MUNIYIELD QUALITY FUND INC
Form N-2/A
September 14, 2005

As filed with the Securities and Exchange Commission on September 14, 2005

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM N-2
[X] REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

[X] PRE-EFFECTIVE AMENDMENT NO. 1

[_] POST-EFFECTIVE AMENDMENT NO.
AND/OR
[C] REGISTRATION STATEMENT UNDER THE INVESTMENT COMPANY ACT OF 1940

[X] AMENDMENT NO. 6
(Check appropriate box or boxes)

MUNIYIELD QUALITY FUND, INC.
(Exact Name of Registrant as Specified in Charter)

800 Scudders Mill Road
Plainsboro, New Jersey 08536
(Address of Principal Executive Offices)

(609) 282-2800
(Registrant s Telephone Number, Including Area Code)

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(Name and Address of Agent for Service)

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Approximate date of proposed public offering: As soon as practicable after the effective date of this Registration Statement.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended (the Securities Act), other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [_]

CALCULATION OF REGISTRATION FEE UNDER THE SECURITIES ACT OF 1933

Title of Securities Being Registered	Amount being Registered	Proposed Maximum Offering Price Per Unit(1)	Proposed Maximum Aggregate Offering Price(1)	Amount of Registration Fee(2)
Auction Market Preferred Stock	**2,000 shares**	**$25,000**	**$50,000,000**	**$5,885**

(1) Estimated solely for the purpose of calculating the registration fee.
(2) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may become necessary to delay its effective date until the Registrant shall file a further amendment, which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to Completion
Preliminary Prospectus dated September 14, 2005

PROSPECTUS

$50,000,000
MuniYield Quality Fund, Inc.

Auction Market Preferred Stock (AMPS)
2,000 Shares, Series E
Liquidation Preference $25,000 per Share

MuniYield Quality Fund, Inc. is a non-diversified, closed-end management investment company seeking to provide shareholders with as high a level of current income exempt from Federal income taxes as is consistent with its investment policies and prudent investment management. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of an aggregate of the Fund s net assets (including proceeds from the issuance of preferred stock), plus the amounts of any borrowings for investment purposes, in a portfolio of municipal obligations the interest on which, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax). The Fund invests in a portfolio of municipal obligations which are rated in the three highest quality ratings categories (A or better) or, if unrated, are considered by the Fund s Investment Adviser to be of comparable quality. The Fund may invest in certain tax exempt securities classified as private activity bonds, as discussed within, that may subject certain investors in the Fund to an alternative minimum tax. There can be no assurance that the Fund s investment objective will be realized.

(continued on following page)

Investing in the AMPS involves certain risks that are described in the Risk Factors and Special Considerations section beginning on page 11 of this prospectus. The minimum purchase amount for the AMPS is $25,000.

	Per Share	Total
Public offering price	$25,000	$50,000,000
Underwriting discount	$250	$500,000
Proceeds, before expenses, to the Fund(1)	$24,750	$49,500,000

(1) The estimated offering expenses payable by the Fund are $150,000.

The public offering price per share will be increased by the amount of accumulated dividends, if any, from the date the shares are first issued.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The AMPS will be ready for delivery in book-entry form through The Depository Trust Company on or about , 2005.

Merrill Lynch & Co.

The date of this prospectus is , 2005.

(continued from previous page)

This prospectus contains information you should know before investing, including information about risks. Please read it before you invest and keep it for future reference. The Fund s statement of additional information dated , 2005 contains further information about the Fund and is incorporated by reference (legally considered to be part of this prospectus) and the table of contents of the statement of additional information appears on page 49 of this prospectus. A copy of the statement of additional information and copies of the Fund s semi-annual and annual reports may be obtained without charge by writing to the Fund at its address at 800 Scudders Mill Road, Plainsboro, New Jersey 08536, or by calling the Fund at (800) 543-6217. Copies of the Fund s semi-annual and annual reports may also be obtained without charge at mutualfunds.ml.com. Due to the relatively short offering period for the AMPS, the statement of additional information is not available at this website. In addition, you may request other information about the Fund or make stockholder inquiries by calling the Fund toll-free at (800) 543-6217. In addition, the Securities and Exchange Commission maintains a website (http://sec.gov) that contains the statement of additional information, material incorporated by reference and other information regarding registrants that file electronically with the Securities and Exchange Commission.

Certain capitalized terms used herein not otherwise defined in this prospectus have the meaning provided in the Glossary at the back of this prospectus.

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Information about the Fund can be reviewed and copied at the Securities and Exchange Commission s Public Reference Room in Washington, D.C. Call 1-202-551-8090 for information on the operation of the public reference room. This information is also available on the Securities and Exchange Commission s Internet site at http://www.sec.gov and copies may be obtained upon payment of a duplicating fee by writing to the Public Reference Section of the Securities and Exchange Commission, Washington, D.C. 20549-0102.

You should rely only on the information contained in this prospectus. We have not, and the underwriter has not, authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We are not, and the underwriter is not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus is accurate only as of the date on the front cover of this prospectus. Our business, financial condition, results of operations and prospects may have changed since that date.

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PROSPECTUS SUMMARY

This summary is qualified in its entirety by reference to the detailed information included in this prospectus and the statement of additional information.

The Fund MuniYield Quality Fund, Inc. is a non-diversified, closed-end management investment company.

The Offering

The Fund is offering a total of 2,000 shares of Auction Market Preferred Stock, Series E, at a purchase price of $25,000 per share plus accumulated dividends, if any, from the date the shares are first issued. The shares of AMPS are being offered by Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch), as underwriter.

The Series E AMPS will be shares of preferred stock of the Fund that entitle their holders to receive cash dividends at an annual rate that may vary for the successive dividend periods. In general, except as described below, each dividend period following the initial dividend period will be seven days. The applicable dividend for a particular dividend period will be determined by an auction conducted on the business day next preceding the start of that dividend period.

Investors and potential investors in shares of Series E AMPS may participate in auctions for the AMPS through their broker-dealers.

Generally, AMPS investors will not receive certificates representing ownership of their shares. Ownership of AMPS will be maintained in book-entry form by the securities depository (The Depository Trust Company) or its nominee for the account of the investor s agent member (generally the investor s broker-dealer). The investor s agent member, in turn, will maintain records of such investor s beneficial ownership of AMPS.

Investment Objective and Policies

The investment objective of the Fund is to provide shareholders with as high a level of current income exempt from Federal income taxes as is consistent with its investment policies and prudent investment management. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of its net assets (including proceeds from the issuance of preferred stock), and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of states, territories and possessions of the United States and their political subdivisions, agencies or instrumentalities, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (Municipal Bonds). In general, the Fund does not intend for its investments to earn a large amount of interest income that is not exempt from Federal income tax, except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax. There can be no assurance that the Fund s investment objective will be realized.

Maturity. The average maturity of the Fund s portfolio securities varies from time to time based upon an assessment of economic and market conditions by Fund Asset Management, L.P., the Fund s investment adviser (the Investment Adviser). The Fund intends to invest primarily in long term Municipal Bonds (that is, Municipal Bonds with maturities of more than ten years). However, the Fund also may invest in intermediate term Municipal Bonds with remaining maturities of between three years and ten years. The Fund also may invest from time to time in short term Municipal Bonds with remaining maturities of less than three years.

Municipal Bond Ratings. The Fund invests in a portfolio of Municipal Bonds that are rated in the three highest quality ratings categories by one or more nationally recognized statistical rating organizations (NRSROs) (A or higher by Moody s

Investors Service, Inc. (Moody s), Standard & Poor s (S&P) or Fitch Ratings (Fitch)), or in unrated bonds considered by the Investment Adviser to be of comparable quality. In assessing the quality of Municipal Bonds, the Investment Adviser takes into account any letters of credit or similar credit enhancement to which particular Municipal Bonds are entitled and the creditworthiness of the financial institution that provided such credit enhancement.

Indexed and Inverse Floating Rate Securities. The Fund may invest in securities whose potential returns are directly related to changes in an underlying index or interest rate, known as indexed securities. The return on indexed securities will rise when the underlying index or interest rate rises and fall when the index or interest rate falls. The Fund may also invest in securities whose return is inversely related to changes in an interest rate (inverse floaters). In general, income on inverse floaters will decrease when short term interest rates increase and increase when short term interest rates decrease. Investments in inverse floaters may subject the Fund to the risks of reduced or eliminated interest payments and loss of principal. In addition, certain indexed securities and inverse floaters may increase or decrease in value at a greater rate than the underlying interest rate, which effectively leverages the Fund s investment. As a result, the market value of such securities will generally be more volatile than that of fixed rate, tax exempt securities. Both indexed securities and inverse floaters are derivative securities and can be considered speculative.

Hedging Transactions. The Fund may seek to hedge its portfolio against changes in interest rates using options and financial futures contracts or swap transactions. The Fund s hedging transactions are designed to reduce volatility, but come at some cost. For example, the Fund may try to limit its risk of loss from a decline in price of a portfolio security by purchasing a put option. However, the Fund must pay for the option, and the price of the security may not in fact drop. In large part, the success of the Fund s hedging activities depends on its ability to forecast movements in securities prices and interest rates. The Fund is not required to hedge its portfolio and may choose not to do so. The Fund cannot guarantee that any hedging strategies it uses will work.

Swap Agreements. The Fund is authorized to enter into swap agreements, which are over-the-counter contracts in which one party agrees to make periodic payments based on the change in the market value of a specific bond, basket of bonds or index in return for periodic payments based on a fixed or variable interest rate or the change in market value of a different bond, basket of bonds or index. Swap agreements may be used to obtain exposure to a bond or market without owning or taking physical custody of securities.

Tax Considerations. While exempt-interest dividends are excluded from gross income for Federal income tax purposes, they may be subject to the Federal alternative minimum tax in certain circumstances. Distributions of any capital gain or other taxable income will be taxable to stockholders. The Fund may not be a suitable investment for investors subject to the Federal alternative minimum tax or who would become subject to such tax by investing in the Fund. See Taxes.

Risk Factors

Set forth below is a summary of the main risks of investing in the Fund s Series E AMPS. For a more detailed description of the main risks as well as certain other risks associated with investing in the Fund s Series E AMPS, see Risk Factors and Special Considerations.

The credit ratings of the AMPS could be reduced or terminated while an investor holds the AMPS, which could affect liquidity.

Neither broker-dealers nor the Fund are obligated to purchase shares of AMPS in an auction or otherwise, nor is the Fund required to redeem shares of AMPS in the event of a failed auction.

If sufficient bids do not exist in an auction, the applicable dividend rate will be the maximum applicable dividend rate, and in such event, owners of AMPS wishing to sell will not be able to sell all, and may not be able to sell any, AMPS in the auction. As a result, investors may not have liquidity of investment.

As a result of bidding by broker-dealers in an auction for their own account, the dividend rate that would apply at the auction may be higher or lower than the rate that would have prevailed had the broker-dealer not bid.

A broker-dealer may bid in an auction in order to prevent what would otherwise be (i) a failed auction, (ii) an all-hold auction, or (iii) an applicable dividend rate that the broker-dealer believes, in its sole discretion, does not reflect the market for the AMPS at the time of the auction.

The relative buying and selling interest of market participants in AMPS and in the auction rate securities market as a whole will vary over time, and such variations may be affected by, among other things, news relating to the issuer, the attractiveness of alternative investments, the perceived risk of owning the security (whether related to credit, liquidity or any other risk), the tax treatment accorded the instruments, the accounting treatment accorded auction rate securities, including recent clarifications of U.S. generally accepted principles relating to the treatment of auction rate securities, reactions to regulatory actions or press reports, financial reporting cycles and market sentiment generally. Shifts of demand in response to any one or simultaneous particular events cannot be predicted and may be short-lived or exist for longer periods.

Merrill Lynch, Pierce, Fenner & Smith Incorporated (Merrill Lynch) has advised the Fund that it and various other broker-dealers and other firms that participate in the auction rate securities market received letters from the staff of the Securities and Exchange Commission last spring. The letters requested that each of these firms voluntarily conduct an investigation regarding its respective practices and procedures in that market. Pursuant to this request, Merrill Lynch conducted its own voluntary review and reported its findings to the Securities and Exchange Commission staff. At the Securities and Exchange Commission staff s request, Merrill Lynch, together with certain other broker-dealers and other firms that participate in the auction rate securities market, is engaging in discussions with the Securities and Exchange Commission staff concerning its inquiry. Neither Merrill Lynch nor the Fund can predict the ultimate outcome of the inquiry or how that outcome will affect the market for the AMPS or the auctions.

Broker-dealers have no obligation to maintain a secondary trading market in the AMPS outside of auctions and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market. An increase in the level of interest rates likely will have an adverse effect on the secondary market price of the AMPS, and a selling stockholder may have to sell AMPS between auctions at a price per share of less than $25,000.

The Fund will issue the AMPS only if the AMPS have received a rating of Aaa from Moody s and AAA from S&P. Under certain circumstances, the Fund may voluntarily terminate compliance with Moody s or S&P guidelines, or both, in which case the AMPS may no longer be rated by Moody s or S&P, as applicable, but will be rated by at least one rating agency.

The Fund issues shares of AMPS, which generally pay dividends based on short term interest rates. The Fund generally will purchase Municipal Bonds that pay interest at fixed or adjustable rates. If market interest rates rise, this could negatively impact the value of the Fund s investment portfolio, reducing the amount of assets serving as asset coverage for the AMPS. If the asset coverage becomes too low, the Fund may be required to redeem some or all of the shares of AMPS.

The Fund is registered as a non-diversified investment company, the Fund may invest a greater percentage of its assets in a single issuer than a diversified investment company. Since the Fund may invest a relatively high percentage of its assets in a limited number of issuers, the Fund may be more exposed to any single economic, political or regulatory occurrence than a more widely diversified fund.

The amount of public information available about Municipal Bonds in the Fund s portfolio is generally less than that for corporate equities or bonds, and the investment performance of the Fund may, therefore, be more dependent on the analytical abilities of the Investment Adviser than the performance of a stock fund or taxable bond fund.

The Fund s investments in Municipal Bonds are subject to interest rate and credit risk. Interest rate risk is the risk that prices of Municipal Bonds generally increase when interest rates decline and decrease when interest rates increase. Prices of the longer term securities in which the Fund primarily invests generally change more in response to changes in interest rates than prices of shorter term securities. Credit risk is the risk that the issuer will be unable to pay the interest or principal when due. Changes in an issuer s credit rating or the market s perception of an issuer s creditworthiness may affect the value of the Fund s investment in that issuer.

Investment Adviser

The Investment Adviser provides investment advisory and administrative services to the Fund. For its services, the Fund pays the Investment Adviser a monthly fee at the annual rate of 0.50% of the Fund s average weekly net assets (including any proceeds from the issuance of preferred stock).

Dividends and Dividend Periods

Dividends on the Series E AMPS will be cumulative from the date the shares are first issued and payable at the annualized cash dividend rate for the initial dividend period on the initial dividend payment date as follows:.

AMPS Series	Initial Dividend Rate	Initial Dividend Period Ending	Initial Dividend Payment Date
Series E	%	, 2005	, 2005

After the initial dividend period, each dividend period for the Series E AMPS will generally consist of seven days; provided however, that before any auction, the Fund may decide, subject to certain limitations and only if it gives notice to holders, to declare a special dividend period of up to five years.

After the initial dividend period, in the case of dividend periods that are not special dividend periods, dividends generally will be payable on each succeeding Monday.

Dividends for the Series E AMPS will be paid through the securities depository (The Depository Trust Company) on each dividend payment date for the AMPS.

For each subsequent dividend period, the auction agent (The Bank of New York) will hold an auction to determine the cash dividend rate on the shares of the Series E AMPS.

Determination of Maximum Dividend Rates

Generally, the applicable dividend rate for any dividend period for the Series E AMPS will not be more than the maximum applicable rate attributable to such shares. The maximum applicable rate for the Series E AMPS will be the higher of (A) the applicable percentage of the reference rate on the auction date or (B) the applicable spread plus the reference rate on the auction date. The reference rate is (A) the higher of the applicable LIBOR Rate (as defined in the Glossary) and the Taxable Equivalent of the Short-Term Municipal Bond Rate (as defined in the Glossary) (for a dividend period or special dividend period of 364 or fewer days), or (B) the applicable Treasury Index Rate (as defined in the Glossary)(for a special dividend period of 365 days or more). The maximum applicable rate for the AMPS will depend on the credit rating assigned to the shares, the length of the dividend period and whether or not the Fund has given notification prior to the auction for the dividend period that any taxable income will be included in the dividend on the AMPS for that dividend period. The applicable percentage and applicable spread are as follows:

Credit Ratings	Applicable Percentage of Reference Rate No	Applicable Percentage of Reference Rate	Applicable Spread Over Reference Rate No	Applicable Spread Over Reference Rate

Moody s	S&P	Notification	Notification	Notification	Notification
Aaa	AAA	110%	125%	1.10%	1.25%
Aa3 to Aa1	AA- to AA	125%	150%	1.25%	1.50%
A3 to A1	A- to A	150%	200%	1.50%	2.00%
Baa3 to Baa1	BBB- to BBB	175%	250%	1.75%	2.50%
Below Baa3	Below BBB-	200%	300%	2.00%	3.00%

The applicable percentage and the applicable spread as so determined may be subject to upward but not downward adjustment in the discretion of the Board of Directors of the Fund after consultation with the broker-dealers participating in the auction for the AMPS.

There is no minimum applicable dividend rate for any dividend period.

Other AMPS

The Fund has outstanding 8,000 shares of four other series of Auction Market Preferred Stock, each with a liquidation preference of $25,000 per share, plus accumulated but unpaid dividends, for an aggregate initial liquidation preference of $200,000,000 (the Other AMPS). The Other AMPS are as follows: 2,000 shares of Auction Market Preferred Stock, Series A; 2,000 shares of Auction Market Preferred Stock, Series B; 2,000 shares of Auction Market Preferred Stock, Series C; and 2,000 shares of Auction Market Preferred Stock, Series D. The Series E AMPS offered hereby rank on a parity with the Other AMPS with respect to dividends and liquidation preference.

Asset Maintenance

Under the Fund s Articles Supplementary creating the Series E AMPS (the Articles Supplementary), the Fund must maintain:

asset coverage of the AMPS and Other AMPS as required by the rating agencies rating the AMPS, and

asset coverage of the AMPS and Other AMPS of at least 200% as required by the Investment Company Act of 1940 (the 1940 Act).

The Fund estimates that, based on the composition of its portfolio at April 30, 2005, asset coverage of the AMPS and Other AMPS as required by the 1940 Act would be approximately 287% immediately after the Fund issues the shares of AMPS offered by this prospectus representing approximately 35% of the Fund s capital, or approximately 53% of the Fund s common stock equity, immediately after the issuance of such AMPS.

Mandatory Redemption

If the required asset coverage is not maintained or, when necessary, restored, the Fund must redeem shares of the Series E AMPS at the price of $25,000 per share plus accumulated but unpaid dividends thereon (whether or not earned or declared). The provisions of the 1940 Act may restrict the Fund s ability to make such a mandatory redemption.

Optional Redemption

The Fund may, at its option, choose to redeem all or a portion of the shares of AMPS on any dividend payment date at the price of $25,000 per share, plus accumulated but unpaid dividends thereon (whether or not earned or declared) plus any applicable premium.

Liquidation Preference

The liquidation preference (that is, the amount the Fund must pay to holders of AMPS if the Fund is liquidated) of each share of AMPS will be $25,000, plus an amount equal to accumulated but unpaid dividends (whether or not earned or declared).

Ratings

The AMPS will be issued with a rating of Aaa from Moody s and AAA from S&P.

Voting Rights	The 1940 Act requires that the holders of AMPS and any other preferred stock, including the Other AMPS, voting as a separate class, have the right to elect at least two directors at all times and to elect a majority of the directors at any time when dividends on the AMPS or any other preferred stock, including the Other AMPS, are unpaid for two full years. The Fund s Charter, the 1940 Act and the General Corporation Laws of the State of Maryland require holders of AMPS and any other preferred stock, including the Other AMPS, to vote as a separate class on certain other matters.

RISK FACTORS AND SPECIAL CONSIDERATIONS

An investment in the Fund s AMPS should not constitute a complete investment program.

Set forth below are the main risks of investing in the Fund s AMPS.

Investment Considerations. Investors in AMPS should consider the following factors:

The credit ratings of the AMPS could be reduced or terminated while an investor holds the AMPS, which could affect liquidity.

Neither broker-dealers nor the Fund are obligated to purchase shares of AMPS in an auction or otherwise, nor is the Fund required to redeem shares of AMPS in the event of a failed auction.

If sufficient bids do not exist in an auction, the applicable dividend rate will be the maximum applicable dividend rate, and in such event, owners of AMPS wishing to sell will not be able to sell all, and may not be able to sell any, AMPS in the auction. As a result, investors may not have liquidity of investment.

Broker-dealers may submit orders in auctions for the AMPS for their own account. If a broker-dealer submits an order for its own account in any auction, it may have knowledge of orders placed through it in that auction and therefore have an advantage over other bidders, but such broker-dealer would not have knowledge of orders submitted by other broker-dealers in that auction. As a result of bidding by a broker-dealer in an auction, the dividend rate that would apply at the auction may be higher or lower than the rate that would have prevailed had the broker-dealer not bid.

A broker-dealer may bid in an auction in order to prevent what would otherwise be (i) a failed auction, (ii) an all-hold auction, or (iii) an applicable dividend rate that the broker-dealer believes, in its sole discretion, does not reflect the market for the AMPS at the time of the auction. A broker-dealer may, but is not obligated to, advise owners of AMPS that the dividend rate that would apply in an all-hold auction may be lower than would apply if owners submit bids and such advice, if given, may facilitate the submission of bids by owners that would avoid the occurrence of an all-hold auction.

The relative buying and selling interest of market participants in AMPS and in the auction rate securities market as a whole will vary over time, and such variations may be affected by, among other things, news relating to the issuer, the attractiveness of alternative investments, the perceived risk of owning the security (whether related to credit, liquidity or any other risk), the tax treatment accorded the instruments, the accounting treatment accorded auction rate securities, including recent clarifications of U.S. generally accepted principles relating to the treatment of auction rate securities, reactions to regulatory actions or press reports, financial reporting cycles and market sentiment generally. Shifts of demand in response to any one or simultaneous particular events cannot be predicted and may be short-lived or exist for longer periods.

Merrill Lynch has advised the Fund that it and various other broker-dealers and other firms that participate in the auction rate securities market received letters from the staff of the Securities and Exchange Commission last spring. The letters requested that each of these firms voluntarily conduct an investigation regarding its respective practices and procedures in that market. Pursuant to this request, Merrill Lynch conducted its own voluntary review and reported its findings to the Securities and Exchange Commission staff. At the Securities and Exchange Commission staff s request, Merrill Lynch, together with certain other broker-dealers and other firms that participate in the auction rate securities market, is engaging in discussions with the Securities and Exchange Commission staff concerning its inquiry. Neither Merrill Lynch nor the Fund can predict the ultimate outcome of the inquiry or how that outcome will affect the market for the AMPS or the auctions.

Secondary Market. Broker-dealers have no obligation to maintain a secondary trading market in the AMPS outside of auctions and there can be no assurance that a secondary market for the AMPS will develop or, if it does develop, that it will provide holders with a liquid trading market. The AMPS will not be registered on any stock exchange or on any automated quotation system. An increase in the level of interest rates likely will have an adverse effect on the secondary market price of the AMPS, and a selling stockholder may have to sell AMPS between auctions at a price per share of less than $25,000.

Rating Agencies. The Fund will issue the AMPS only if the AMPS have received a rating of Aaa from Moody s and AAA from S&P. As a result of such ratings the Fund will be subject to guidelines of Moody s, S&P or another substitute NRSRO that may issue ratings for its preferred stock. These guidelines may impose asset coverage or portfolio composition requirements that are more stringent than those imposed by the 1940 Act and may prohibit or limit the use by the Fund of certain portfolio management techniques or investments. The Fund does not expect these guidelines to prevent the Investment Adviser from managing the Fund s portfolio in accordance with the Fund s investment objective and policies. Also, under certain circumstances, the Fund may voluntarily terminate compliance with Moody s or S&P s guidelines, or both, in which case the AMPS may no longer be rated by Moody s or S&P, as applicable, but will be rated by at least one rating agency.

Non-Diversification. The Fund is registered as a non-diversified investment company. This means that the Fund may invest a greater percentage of its assets in a single issuer than a diversified investment company. Since the Fund may invest a relatively high percentage of its assets in a limited number of issuers, the Fund may be more exposed to any single economic, political or regulatory occurrence than a more widely diversified fund. Even as a non-diversified fund, the Fund must still meet the diversification requirements applicable to regulated investment companies under the Federal income tax laws.

Interest Rate Risk and AMPS. The Fund issues shares of AMPS, which generally pay dividends based on short-term interest rates. The Fund generally will purchase Municipal Bonds that pay interest at fixed or adjustable rates. If short-term interest rates rise, dividend rates on the shares of AMPS may rise so that the amount of dividends paid to the holders of shares of AMPS exceeds the income from the Fund s portfolio securities. Because income from the Fund s entire investment portfolio (not just the portion of the portfolio purchased with the proceeds of the AMPS offering) is available to pay dividends on the shares of AMPS, dividend rates on the shares of AMPS would need to greatly exceed the Fund s net portfolio income before the Fund s ability to pay dividends on the shares of AMPS would be jeopardized. If market interest rates rise, this could negatively impact the value of the Fund s investment portfolio, reducing the amount of assets serving as asset coverage for the AMPS. If the asset coverage becomes too low, the Fund may be required to redeem some or all of the shares of AMPS.

Market Risk and Selection Risk. Market risk is the risk that the bond market will go down in value, including the possibility that the market will go down sharply and unpredictably. Selection risk is the risk that the securities that Fund management selects will underperform the bond market, the market relevant indices, or other funds with similar investment objectives and investment strategies.

Tax Exempt Securities Market Risk. The amount of public information available about Municipal Bonds in the Fund s portfolio is generally less than that for corporate equities or bonds, and the investment performance of the Fund may therefore be more dependent on the analytical abilities of the Investment Adviser than that of a stock fund or taxable bond fund.

Interest Rate and Credit Risk. The Fund invests in Municipal Bonds, which are subject to interest rate and credit risk. Interest rate risk is the risk that prices of Municipal Bonds generally increase when interest rates decline and decrease when interest rates increase. Prices of longer term securities generally change more in response to interest rate changes than prices of shorter term securities. The Fund s use of leverage by the issuance of preferred stock and its investment in inverse floating obligations, as discussed below, may increase interest rate risk. Because market interest rates are currently near their lowest levels in many years, there is a greater risk that the Fund s portfolio will decline in value if interest rates increase in the future. Changes in an issuer s credit rating or the market s perception of an issuer s creditworthiness may affect the value of the Fund s investment in that issuer. Credit risk is the risk that the issuer will be unable to pay the interest or principal when due. The degree of credit risk depends on both the financial condition of the issuer and the terms of the obligation.

Set forth below are certain other risks associated with investing in the Fund s AMPS.

Call and Redemption Risk. A Municipal Bond s issuer may call the bond for redemption before it matures. If this happens to a Municipal Bond that the Fund holds, the Fund may lose income and may have to invest the proceeds in Municipal Bonds with lower yields.

Reinvestment Risk. Reinvestment risk is the risk that income from the Fund s Municipal Bond portfolio will decline if and when the Fund invests the proceeds from matured, traded or called bonds at market interest rates that are below the portfolio s current earnings rate. A decline in income could negatively affect the Fund s yield, return or the market price of the common stock.

Private Activity Bonds. The Fund may invest in certain tax exempt securities classified as private activity bonds. These bonds may subject certain investors in the Fund to the Federal alternative minimum tax.

Liquidity of Investments. Certain Municipal Bonds in which the Fund invests may lack an established secondary trading market or are otherwise considered illiquid. Liquidity of a security relates to the ability to easily dispose of the security and the price to be obtained and does not generally relate to the credit risk or likelihood of receipt of cash at maturity. Illiquid securities may trade at a discount from comparable, more liquid investments.

Portfolio Strategies. The Fund may engage in various portfolio strategies both to seek to increase the return of the Fund and to seek to hedge its portfolio against adverse effects from movements in interest rates and in the securities markets. These portfolio strategies include the use of derivatives, such as indexed securities, inverse securities, options, futures, options on futures, interest rate swap transactions and credit default swaps. Such strategies subject the Fund to the risk that, if the Investment Adviser incorrectly forecasts market values, interest rates or other applicable factors, the Fund s performance could suffer. Certain of these strategies such as investments in inverse securities and credit default swaps may provide investment leverage to the Fund s portfolio. The Fund is not required to use derivatives or other portfolio strategies to seek to increase return or to seek to hedge its portfolio and may choose not to do so. There can be no assurance that the Fund s portfolio strategies will be effective. Some of the derivative strategies that the Fund may use to seek to increase its return are riskier than its hedging transactions and have speculative characteristics. Such strategies do not attempt to limit the Fund s risk of loss.

General Risks Related to Derivatives. Derivatives are financial contracts or instruments whose value depends on, or is derived from, the value of an underlying asset, reference rate or index (or relationship between two indices). The Fund may invest in a variety of derivative instruments for investment purposes, hedging purposes or to seek to increase its return, such as options, futures contracts and swap agreements. The Fund may use derivatives as a substitute for taking a position in an underlying security or other asset and/or as part of a strategy designed to reduce exposure to other risks, such as interest rate risk. The Fund also may use derivatives to add leverage to the portfolio and/or to hedge against increases in the Fund s costs associated with the dividend payments on the preferred stock, including the AMPS. The Fund also may invest in certain derivative products that pay tax exempt income interest via a trust or partnership through which the Fund holds interests in one or more underlying long term municipal securities. The Fund s use of derivative instruments involves risks different from, and possibly greater than, the risks associated with investing directly in securities and other traditional investments. Derivatives are subject to a number of risks such as liquidity risk, interest rate risk, credit risk, leverage risk and management risk. They also involve the risk of mispricing or improper valuation and correlation risk (*i.e.*, the risk that changes in the value of the derivative may not correlate perfectly with the underlying asset, rate or index). If the Fund invests in a derivative instrument it could lose more than the principal amount invested. Moreover, derivatives raise certain tax, legal, regulatory and accounting issues that may not be presented by investments in Municipal Bonds, and there is some risk that certain issues could be resolved in a manner that could adversely impact the performance of the Fund and/or the tax exempt nature of the dividends paid by the Fund.

Also, suitable derivative transactions may not be available in all circumstances and there can be no assurance that the Fund will engage in these transactions to reduce exposure to other risks when that would be beneficial.

Swaps. Swap agreements are types of derivatives. In order to seek to hedge the value of the Fund s portfolio, to hedge against increases in the Fund s cost associated with the dividend payments on preferred stock, including the AMPS, or to seek to increase the Fund s return, the Fund may enter into interest rate or credit default swap transactions. In interest rate swap transactions, there is a risk that yields will move in the direction opposite of the direction anticipated by the Fund, which would cause the Fund to make payments to its counterparty in the transaction that could adversely affect Fund performance. In addition to the risks applicable to swaps generally, credit default swap transactions involve special risks because they are difficult to value, are highly susceptible to liquidity and credit risk, and generally pay a return to the party that has paid the premium only in the event of an

actual default by the issuer of the underlying obligation (as opposed to a credit downgrade or other indication of financial difficulty). The Fund is not required to enter into interest rate or credit default swap transactions for hedging purposes or to enhance its return and may choose not to do so.

Federal Taxability Risk. The Fund intends to minimize the payment of taxable income to stockholders by investing in Municipal Bonds and other tax exempt securities in reliance on an opinion of bond counsel to the issuer that the interest paid on those securities will be excludable from gross income for Federal income tax purposes. Such securities, however, may be determined for Federal income tax purposes to pay, or to have paid, taxable income subsequent to the Fund s acquisition of the securities. In that event, the Internal Revenue Service may demand that the Fund pay taxes on the affected interest income, and, if the Fund agrees to do so, the Fund s yield on its common stock could be adversely affected. A determination that interest on a security held by the Fund is includable in gross income for Federal income tax purposes retroactively to its date of issue may, likewise, cause a portion of prior distributions received by stockholders, including holders of AMPS, to be taxable to those stockholders in the year of receipt. The Fund will not pay an Additional Dividend (as defined herein) to a holder of AMPS under these circumstances.

Antitakeover Provisions. The Fund s Charter, By-laws and the General Corporation Law of the State of Maryland include provisions that could limit the ability of other entities or persons to acquire control of the Fund or to change the composition of its Board of Directors. Such provisions could limit the ability of stockholders to sell their shares at a premium over prevailing market prices by discouraging a third party from seeking to obtain control of the Fund. See Description of Capital Stock Certain Provisions of the Charter and By-laws.

Market Disruption. The terrorist attacks in the United States on September 11, 2001 had a disruptive effect on the securities markets, some of which were closed for a four-day period. The continued threat of similar attacks and related events, including U.S. military actions in Iraq and continued unrest in the Middle East, have led to increased short term market volatility and may have long term effects on U.S. and world economies and markets. Similar disruptions of the financial markets could adversely affect the market prices of the Fund s portfolio securities, interest rates, auctions, secondary trading, ratings, credit risk, inflation and other factors relating to the Fund s AMPS.

FINANCIAL HIGHLIGHTS

The following Financial Highlights table is intended to help you understand the Fund s financial performance for the periods shown. Certain information reflects financial results for a single share of common stock or preferred stock of the Fund. The total returns in the table represent the rate an investor would have earned or lost on an investment in shares of common stock of the Fund (assuming reinvestment of all dividends). The information with respect to the fiscal years ended October 31, 1995 to October 31, 2004 has been audited by Deloitte & Touche LLP, whose report for the fiscal year ended October 31, 2004, along with the financial statements of the Fund, is included in the Fund s 2004 Annual Report, which is incorporated by reference herein. The information with respect to the six months ended April 30, 2005 is unaudited and is included in the Fund s 2005 Semi-Annual Report, which is incorporated by reference herein. You may obtain a copy of the Fund s 2004 Annual Report and the 2005 Semi-Annual Report at no cost by calling (800) 543-6217 between 8:30 a.m. and 5:30 p.m. Eastern time on any business day.

The following per share data and ratios have been derived from information provided in the financial statements.

	For the Six Months Ended April 30, 2005 (unaudited)	2004	2003	2002	2001##	2000##	1999##	1998##	1997	1996	1995
Per Share Operating Performance											
Net asset value, beginning of period	$15.54	$15.36	$15.19	$15.27	$14.18	$13.54	$15.58	$15.17	$14.57	$14.58	$13.16
Investment income net	.50	1.03	1.07	1.06	1.06	1.07	1.07	1.12	1.13	1.14	1.15
Realized and unrealized gain (loss) net	(.08)	.19	.13	(.13)	1.08	.66	(2.04)	.40	.59	(.01)	1.43
Less dividends and distributions to Preferred Stock shareholders:											
Investment income net	(.06)	(.07)	(.07)	(.09)	(.21)	(.27)	(.21)	(.23)			
Realized Gain net											
Total from investment											

	For the Six Months Ended April 30, 2005 (unaudited)	**2004**	**2003**	**2002**	**2001##**	**2000##**	**1999##**	**1998##**	**1997**	**1996**	**1995**
operations	.36	1.15	1.13	.84	1.93	1.46	(1.18)	1.29	1.72	1.13	2.58
Less dividends and distributions to Common Stock shareholders:											
Investment income net	(.49)	(.97)	(.96)	(.91)	(.84)	(.82)	(.86)	(.88)	(.89)	(.90)	(.89)
Realized gain net				(.01)							(.02)
In excess of realized gain net											
Total dividends and distributions to Common Stock shareholders	(.49)	(.97)	(.96)	(.92)	(.84)	(.82)	(.86)	(.88)	(.89)	(.90)	(.91)
Effect of Preferred Stock activity:											
Dividends and distributions to Preferred Stock shareholders:											
Investment income net									(.23)	(.24)	(.25)
Realized gain net											
In excess of realized gain net											
Total Effect of Preferred Stock activity									(.23)	(.24)	(.25)
Net asset value, end of period	$15.41	$15.54	$15.36	$15.19	$15.27	$14.18	$13.54	$15.58	$15.17	$14.57	$14.58
Market price per share, end of period	$14.54	$14.83	$14.35	$13.74	$14.24	$12.0625	$12.0625	$15.5625	$14.4375	$12.875	$12.625
Total Investment Return**											
Based on net asset value per share	2.50%	8.26%	8.13%	6.12%	14.46%	12.09%	(7.62%)	8.93%	11.03%	6.93%	19.34%
Based on market price per share	1.34%	10.58%	11.68%	2.94%	25.47%	7.03%	(17.61%)	14.33%	19.58%	9.12%	23.63%
Ratios Based on Average Net Assets of Common Stock											
Total expenses, net of reimbursement***	.94%*	.94%	.94%	.96%	.98%	.99%	.95%	.91%	.94%	.96%	.97%
Total expenses***	.94%*	.95%	.95%	.96%	.98%	.99%	.95%	.91%	.94%	.96%	.97%
Total investment income net***	6.55%*	6.74%	6.89%	7.03%	7.18%	7.74%	7.17%	7.30%	7.69%	7.79%	8.28%

	For the Six Months Ended April 30, 2005 (unaudited)	2004	2003	2002	2001##	2000##	1999##	1998##	1997	1996	1995
Amount of dividends to Preferred Stock shareholders	.77%*	.45%	.42%	.61%	1.45%	1.94%	1.41%	1.50%	1.56%	1.64%	1.78%
Investment income net, to Common Stock shareholders	5.78%*	6.29%	6.47%	6.42%	5.73%	5.81%	5.76%	5.80%	6.13%	6.15%	6.50%

(continued from prior page)

	For the Six Months Ended April 30, 2005 (unaudited)	2004	2003	2002	2001##	2000##	1999##	1998##	1997	1996	1995
Ratios Based on Average Net Assets of Preferred Stock											
Dividends to Preferred Stock shareholders	1.81%*	1.04%	.99%	1.40%	3.27%	4.03%	3.21%	3.51%	3.51%	3.61%	3.78%
Supplemental Data											
Net assets applicable to Common Stock, end of period (in thousands)	$468,970	$472,848	$467,370	$462,156	$464,522	$431,471	$411,883	$473,898	$461,647	$443,154	$443,718
Preferred Stock outstanding, end of period (in thousands)	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000	$200,000
Portfolio turnover	14.76%	32.87%	33.92%	46.29%	89.58%	51.19%	91.78%	42.95%	36.87%	68.22%	57.56%
Leverage											
Asset coverage per $1,000 .	$3,345	$3,364	$3,337	$3,311	$3,323	$3,157	$3,059	$3,369	$3,308	$3,216	$3,219
Liquidation preference per share	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000
Average market value per share#	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000	$25,000

	For the Six Months Ended April 30, 2005 (unaudited)	2004	2003	2002	2001##	2000##	1999##	1998##	1997	1996	1995
Dividends Per Share on Preferred Stock Outstanding											
Series A											
Investment income net	$213	$271	$273	$370	$852	$1,024	$824	$961	$864	$953	$961
Series B											
Investment income net	$225	$255	$238	$337	$792	$1,015	$779	$879	$892	$880	$917
Series C											
Investment income net	$243	$261	$253	$349	$832	$999	$809	$815	$884	$888	$977
Series D											
Investment income net	$224	$251	$228	$339	$791	$1,002	$787	$856	$873	$885	$921

* Annualized.

** Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially different returns. Total investment returns exclude the effects of sales charges.

*** Do not reflect the effect of dividends to Preferred Stock shareholders.

Based on average shares outstanding.

Amount is less than $(.01) per shares.

Aggregate total investment return.

Based on monthly market value per share.

Certain prior year amounts have been reclassified to conform to current year presentation.

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THE FUND

MuniYield Quality Fund, Inc. (the Fund) is a non-diversified, closed-end fund. The Fund was incorporated under the laws of the State of Maryland on May 5, 1992, and has registered under the Investment Company Act of 1940, as amended (the 1940 Act). The Fund s principal executive office is located at 800 Scudders Mill Road, Plainsboro, New Jersey 08536, and its telephone number is (609) 282-2800.

The Board of Directors of the Fund may at any time consider a merger, consolidation or other form of reorganization of the Fund with one or more other investment companies advised by Fund Asset Management, L.P. (the Investment Adviser) that have similar investment objectives and policies as the Fund. Any such merger, consolidation or other form of reorganization would require the prior approval of the Board of Directors and, if the Fund is the acquired fund, the stockholders of the Fund. See Description of Capital Stock Certain Provisions of the Charter and By-laws.

USE OF PROCEEDS

The net proceeds of this offering will be approximately $49,350,000 after payment of offering expenses (estimated to be approximately $150,000) and the deduction of the underwriting discount.

The net proceeds of the offering will be invested in accordance with the Fund s investment objective and policies within approximately three months after completion of this offering, depending on market conditions and the availability of appropriate securities. Pending such investment, it is anticipated that the proceeds will be invested in short term, tax exempt securities. See Investment Objective and Policies.

CAPITALIZATION

The following table sets forth the unaudited capitalization of the Fund as of April 30, 2005 and as adjusted to give effect to the issuance of the shares of AMPS offered hereby.

	Actual	As Adjusted
Preferred Stock (8,000 shares of Other AMPS authorized, issued and outstanding at $25,000 per share liquidation preference, plus accumulated but unpaid dividends; 10,000 shares of AMPS and Other AMPS authorized, issued and outstanding, as adjusted, at $25,000 per share liquidation preference, plus accumulated but unpaid dividends)	$ 200,024,220	$ 250,024,220
Common stock, par value $.10 per share (199,992,000 shares authorized, 30,425,258 shares issued and outstanding; 199,990,000 shares authorized, 30,425,258 shares issued and outstanding, as adjusted)	$ 3,042,526	$ 3,042,526
Paid-in capital in excess of par value	423,867,385	423,217,385
Undistributed investment income net	5,870,848	5,870,848
Accumulated realized capital losses net	(8,409,058)	(8,409,058)
Unrealized appreciation net	44,598,613	44,598,613
Net assets applicable to outstanding common stock	$ 468,970,314	$ 468,320,314

PORTFOLIO COMPOSITION

As of April 30, 2005, approximately 99.15% of the market value of the Fund s portfolio was invested in long term and intermediate term municipal obligations and approximately 0.85% of the market value of the Fund s portfolio was invested in short term tax exempt securities. The following table sets forth certain information with respect to the composition of the Fund s long term and intermediate term municipal obligations investment portfolio as of April 30, 2005.

Moody s*	S&P*	Number of Issues	Value (in thousands)	Percent
Aaa	AAA	127	$584,519	87.95%
Aa	AA	9	26,051	3.92
A	A	13	44,791	6.74
Baa	BBB	2	2,422	0.36
NR**	NR**	1	6,821	1.03
Total		152	$664,604	100.00%

* Ratings: Using the higher of Moody s or S&P ratings on the Fund s investments. Moody s rating categories may be modified further by a 1, 2 or 3 in Aa, A, Baa, Ba, B and Caa ratings. S&P rating categories may be modified further by a plus ( ) or minus (-) in AA, A, BBB, BB, B and CCC ratings.

** Not Rated.

INVESTMENT OBJECTIVE AND POLICIES

The Fund s investment objective is to provide shareholders with as high a level of current income exempt from Federal income taxes as is consistent with its investment policies and prudent investment management. The Fund seeks to achieve its investment objective by investing, as a fundamental policy, at least 80% of an aggregate of the Fund s net assets (including proceeds from the issuance of preferred stock), and the proceeds of any borrowings for investment purposes, in a portfolio of municipal obligations issued by or on behalf of states, territories and possessions of the United States and their political subdivisions, agencies or instrumentalities, each of which pays interest that, in the opinion of bond counsel to the issuer, is excludable from gross income for Federal income tax purposes (except that the interest may be includable in taxable income for purposes of the Federal alternative minimum tax) (Municipal Bonds). The Fund invests in Municipal Bonds which are rated in the three highest quality ratings categories (A or better) or, if unrated, are considered by the Investment Adviser to be of comparable quality. The Fund s investment objective and its policy of investing at least 80% of an aggregate of the Fund s net assets (including proceeds from the issuance of preferred stock), and the proceeds of any borrowings for investment purposes, in Municipal Bonds are fundamental policies that may not be changed without a vote of a majority of the outstanding voting securities of the Fund (as defined in the 1940 Act). There can be no assurance that the Fund s investment objective will be realized.

The Fund may invest in certain tax exempt securities classified as private activity bonds (or industrial development bonds, under pre-1986 law) (PABs) (in general, bonds that benefit non-governmental entities) that may subject certain investors in the Fund to an alternative minimum tax. See Taxes. The percentage of the Fund s total assets invested in PABs will vary from time to time. The Fund will not invest more than 25% of its total assets (taken at market value) in Municipal Bonds whose issuers are located in the same state.

The Municipal Bonds in which the Fund invests are those Municipal Bonds rated at the date of purchase in the three highest quality ratings as determined by either Moody s Investors Service, Inc. (Moody s) (currently Aaa, Aa and A), Standard & Poor s (S&P) (currently AAA, AA and A) or Fitch Ratings (Fitch) (currently AAA, AA and A). In the case of short term notes, these quality rating categories are SP-1 through SP-2 for S&P, MIG-1 through MIG-3 for Moody s and F-1 through F-2 for Fitch. In the case of tax exempt commercial paper, these quality rating categories are A-1 through A-2 for S&P, Prime-1 through Prime-2 for Moody s and F-1 through F-2 for Fitch. There may be sub-categories or gradations indicating relative standing within the rating categories set forth above. In assessing the quality of Municipal Bonds with respect to the foregoing requirements, the Investment Adviser takes into account the nature of any letters of credit or similar credit enhancement to which particular Municipal Bonds are entitled and the creditworthiness of the financial institution that provided such credit enhancement. See Appendix A Description of Municipal Bond Ratings to the statement of additional information. If unrated, such securities will possess creditworthiness comparable, in the opinion of the Investment Adviser, to other obligations in which the Fund may invest.

All percentage and ratings limitations on securities in which the Fund may invest apply at the time of making an investment and shall not be considered violated if an investment rating is subsequently downgraded to a rating that would have precluded the Fund s initial investment in such security. In the event that the Fund disposes of a portfolio security subsequent to its being downgraded, the Fund may experience a greater risk of loss than if such security had been sold prior to such downgrade.

The net asset value of the shares of common stock of a closed-end investment company, such as the Fund, which invests primarily in fixed income securities, changes as the general levels of interest rates fluctuate. When interest rates decline, the value of a fixed income portfolio can be expected to rise. Conversely, when interest rates rise, the value of a fixed income portfolio can be expected to decline. Prices of longer term securities in which the Fund primarily invests generally fluctuate more in response to interest rate changes than do shorter term securities. These changes in net asset value are likely to be greater in the case of a fund having a leveraged capital structure, such as the Fund.

The Fund intends to invest primarily in long term Municipal Bonds with maturities of more than ten years. However, the Fund also may invest in intermediate term Municipal Bonds with maturities of between three years and ten years. The Fund also may invest from time to time in short term Municipal Bonds with maturities of less than three years. The average maturity of the Fund s portfolio securities will vary based upon the Investment Adviser s assessment of economic and market conditions. As of April 30, 2005, the weighted average maturity of the Fund s portfolio was approximately 20.22 years.

For temporary periods or to provide liquidity, the Fund has the authority to invest as much as 20% of its total assets in tax exempt and taxable money market obligations with a maturity of one year or less (such short term obligations being referred to herein as Temporary Investments). In addition, the Fund reserves the right as a defensive measure to invest temporarily a greater portion of its assets in Temporary Investments, when, in the opinion of the Investment Adviser, prevailing market or financial conditions warrant. Taxable money market obligations will yield taxable income. The Fund also may invest in variable rate demand obligations (VRDOs) and VRDOs in the form of participation interests (Participating VRDOs) in variable rate tax exempt obligations held by a financial institution. See Other Investment Policies Temporary Investments. The Fund s hedging strategies, which are described in more detail under Hedging Transactions Financial Futures Transactions and Options, are not fundamental policies and may be modified by the Board of Directors of the Fund without the approval of the Fund s stockholders. The Fund is also authorized to invest in indexed and inverse floating rate obligations for hedging purposes and to seek to enhance return.

The Fund may invest in securities not issued by or on behalf of a state or territory or by an agency or instrumentality thereof, if the Fund receives an opinion of counsel to the issuer that such securities pay interest that is excludable from gross income for Federal income tax purposes (Non-Municipal Tax Exempt Securities). Non-Municipal Tax Exempt Securities could include trust certificates, partnership interests or other instruments evidencing interest in one or more long term municipal securities. Non-Municipal Tax Exempt Securities also may include securities issued by other investment companies that invest in Municipal Bonds, to the extent such investments are permitted by the Fund s investment restrictions and applicable law. Non-Municipal Tax Exempt Securities are subject to the same risks associated with an investment in Municipal Bonds as well as many of the risks associated with investments in derivatives. While the Fund receives opinions of legal counsel to the effect that the income from the Non-Municipal Tax Exempt Securities in which the Fund invests is excludable from gross income for Federal income tax purposes to the same extent as the underlying municipal securities, the Internal Revenue Service (IRS) has not issued a ruling on this subject. Were the IRS to issue an adverse ruling or take an adverse position with respect to the taxation of these types of securities, there is a risk that the interest paid on such securities would be deemed taxable at the Federal level.

The Fund ordinarily does not intend to realize significant investment income not exempt from Federal income tax. From time to time, the Fund may realize taxable capital gains.

Federal tax legislation has limited the types and volume of bonds the interest on which qualifies for a Federal income tax exemption. As a result, this legislation and legislation that may be enacted in the future may affect the availability of Municipal Bonds for investment by the Fund.

Risk Factors and Special Considerations Relating to Municipal Bonds

The risks and special considerations involved in investment in Municipal Bonds vary with the types of instruments being acquired. Investments in Non-Municipal Tax Exempt Securities may present similar risks, depending on the particular product. Certain instruments in which the Fund may invest may be characterized as derivative instruments. See Description of Municipal Bonds and Hedging Transactions Financial Futures Transactions and Options.

The value of Municipal Bonds generally may be affected by uncertainties in the municipal markets as a result of legislation or litigation, including legislation or litigation that changes the taxation of Municipal Bonds or the rights of Municipal Bond holders in the event of a bankruptcy. Municipal bankruptcies are rare, and certain provisions of the U.S. Bankruptcy Code governing such bankruptcies are unclear. Further, the application of state law to Municipal Bond issuers could produce varying results among the states or among Municipal Bond issuers within a state. These uncertainties could have a significant impact on the prices of the Municipal Bonds in which the Fund invests.

Description of Municipal Bonds

Set forth below is a detailed description of the Municipal Bonds and Temporary Investments in which the Fund may invest. Information with respect to ratings assigned to tax exempt obligations that the Fund may purchase is set forth in Appendix A Description of Municipal Bond Ratings to the statement of additional information. Obligations are included within the term Municipal Bonds if the interest paid thereon is excluded from gross income for Federal income tax purposes in the opinion of bond counsel to the issuer.

Municipal Bonds include debt obligations issued to obtain funds for various public purposes, including the construction of a wide range of public facilities, refunding of outstanding obligations and obtaining funds for general operating expenses and loans to other public institutions and facilities. In addition, certain types of bonds are issued by or on behalf of public authorities to finance various privately owned or operated facilities, including certain facilities for the local furnishing of electric energy or gas, sewage facilities, solid waste disposal facilities and other specialized facilities. Other types of industrial development bonds or private activity bonds, the proceeds of which are used for the construction, equipment or improvement of privately operated industrial or commercial facilities, may constitute Municipal Bonds, although the current Federal tax laws place substantial limitations on the size of such issues. The interest on Municipal Bonds may bear a fixed rate or be payable at a variable or floating rate. The two principal classifications of Municipal Bonds are general obligation and revenue bonds, which latter category includes PABs.

The Fund has not established any limit on the percentage of its portfolio that may be invested in IDBs or PABs. The Fund may not be a suitable investment for investors who are already subject to the Federal alternative minimum tax or who would become subject to the Federal alternative minimum tax as a result of an investment in the Fund s common stock. See Taxes.

General Obligation Bonds. General obligation bonds are secured by the issuer s pledge of its faith, credit and taxing power for the payment of principal and interest. The taxing power of any governmental entity may be limited, however, by provisions of its state constitution or laws, and an entity s creditworthiness will depend on many factors, including potential erosion of its tax base due to population declines, natural disasters, declines in the state s industrial base or inability to attract new industries, economic limits on the ability to tax without eroding the tax base, state legislative proposals or voter initiatives to limit ad valorem real property taxes and the extent to which the entity relies on Federal or state aid, access to capital markets or other factors beyond the state s or entity s control. Accordingly, the capacity of the issuer of a general obligation bond as to the timely payment of interest and the repayment of principal when due is affected by the issuer s maintenance of its tax base.

Revenue Bonds. Revenue bonds are payable only from the revenues derived from a particular facility or class of facilities or, in some cases, from the proceeds of a special excise tax or other specific revenue sources such as payments from the user of the facility being financed. Accordingly, the timely payment of interest and the repayment of principal in accordance with the terms of the revenue or special obligation bond is a function of the economic viability of such facility or such revenue source.

PABs. The Fund may purchase PABs. PABs are, in most cases, tax exempt securities issued by states, municipalities or public authorities to provide funds, usually through a loan or lease arrangement, to a private entity for the purpose of financing construction or improvement of a facility to be used by the entity. Such bonds are secured primarily by revenues derived from loan repayments or lease payments due from the entity which may or may not be guaranteed by a parent company or otherwise secured. PABs generally are not secured by a pledge of the taxing power of the issuer of such bonds. Therefore, an investor should be aware that repayment of such bonds generally depends on the revenues of a private entity and be aware of the risks that such an investment may entail. Continued ability of an entity to generate sufficient revenues for the payment of principal and interest on such bonds will be affected by many factors including the size of the entity, capital structure, demand for its products or services, competition, general economic conditions, government regulation and the entity s dependence on revenues for the operation of the particular facility being financed.

Moral Obligation Bonds. The Fund also may invest in moral obligation bonds, which are normally issued by special purpose public authorities. If an issuer of moral obligation bonds is unable to meet its obligations, the repayment of such bonds becomes a moral commitment but not a legal obligation of the state or municipality in question.

Municipal Lease Obligations. Also included within the general category of Municipal Bonds are certificates of participation (COPs) issued by government authorities or entities to finance the acquisition or construction of equipment, land and/or facilities. COPs represent participations in a lease, an installment purchase contract or a conditional sales contract (hereinafter collectively called lease obligations) relating to such equipment, land or facilities. Although lease obligations do not constitute general obligations of the issuer for which the issuer s unlimited taxing power is pledged, a lease obligation is frequently backed by the issuer s covenant to budget for,

appropriate and make the payments due under the lease obligation. However, certain lease obligations contain non-appropriation clauses which provide that the issuer has no obligation to make lease or installment purchase payments in future years unless money is appropriated for such purpose on a yearly basis. Although non-appropriation lease obligations are secured by the leased property, disposition of the property in the event of foreclosure might prove difficult and the value of the property may be insufficient to issue lease obligations. Certain investments in lease obligations may be illiquid.

Indexed and Inverse Floating Rate Securities. The Fund may invest in Municipal Bonds (and Non- Municipal Tax Exempt Securities) that yield a return based on a particular index of value or interest rates. For example, the Fund may invest in Municipal Bonds that pay interest based on an index of Municipal Bond interest rates. The principal amount payable upon maturity of certain Municipal Bonds also may be based on the value of the index. To the extent the Fund invests in these types of Municipal Bonds, the Fund s return on such Municipal Bonds will be subject to risk with respect to the value of the particular index. Interest and principal payable on the Municipal Bonds may also be based on relative changes among particular indices. Also, the Fund may invest in so-called inverse floating obligations or residual interest bonds on which the interest rates vary inversely with a short term floating rate (which may be reset periodically by a dutch auction, a remarketing agent, or by reference to a short term tax exempt interest rate index). The Fund may purchase synthetically created inverse floating rate bonds evidenced by custodial or trust receipts. Generally, income on inverse floating rate bonds will decrease when short term interest rates increase, and will increase when short term interest rates decrease. Such securities have the effect of providing a degree of investment leverage, since they may increase or decrease in value in response to changes, as an illustration, in market interest rates at a rate which is a multiple (typically two) of the rate at which fixed rate long term tax exempt securities increase or decrease in response to such changes. As a result, the market values of such securities will generally be more volatile than the market values of fixed rate tax exempt securities. To seek to limit the volatility of these securities, the Fund may purchase inverse floating obligations with shorter-term maturities or which contain limitations on the extent to which the interest rate may vary. Certain investments in such obligations may be illiquid.

When Issued Securities, Delayed Delivery Securities and Forward Commitments. The Fund may purchase or sell securities that it is entitled to receive on a when issued basis. The Fund may also purchase or sell securities on a delayed delivery basis. The Fund may also purchase or sell securities through a forward commitment. These transactions involve the purchase or sale of securities by the Fund at an established price with payment and delivery taking place in the future. The purchase will be recorded on the date the Fund enters into the commitment and the value of the securities will thereafter be reflected in the Fund s net asset value. The Fund enters into these transactions to obtain what is considered an advantageous price to the Fund at the time of entering into the transaction. The Fund has not established any limit on the percentage of its assets that may be committed in connection with these transactions. When the Fund purchases securities in these transactions, the Fund segregates liquid securities in an amount equal to the amount of its purchase commitments.

There can be no assurance that a security purchased on a when issued basis will be issued or that a security purchased or sold through a forward commitment will be delivered. A default by a counterparty may result in the Fund missing the opportunity of obtaining a price considered to be advantageous. The value of securities in these transactions on the delivery date may be more or less than the Fund s purchase price. The Fund may bear the risk of a decline in the value of the security in these transactions and may not benefit from an appreciation in the value of the security during the commitment period.

Call Rights. The Fund may purchase a Municipal Bond issuer s right to call all or a portion of such Municipal Bond for mandatory tender for purchase (a Call Right). A holder of a Call Right may exercise such right to require a mandatory tender for the purchase of related Municipal Bonds, subject to certain conditions. A Call Right that is not exercised prior to maturity of the related Municipal Bond will expire without value. The economic effect of holding both the Call Right and the related Municipal Bond is identical to holding a Municipal Bond as a non-callable security. Certain investments in such obligations may be illiquid.

Yields. Yields on Municipal Bonds are dependent on a variety of factors, including the general condition of the money market and of the municipal bond market, the size of a particular offering, the financial condition of the issuer, the maturity of the obligation and the rating of the issue. The ability of the Fund to achieve its investment objective is also dependent on the continuing ability of the issuers of the securities in which the Fund invests to meet their obligations for the payment of interest and principal when due. There are variations in the

risks involved in holding Municipal Bonds, both within a particular classification and between classifications, depending on numerous factors. Furthermore, the rights of owners of Municipal Bonds and the obligations of the issuer of such Municipal Bonds may be subject to applicable bankruptcy, insolvency and similar laws and court decisions affecting the rights of creditors generally and to general equitable principles, which may limit the enforcement of certain remedies.

Hedging Transactions

The Fund may hedge all or a portion of its portfolio investments against fluctuations in interest rates through the use of options and certain financial futures contracts and options thereon. While the Fund s use of hedging strategies is intended to reduce the volatility of the net asset value of the Fund s shares of common stock, the net asset value of the Fund s shares of common stock will fluctuate. No assurance can be given that the Fund s hedging transactions will be effective. The Fund only may engage in hedging activities from time to time and may not necessarily be engaging in hedging activities when movements in interest rates occur. The Fund has no obligation to enter into hedging transactions and may choose not to do so. Furthermore, for so long as the AMPS are rated by Moody s and S&P, the Fund s use of options and certain financial futures and options thereon will be subject to the limitations described under Rating Agency Guidelines.

Financial Futures Transactions and Options. The Fund is authorized to purchase and sell certain exchange traded financial futures contracts (financial futures contracts) in order to hedge its investments in Municipal Bonds against declines in value, and to hedge against increases in the cost of securities it intends to purchase or to seek to enhance the Fund s return. However, any transactions involving financial futures or options (including puts and calls associated therewith) will be in accordance with the Fund s investment policies and limitations. A financial futures contract obligates the seller of a contract to deliver and the purchaser of a contract to take delivery of the type of financial instrument covered by the contract, or in the case of index-based futures contracts to make and accept a cash settlement, at a specific future time for a specified price. To hedge its portfolio, the Fund may take an investment position in a futures contract which will move in the opposite direction from the portfolio position being hedged. A sale of financial futures contracts may provide a hedge against a decline in the value of portfolio securities because such depreciation may be offset, in whole or in part, by an increase in the value of the position in the financial futures contracts. A purchase of financial futures contracts may provide a hedge against an increase in the cost of securities intended to be purchased because such appreciation may be offset, in whole or in part, by an increase in the value of the position in the futures contracts.

Distributions, if any, of net long term capital gains from certain transactions in futures or options are taxable at long term capital gains rates for Federal income tax purposes. See Taxes.

Futures Contracts. A futures contract is an agreement between two parties to buy and sell a security or, in the case of an index-based futures contract, to make and accept a cash settlement for a set price on a future date. A majority of transactions in futures contracts, however, do not result in the actual delivery of the underlying instrument or cash settlement, but are settled through liquidation, *i.e.*, by entering into an offsetting transaction. Futures contracts have been designed by boards of trade which have been designated contracts markets by the Commodity Futures Trading Commission (CFTC).

The purchase or sale of a futures contract differs from the purchase or sale of a security in that no price or premium is paid or received. Instead, an amount of cash or securities acceptable to the broker and the relevant contract market, which varies, but is generally about 5% of the contract amount, must be deposited with the broker. This amount is known as initial margin and represents a good faith deposit assuring the performance of both the purchaser and seller under the futures contract. Subsequent payments to and from the broker, called variation margin, are required to be made on a daily basis as the price of the futures contract fluctuates making the long and short positions in the futures contract more or less valuable, a process known as marking to the market. At any time prior to the settlement date of the futures contract, the position may be closed out by taking an opposite position that will operate to terminate the position in the futures contract. A final determination of variation margin is then made, additional cash is required to be paid to or released by the broker and the purchaser realizes a loss or gain. In addition, a nominal commission is paid on each completed sale transaction.

The Fund deals in financial futures contracts based on a long term municipal bond index developed by the Chicago Board of Trade (CBT) and The Bond Buyer (the Municipal Bond Index). The Municipal Bond Index is comprised of 40 tax exempt municipal revenue and general obligation bonds. Each bond included in the Municipal Bond Index must be rated A or higher by Moody s or S&P and must have a remaining maturity of 19 years or more. Twice a month new issues satisfying the eligibility requirements are added to, and an equal number of old issues are deleted from, the Municipal Bond Index. The value of the Municipal Bond Index is computed daily according to a formula based on the price of each bond in the Municipal Bond Index, as evaluated by six dealer-to-dealer brokers.

The Municipal Bond Index futures contract is traded only on the CBT. Like other contract markets, the CBT assures performance under futures contracts through a clearing corporation, a nonprofit organization managed by the exchange membership which is also responsible for handling daily accounting of deposits or withdrawals of margin.

The Fund may also purchase and sell financial futures contracts on U.S. Government securities as a hedge against adverse changes in interest rates as described below. With respect to U.S. Government securities, currently there are financial futures contracts based on long term U.S. Treasury bonds, U.S. Treasury notes, Government National Mortgage Association (GNMA) Certificates and three-month U.S. Treasury bills. The Fund may purchase and write call and put options on futures contracts on U.S. Government securities and purchase and sell Municipal Bond Index futures contracts in connection with its hedging strategies.

The Fund also may engage in other futures contracts transactions such as futures contracts on other municipal bond indices that may become available if the Investment Adviser should determine that there is normally a sufficient correlation between the prices of such futures contracts and the Municipal Bonds in which the Fund invests to make such hedging appropriate.

Futures Strategies. The Fund may sell a financial futures contract (*i.e.*, assume a short position) in anticipation of a decline in the value of its investments in Municipal Bonds resulting from an increase in interest rates or otherwise. The risk of decline could be reduced without employing futures as a hedge by selling such Municipal Bonds and either reinvesting the proceeds in securities with shorter maturities or by holding assets in cash. This strategy, however, entails increased transaction costs in the form of dealer spreads and typically would reduce the average yield of the Fund s portfolio securities as a result of the shortening of maturities. The sale of futures contracts provides an alternative means of hedging against declines in the value of its investments in Municipal Bonds. As such values decline, the value of the Fund s positions in the futures contracts will tend to increase, thus offsetting all or a portion of the depreciation in the market value of the Fund s Municipal Bond investments that are being hedged. While the Fund will incur commission expenses in selling and closing out futures positions, commissions on futures transactions are lower than transaction costs incurred in the purchase and sale of Municipal Bonds. In addition, the ability of the Fund to trade in the standardized contracts available in the futures markets may offer a more effective defensive position than a program to reduce the average maturity of the portfolio securities due to the unique and varied credit and technical characteristics of the municipal debt instruments available to the Fund. Employing futures as a hedge also may permit the Fund to assume a defensive posture without reducing the yield on its investments beyond any amounts required to engage in futures trading.

When the Fund intends to purchase Municipal Bonds, the Fund may purchase futures contracts as a hedge against any increase in the cost of such Municipal Bonds resulting from a decrease in interest rates or otherwise, that may occur before such purchases can be effected. Subject to the degree of correlation between the Municipal Bonds and the futures contracts, subsequent increases in the cost of Municipal Bonds should be reflected in the value of the futures held by the Fund. As such purchases are made, an equivalent amount of futures contracts will be closed out. Due to changing market conditions and interest rate forecasts, however, a futures position may be terminated without a corresponding purchase of portfolio securities.

Call Options on Futures Contracts. The Fund may also purchase and sell exchange traded call and put options on financial futures contracts. The purchase of a call option on a futures contract is analogous to the purchase of a call option on an individual security. Depending on the pricing of the option compared to either the futures contract upon which it is based or the price of the underlying debt securities, it may or may not be less risky than ownership of the futures contract or underlying debt securities. Like the purchase of a futures contract, the Fund will purchase a call option on a futures contract to hedge against a market advance when the Fund is not fully invested.

The writing of a call option on a futures contract constitutes a partial hedge against declining prices of the securities which are deliverable upon exercise of the futures contract. If the futures price at expiration is below the exercise price, the Fund will retain the full amount of the option premium which provides a partial hedge against any decline that may have occurred in the Fund s portfolio holdings.

Put Options on Futures Contracts. The purchase of a put option on a futures contract is analogous to the purchase of a protective put option on portfolio securities. The Fund will purchase a put option on a futures contract to hedge the Fund s portfolio against the risk of rising interest rates.

The writing of a put option on a futures contract constitutes a partial hedge against increasing prices of the securities which are deliverable upon exercise of the futures contract. If the futures price at expiration is higher than the exercise price, the Fund will retain the full amount of the option premium which provides a partial hedge against any increase in the pric