 Act not exposed to the trading abuses that have affected *open-end mutual funds*. Yet the SEC proposals and complex rules make no allowance for either fund size or type of investment company. Perhaps they should!

We understand that it is the responsibility of the SEC to weigh the costs and benefits of regulation. However, the impact of the proposals *without modification* would be to disproportionally increase the expense burden on the shareholders of small to mid-sized funds. Ultimately, the effect will be to encourage concentration in the large fund groups that can more easily absorb the increased regulatory burden, create barriers to entry for new funds and reduce investment choice for investors.

We encourage you to consider fund size and type of investment company in issuing the final regulations, and invite you questions or comments.

Very truly yours,

Martin Brody
David Gale
Morgan Gust
Robert F. Wulf, C.F.A.

The Independent Directors of Flaherty & Crumrine
Preferred Income Opportunity Fund Incorporated

Cc: Paul F. Roye, Director, Division of Investment Management
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