THE MERGER FUND®

(MERFX)

100 Summit Lake Drive
Valhalla, New York 10595

A no-load, open-end, non-diversified investment company which seeks capital growth by engaging in merger arbitrage.

STATEMENT OF ADDITIONAL INFORMATION

February 29, 2012

This Statement of Additional Information is not a prospectus and should be read in conjunction with the prospectus of The Merger Fund dated February 29, 2012, a copy of which may be obtained without charge by contacting the Fund's Transfer Agent, U.S. Bancorp Fund Services, LLC, P.O. Box 701, Milwaukee, Wisconsin 53201-0701 or 1-800-343-8959.

The Fund's financial statements are incorporated by reference in this Statement of Additional Information from the Fund's Annual Report, a copy of which may be obtained without charge by contacting the Fund's Transfer Agent, U.S. Bancorp Fund Services, LLC, P.O. Box 701, Milwaukee, Wisconsin 53201-0701 or 1-800-343-8959.

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INVESTMENT OBJECTIVES AND POLICIES

(See "INVESTMENT OBJECTIVES AND
POLICIES" in the Fund's prospectus.)

The Merger Fund (the "Fund") is a no-load, open-end, non-diversified, registered management investment company which seeks to achieve capital growth by engaging in merger arbitrage. The Fund's investment adviser is Westchester Capital Management, LLC, 100 Summit Lake Drive, Valhalla, New York 10595 (the "Adviser").

Trading to seek short-term capital appreciation can be expected to cause the Fund's portfolio turnover rate to be substantially higher than that of the average equity-oriented investment company and, as a result, may involve increased brokerage commission costs which will be borne directly by the Fund and ultimately by its investors. See "Allocation of Portfolio Brokerage" and "Portfolio Turnover." Certain investments of the Fund may, under certain circumstances, be subject to rapid and sizable losses, and there are additional risks associated with the Fund's overall investment strategy, which may be considered speculative.

Merger Arbitrage

Under normal market conditions, the Fund invests at least 80% of its total assets principally in the equity securities of companies which are involved in publicly announced mergers, takeovers and other corporate reorganizations ("merger-arbitrage investments"). The Fund will not change this objective without providing shareholders with 60 days' advance written notice. Depending upon the level of merger activity and other economic and market conditions, the Fund may temporarily invest a substantial portion of its assets in cash or cash equivalents, including money-market instruments such as Treasury bills and other short-term obligations of the United States Government, its agencies or instrumentalities; negotiable bank certificates of deposit; commercial paper; and repurchase agreements with respect to the above securities. The Fund may also invest in various types of corporate debt obligations as part of its merger-arbitrage strategy or otherwise.

Although a variety of strategies may be employed depending upon the nature of the reorganizations selected for investment, the most common merger-arbitrage activity involves purchasing the shares of an announced acquisition target at a discount to the expected value of such shares upon completion of the acquisition. The size of the discount, or "spread," and whether the potential reward justifies the potential risk, are functions of numerous factors affecting the riskiness and timing of the acquisition. Such factors include the status of the negotiations between the two companies (for example, spreads typically narrow as the parties advance from an agreement in principle to a definitive agreement), the complexity of the transaction, the number of regulatory approvals required, the likelihood of government intervention on antitrust or other grounds, the type of consideration to be received and the possibility of competing offers for the target company.

Because the expected gain on an individual arbitrage investment is normally considerably smaller than the possible loss should the transaction be unexpectedly terminated, Fund assets will not be committed unless the proposed acquisition or other reorganization plan appears to the

Adviser to have a substantial probability of success. The expected timing of each transaction is also important since the length of time that the Fund's capital must be committed to any given reorganization will affect the rate of return realized by the Fund, and delays can substantially reduce such returns. See "Portfolio Turnover."

Investments in Corporate Debt Obligations

As part of its merger-arbitrage strategy, the Fund may invest in corporate bonds and other evidences of indebtedness ("Debt Securities") issued by companies involved in publicly announced mergers, takeovers and other corporate reorganizations, including reorganizations undertaken pursuant to Chapter 11 of the U.S. Bankruptcy Code. The Fund may also invest in other Debt Securities, subject only to the requirement that, under normal market conditions, at least 80% of the Fund's assets will be invested in merger-arbitrage situations. Some or all of these Debt Securities may carry non-investment-grade credit ratings.

Although generally not as risky as the equity securities of the same issuer, Debt Securities may gain or lose value due to changes in interest rates and other general economic conditions, industry fundamentals, market sentiment and the issuer's operating results, balance sheet and credit ratings. The market value of convertible Debt Securities will also be affected to a greater or lesser degree by changes in the price of the underlying equity securities, and the Fund may attempt to hedge certain of its investments in convertible Debt Securities by selling short the issuer's common stock. The market value of Debt Securities issued by companies involved in pending corporate mergers and takeovers may be determined in large part by the status of the transaction and its eventual outcome, especially if the Debt Securities are subject to change-of-control provisions that entitle the holder to be paid par value or some other specified dollar amount upon completion of the merger or takeover. Accordingly, the principal risk associated with investing in these Debt Securities is the possibility that the transaction may not be completed.

Over-the-Counter Option Transactions

As part of its merger-arbitrage strategy, the Fund may engage in transactions involving options and futures contracts which are traded over-the-counter ("OTC contracts"). OTC contracts differ from exchange-traded contracts in important respects. OTC contracts are transacted directly with broker-dealers, and the performance of these contracts is not guaranteed by the Options Clearing Corporation. Also, OTC contract pricing is normally done by reference to information from market makers, which information is carefully monitored by the Adviser and verified in appropriate cases.

Because OTC contracts are transacted directly with broker-dealers, there is a risk of non-performance by the broker-dealer as a result of the insolvency of such broker-dealer or otherwise, in which case the Fund may experience a loss. An OTC contract may only be terminated voluntarily by entering into a closing transaction with the broker-dealer with whom the Fund originally dealt. Any such cancellation, if agreed to, may require the Fund to pay a premium to that broker-dealer.

It is the Fund's intention to enter into OTC contracts only with broker-dealers which agree to, and which are expected to be capable of, entering into closing transactions with the Fund, although there is no assurance that a broker-dealer will voluntarily agree to terminate the transaction. There is also no assurance that the Fund will be able to liquidate an OTC contract at any time prior to expiration. OTC transactions for which there is no secondary market will be considered illiquid.

Equity-Swap Contracts

The Fund may enter into both long and short equity-swap contracts with qualified broker-dealer counterparties. A long equity-swap contract entitles the Fund to receive from the counterparty any appreciation and dividends paid on an individual security, while obligating the Fund to pay the counterparty any depreciation on the security as well as interest on the notional amount of the contract. A short equity-swap contract obligates the Fund to pay the counterparty any appreciation and dividends paid on an individual security, while entitling the Fund to receive from the counterparty any depreciation on the security as well as interest on the notional value of the contract.

The Fund may also enter into equity-swap contracts whose value is determined by the spread between a long equity position and a short equity position. This type of swap contract obligates the Fund to pay the counterparty an amount tied to any increase in the spread between the two securities over the term of the contract. The Fund is also obligated to pay the counterparty any dividends paid on the short equity holding as well as any net financing costs. This type of swap contract entitles the Fund to receive from the counterparty any gains based on a decrease in the spread as well as any dividends paid on the long equity holding and any net interest income.

Fluctuations in the value of an open contract are recorded daily as a net unrealized gain or loss. The Fund will realize gain or loss upon termination or reset of the contract. Either party, under certain conditions, may terminate the contract prior to the contract's expiration date.

Credit risk may arise as a result of the failure of the counterparty to comply with the terms of the contract. The Fund considers the creditworthiness of each counterparty to a contract in evaluating potential credit risk. The counterparty risk to the Fund is limited to the net unrealized gain, if any, on the contract, along with dividends receivable on long equity contracts and interest receivable on short equity contracts. Additionally, risk may arise from unanticipated movements in interest rates or in the value of the underlying securities.

Investments in New Issues

The Fund is permitted to invest in U.S. equity securities that are offered in initial public offerings (also referred to as "new issue" securities). New issue securities have no trading history, and there may be less public information about the companies. In addition, the prices of new issue securities may be highly volatile or may decline shortly after the initial public offering. New issues may also be subject to varying patterns of trading volume and may, at times, be difficult to sell. When an initial public offering is brought to the market, availability may be limited and the Fund may not be able to buy any shares at the offering price. The Adviser

follows written allocation procedures designed to allocate new issue securities among the Fund, The Merger Fund VL and other eligible institutional and non-registered investment accounts in a fair and equitable manner.

Investment Restrictions

The following investment restrictions have been adopted by the Fund as fundamental policies and may be changed only by the affirmative vote of a majority of the outstanding shares of the Fund. As used in this Statement of Additional Information and in the Fund's prospectus, the term "majority of the outstanding shares of the Fund" means the vote of (i) 67% or more of the Fund's shares present at a meeting, if the holders of more than 50% of the outstanding shares of the Fund are present or represented by proxy, or (ii) more than 50% of the Fund's outstanding shares, whichever is less.

These investment restrictions provide that:

(1) The Fund may not issue senior securities, except that this restriction shall not be deemed to prohibit the Fund from (a) making any permitted borrowings, loans, mortgages, or pledges, (b) entering into options, futures contracts, forward contracts, repurchase transactions or reverse repurchase transactions, or (c) making short sales of securities, in each case to the extent permitted by the Investment Company Act of 1940, as amended (the "1940 Act"), and any rule or order thereunder, or Securities and Exchange Commission ("SEC") staff interpretation thereof.

(2) The Fund may not borrow money except that it may borrow: (a) from banks to purchase or carry securities or other investments, (b) from banks for temporary or emergency purposes, (c) by entering into reverse repurchase agreements, or (d) by entering into equity swap contracts if, immediately after any such borrowing, the value of the Fund's assets, including all borrowings then outstanding less its liabilities, is equal to at least 300% of the aggregate amount of borrowings then outstanding (for the purpose of determining the 300% asset coverage, the Fund's liabilities will not include amounts borrowed), in each case to the extent permitted by the 1940 Act, and any rule or order thereunder, or Securities and Exchange Commission staff interpretation thereof. Any such borrowings may be secured or unsecured.

(3) The Fund may not underwrite or participate in the marketing of securities issued by other persons except to the extent that the Fund may be deemed to be an underwriter under federal securities laws in connection with the disposition of portfolio securities.

(4) The Fund may not purchase any securities that would cause more than 25% of the total assets of the Fund to be invested in the securities of one or more issuers conducting their principal business activities in the same industry, provided that this limitation does not apply to the securities of other investment companies, investments in obligations issued or guaranteed by the United States Government, its agencies or instrumentalities or tax-exempt municipal securities, in each case to the extent permitted by the 1940 Act, and any rule or order thereunder, or Securities and Exchange Commission staff interpretation thereof.

(5) The Fund may not purchase or sell real estate or real estate mortgage loans as such, except that the Fund may purchase securities issued by issuers, including real estate

investment trusts, which invest in real estate or interests therein, in each case to the extent permitted by the 1940 Act, and any rule or order thereunder, or Securities and Exchange Commission staff interpretation thereof.

(6) The Fund may not purchase or sell commodities or commodity contracts.

(7) The Fund will not make loans if, as a result, more than 33 1/3% of the Fund's total assets would be loaned to other parties, except that the Fund may (a) purchase or hold debt instruments in accordance with its investment objective and policies, (b) enter into repurchase agreements, and (c) lend its securities, in each case to the extent permitted by the 1940 Act, and any rule or order thereunder, or Securities and Exchange Commission staff interpretation thereof.

Although the Fund may lend its securities, the Board of Trustees may have to recall such loans to vote proxies if the Adviser has knowledge that an event will occur having a material effect on the Fund's investment in a loaned security.

When the Fund lends its securities, the Fund bears the risk of loss in the event of a decline in value of the collateral.

With respect to the fundamental policy relating to issuing senior securities set forth in (1) above, "senior securities" are defined as fund obligations that have a priority over the fund's shares with respect to the payment of dividends or the distribution of fund assets. The 1940 Act prohibits a fund from issuing senior securities except that the fund may borrow money in amounts of up to one-third of the fund's total assets from banks for any purpose. A fund also may borrow up to 5% of the fund's total assets from banks or other lenders for temporary purposes, and these borrowings are not considered senior securities. The issuance of senior securities by a fund can increase the speculative character of the fund's outstanding shares through leveraging. Leveraging of a fund's portfolio through the issuance of senior securities magnifies the potential for gain or loss on monies, because even though the fund's net assets remain the same, the total risk to investors is increased. Certain widely used investment practices that involve a commitment by a fund to deliver money or securities in the future are not considered by the SEC to be senior securities, provided that a fund segregates cash or liquid securities in an amount necessary to pay the obligation or the fund holds an offsetting commitment from another party. These investment practices include repurchase and reverse repurchase agreements, swaps, dollar rolls, options, futures and forward contracts. The policy in (1) above will be interpreted not to prevent collateral arrangements with respect to swaps, options, forward or futures contracts or other derivatives, or the posting of initial or variation margin.

With respect to the fundamental policy relating to borrowing money set forth in (2) above, the 1940 Act permits a fund to borrow money in amounts of up to one-third of the fund's total assets from banks for any purpose, and to borrow up to 5% of the fund's total assets from banks or other lenders for temporary purposes. To limit the risks attendant to borrowing, the 1940 Act requires the fund to maintain at all times an "asset coverage" of at least 300% of the amount of its borrowings. Asset coverage means the ratio that the value of the fund's total assets, minus liabilities other than borrowings, bears to the aggregate amount of all borrowings. Borrowing money to increase a fund's investment portfolio is known as "leveraging."

Borrowing, especially when used for leverage, may cause the value of a fund's shares to be more volatile than if the fund did not borrow. This is because borrowing tends to magnify the effect of any increase or decrease in the value of the fund's portfolio holdings. Borrowed money thus creates an opportunity for greater gains, but also greater losses. To repay borrowings, the fund may have to sell securities at a time and at a price that is unfavorable to the fund. There also are costs associated with borrowing money, and these costs would offset and could eliminate a fund's net investment income in any given period. The policy in (2) above will be interpreted to permit the Fund to engage in trading practices and investments that may be considered to be borrowing to the extent permitted by the 1940 Act. Reverse repurchase agreements may be considered to be a type of borrowing. Short-term credits necessary for the settlement of securities transactions and arrangements with respect to securities lending will not be considered to be borrowings under the policy. Practices and investments that may involve leverage but are not considered to be borrowings are not subject to the policy. Such trading practices may include futures, options on futures, forward contracts and other derivative investments.

With respect to the fundamental policy relating to concentration set forth in (4) above, the 1940 Act does not define what constitutes "concentration" in an industry. The SEC staff has taken the position that investment of 25% or more of a fund's total assets in one or more issuers conducting their principal activities in the same industry or group of industries constitutes concentration. It is possible that interpretations of concentration could change in the future. A fund that invests a significant percentage of its total assets in a single industry may be particularly susceptible to adverse events affecting that industry and may be more risky than a fund that does not concentrate in an industry. The policy in (4) above will be interpreted to refer to concentration as that term may be interpreted from time to time. The policy also will be interpreted to give broad authority to the Fund as to how to classify issuers within or among industries. When identifying industries or sectors for purposes of its concentration policy, the Fund may rely upon available industry classifications.

With respect to the fundamental policy relating to real estate set forth in (5) above, the 1940 Act does not prohibit a fund from owning real estate; however, a fund is limited in the amount of illiquid assets it may purchase. Investing in real estate may involve risks, including that real estate is generally considered illiquid and may be difficult to value and sell. Owners of real estate may be subject to various liabilities, including environmental liabilities. To the extent that investments in real estate are considered illiquid, the current SEC staff position generally limits a fund's purchases of illiquid securities to 15% of net assets. The policy in (5) above will be interpreted not to prevent the Fund from investing in real estate-related companies, companies whose businesses consist in whole or in part of investing in real estate, instruments (like mortgages) that are secured by real estate or interests therein, or real estate investment trust securities.

With respect to the fundamental policy relating to lending set forth in (7) above, the 1940 Act does not prohibit a fund from making loans; however, SEC staff interpretations currently prohibit funds from lending more than one-third of their total assets, except through the purchase of debt obligations or the use of repurchase agreements. (A repurchase agreement is an agreement to purchase a security, coupled with an agreement to sell that security back to the original seller on an agreed-upon date at a price that reflects current interest rates. The SEC frequently treats repurchase agreements as loans.) While lending securities may be a source of

income to a fund, as with other extensions of credit, there are risks of delay in recovery or even loss of rights in the underlying securities should the borrower fail financially. However, loans would be made only when the Adviser believes the income justifies the attendant risks. The Fund also will be permitted by this policy to make loans of money, including to other funds. The policy in (7) above will be interpreted not to prevent the Fund from purchasing or investing in debt obligations and loans. In addition, collateral arrangements with respect to options, forward currency and futures transactions and other derivative instruments, as well as delays in the settlement of securities transactions, will not be considered loans.

The following investment restrictions have been adopted by the Fund as non-fundamental policies. Non-fundamental restrictions may be amended by a majority vote of the Trustees of the Fund. Under the non-fundamental investment restrictions:

(1) The Fund will not invest more than 15% of the value of its net assets in illiquid securities and restricted securities. Restricted securities are those that are subject to legal or contractual restrictions on resale. Illiquid securities are those securities without readily available market quotations, including repurchase agreements having a maturity of more than seven days.

(2) The Fund may not purchase securities of other investment companies, except in accordance with the 1940 Act.

Under the 1940 Act, the Fund's purchase of securities of other investment companies currently is limited to, subject to certain exceptions including investments in money market mutual funds, (i) 3% of the total outstanding voting stock of any one investment company, (ii) 5% of the Fund's total assets with respect to any one investment company and (iii) 10% of the Fund's total assets with respect to investment companies in the aggregate.

If a particular percentage restriction as set forth above is adhered to at the time of investment, a later increase or decrease in percentage resulting from a change in values or assets will not constitute a violation of that restriction.

Portfolio Holdings

The Adviser and the Fund maintain portfolio-holdings disclosure policies that govern the timing and circumstances of disclosure to shareholders and third parties of information regarding the portfolio investments held by the Fund. These portfolio-holdings disclosure policies have been approved by the Board of Trustees of the Fund. Disclosure of the Fund's complete holdings is required to be made quarterly within 60 days of the end of each fiscal quarter in the Annual Report and Semi-Annual Report to Fund shareholders and in the quarterly holdings report on Form N-Q. These reports are available, free of charge, on the EDGAR database on the SEC's website at www.sec.gov or by contacting The Merger Fund c/o U.S. Bancorp Fund Services, LLC, P.O. Box 701, Milwaukee, Wisconsin 53201-0701 or calling 1-800-343-8959.

The Fund generally makes available on its website by the 18th of the month following the end of each quarter its ten largest equity holdings as of the end of the most recent calendar quarter, and the percentage of the Fund's total assets that each of these holdings represents, at www.mergerfund.com/pdfs/TMF_Fact_Sheet.pdf. This information remains available until the next quarterly fact sheet is posted on the website.

From time to time, fund-rating companies such as Morningstar, Inc. may request complete portfolio-holdings information in connection with rating the Fund. The Fund believes that these third parties have legitimate objectives in requesting such portfolio-holdings information. To prevent such parties from potentially misusing portfolio-holdings information, the Fund will generally only disclose such information as of the end of the most recent calendar quarter, with a lag of at least thirty days. In addition, the Adviser may grant exceptions to permit additional disclosure of portfolio-holdings information at differing times and with differing lag times to rating agencies, provided that (i) the recipient is subject to a confidentiality agreement, which includes a duty not to purchase or sell Fund shares or Fund portfolio holdings before the portfolio holdings become public, (ii) the recipient will utilize the information to reach certain conclusions about the investment characteristics of the Fund and will not use the information to facilitate or assist in any investment program, and (iii) the recipient will not provide access to this information to third parties, other than the Fund's service providers who need access to such information in the performance of their contractual duties and responsibilities, and are subject to duties of confidentiality.

In addition, the Fund's service providers, such as its custodian, fund administrator, fund accounting, legal counsel and transfer agent, who are subject to duties of confidentiality, including a duty not to trade on non-public information, imposed by law or contract, may receive portfolio-holdings information in connection with their services to the Fund.

The furnishing of non-public portfolio-holdings information to any third party (other than authorized governmental and regulatory personnel) requires the approval of the Adviser. The Adviser will approve the furnishing of non-public portfolio holdings to a third party only if the furnishing of such information is believed to be in the best interest of the Fund and its shareholders. No consideration may be received by the Fund, the Adviser, any affiliate of the Adviser or their employees in connection with the disclosure of portfolio-holdings information. There are currently no ongoing arrangements to make available information about the Fund's portfolio securities, other than as described above. The Board of Trustees receives and reviews annually a list of the persons who receive non-public portfolio-holdings information and the purpose for which it is furnished.

INVESTMENT ADVISER

(See "INVESTMENT ADVISER" in the Fund's prospectus.)

Investment Adviser and Advisory Contract

Mr. Roy Behren and Mr. Michael T. Shannon are primarily responsible for the day-to-day management of the Fund's portfolio. Each of Messrs. Behren and Shannon is a principal of a limited liability company that controls the Adviser.

Mr. Behren has served as Co-President of the Adviser since 2011 and also serves as Co-President, Treasurer and a Trustee of the Fund. Mr. Behren served as a research analyst for Westchester Capital Management, Inc. ("Westchester"), the Fund's previous investment adviser, from 1994 until 2010 and as the Chief Compliance Officer of Westchester and the Fund from 2004 until June 2010, and has served as a portfolio manager for the Fund since January 2007.

Mr. Shannon has served as Co-President of the Adviser since 2011 and also serves as Co-President of the Fund. Mr. Shannon served as Westchester's Director of Research from May 1996 until April 2005. From April 2005 to April 2006, Mr. Shannon was Senior Vice President in charge of the Special Situations and Mergers Group of D.E. Shaw & Co. Mr. Shannon returned to Westchester in May 2006 as a research analyst and portfolio strategist and has served as a portfolio manager for the Fund since January 2007.

The Fund's investment advisory contract with the Adviser, together with the Fee Waiver Agreement between the Fund and the Adviser (the "Advisory Contract") provides that the Fund pay all of the Fund's expenses, including, without limitation, (i) the costs incurred in connection with registration and maintenance of its registration under the Securities Act of 1933, as amended, the 1940 Act, and state securities laws and regulations, (ii) preparation, printing and mailing of reports, notices and prospectuses to current shareholders, (iii) transfer taxes on the sales of the Fund's shares and on the sales of portfolio securities, (iv) brokerage commissions, (v) custodial and shareholder transfer charges, (vi) legal, auditing, administration and accounting expenses, (vii) expenses of servicing shareholder accounts, (viii) insurance expenses for fidelity and other coverage, (ix) fees and expenses of Trustees who are not "interested persons" within the meaning of the 1940 Act, (x) expenses of Trustee and shareholder meetings and (xi) any expenses of distributing the Fund's shares which may be payable pursuant to a Plan of Distribution adopted pursuant to Rule 12b-1 under the 1940 Act. The Fund is also liable for such non-recurring expenses as may arise, including litigation to which the Fund may be a party. The Fund has an obligation to indemnify each of its officers and Trustees with respect to such litigation but not against any liability to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of his office.

Except as described below, the Adviser receives an advisory fee, payable monthly, for the performance of its services at an annual rate of 1.0% of the average daily net assets of the Fund. The fee will be accrued daily for the purpose of determining the offering and redemption price of the Fund's shares.

The Adviser has entered into an agreement with the Fund whereby the Adviser has agreed to reduce its advisory fee so that the advisory fee will be: (i) 1.0% on an annualized basis of the average daily net assets of the Fund on net assets below $1.5 billion; (ii) 0.9% on an annualized basis of the average daily net assets of the Fund on net assets between $1.5 billion and $2.0 billion; (iii) 0.8% on an annualized basis of the average daily net assets of the Fund on net assets between $2.0 billion and $5.0 billion and (iv) 0.75% on an annualized basis of the average daily net assets of the Fund on net assets over $5.0 billion. This agreement is effective for the period from January 1, 2011 through December 31, 2012 and shall continue in effect from year-to-year thereafter only upon mutual agreement of the Fund and the Adviser.

The Advisory Contract will continue in effect from year-to-year provided such continuance is approved at least annually by (i) a vote of the majority of the Fund's Trustees who are not parties thereto or "interested persons" (as defined in the 1940 Act) of the Fund or the Adviser, cast in person at a meeting specifically called for the purpose of voting on such approval and by (ii) the majority vote of either all of the Fund's Trustees or the vote of a

majority of the outstanding shares of the Fund. The Advisory Contract may be terminated without penalty on 60 days' written notice by a vote of a majority of the Fund's Trustees or by the Adviser, or by holders of a majority of the Fund's outstanding shares. The Advisory Contract shall terminate automatically in the event of its assignment. A discussion regarding the Board of Trustees' basis for approving the Advisory Contract is available in the Annual Report to Fund shareholders for the year ended September 30, 2010.

For the three months ended December 31, 2011 and the fiscal years ended September 30, 2011 and September 30, 2010, the Fund paid advisory fees of $12,593,719, $43,967,215 and $27,503,555, respectively, to Westchester or the Adviser. However, Westchester or the Adviser waived $1,639,710, $5,296,618 and $2,016,250 for the three months ended December 31, 2011 and the fiscal years ended September 30, 2011 and September 30, 2010, respectively.

Distributor and Other Service Providers

Shares of the Fund are offered on a continuous basis. As of March 1, 2012, the Fund's principal underwriter is Quasar Distributors, LLC ("Quasar"), 615 East Michigan Street, Milwaukee, Wisconsin 53202. Quasar is a Delaware limited liability company organized in 2000, and is currently wholly-owned by U.S. Bancorp Fund Services, LLC, the Fund's administrator, transfer agent, dividend-paying agent and accounting services agent. Quasar is a broker-dealer registered under the Securities Exchange Act of 1934, as amended, and a member of the Financial Industry Regulatory Authority.

The Board of Trustees of the Fund has approved a Distribution Agreement (the "Distribution Agreement") pursuant to which Quasar acts as the Fund's non-exclusive agent for the sale and distribution of the Fund's shares on a best efforts basis, provides certain administration services and promotes and arranges for the sale of the Fund's shares. The Distribution Agreement provides that the Fund will pay Quasar a base annual fee, fees for sales literature compliance reviews and certain out-of-pocket expenses.

The Distribution Agreement has an initial term of two years and will continue in effect only if such continuance is specifically approved at least annually by the Board or by the vote of a majority of the Fund's outstanding voting securities and, in either case, by a majority of the Independent Trustees. The Distribution Agreement may be terminated without penalty, including by the Fund on 60 days' written notice when authorized either by a majority vote of the Independent Trustees or by the vote of a majority of the Fund's outstanding voting securities, and will automatically terminate in the event of its "assignment" (as defined in the 1940 Act).

The Fund has adopted an amended and restated plan of distribution dated February 21, 2012 (the "Plan") pursuant to Rule 12b-1 under the 1940 Act. Under the Plan, the Fund may pay to Quasar, to any broker-dealer with whom the Fund has entered into a contract to distribute Fund shares, or to any other qualified financial services firm, compensation for distribution and/or shareholder-related services with respect to shares held or purchased by their respective customers or in connection with the purchase of shares attributable to their efforts. The amount of such compensation paid in any one year shall not exceed 0.25% annually of the average daily net assets of the Fund.

The Plan provides that the Trustees will review, at least quarterly, a report of distribution expenses incurred under the Plan and the purposes for which such expenses were incurred. The Plan will remain in effect from year to year provided such continuance is approved at least annually by the vote of a majority of the Fund's Trustees who are not "interested persons" (as defined in the 1940 Act) of the Fund, the Adviser or Quasar and who have no direct or indirect interest in the operation of the Plan or any related agreement (the "Rule 12b-1 Trustees"), cast in person at a meeting called for the purpose of voting on such approval, and additionally by a vote of either a majority of the Fund's Trustees or a majority of the outstanding shares of the Fund.

The Plan may be terminated at any time by vote of a majority of the Rule 12b-1 Trustees or by vote of a majority of the Fund's outstanding shares. The Plan may not be amended to increase materially the amount of distribution expenses payable under the Plan without approval of the Fund's shareholders. In addition, all material amendments to the Plan must be approved by the Fund's Trustees in the manner described above.

The Fund has entered into service agreements with, among others, Charles Schwab & Company, Inc. ("Schwab") and National Financial Services Corporation ("NFSC"). Though the terms of the Fund's agreements vary, service providers generally are required to provide various shareholder services to the Fund, including records maintenance, shareholder communications, transactional services, tax information and reports, and facilitation of purchase and redemption orders. Payments generally are made under the Plan at the annual rate of 0.25% of the average daily net assets of the Fund. In the case of the Fund's agreements with Schwab, NFSC and certain other service providers, the Fund pays out of its assets, but not pursuant to the Plan, additional amounts representing the cost of such service provider providing other permitted services. The Fund and/or the Adviser is required to make these payments to its service providers regardless of any actual expenses incurred by them.

The Fund incurred total expenses of $3,144,918, $10,771,317 and $6,575,889 during the three months ended December 31, 2011 and the fiscal years ended September 30, 2011 and September 30, 2010, respectively, under its agreements with its service providers. During the three months ended December 31, 2011, the Fund paid $515,540 to Schwab and $1,293,360 to NFSC. During the fiscal year ended September 30, 2011, the Fund paid $1,887,033 to Schwab and $4,482,905 to NFSC. During the fiscal year ended September 30, 2010, the Fund paid $1,426,172 to Schwab and $2,948,168 to NFSC. During the three months ended December 31, 2011, the Fund paid the following amounts for the following services under the Plan:

Advertising……………………………	$22,238
Printing and mailing of prospectuses to other than current shareholders……….	1,766
Compensation to broker-dealers……...	2,460,226
Compensation to sales personnel….….	0
Interest, carrying or other financing charges……………………………..…	0

Other………………………………. 0

SECTION 15(f) OF THE 1940 ACT

On October 12, 2010, Westchester, the Fund's previous investment adviser, and Frederick W. Green, Westchester's President and the former President and a former Trustee of the Fund, entered into an agreement to transfer substantially all of its business and assets to the Adviser (the "Transaction"). Under the 1940 Act, the closing of the Transaction resulted in the assignment, and automatic termination, of the Fund's investment advisory agreement with Westchester. The investment advisory agreement with the Adviser was approved by the Board of Trustees on September 25, 2010 and by the Fund's shareholders at a special meeting held on November 24, 2010. The closing of the Transaction occurred on December 31, 2010.

Section 15(f) of the 1940 Act provides a safe harbor for the receipt by an investment adviser or any of its affiliated persons of any amount or benefit in connection with an assignment of an advisory contract as long as two conditions are satisfied.

The first condition requires that no "unfair burden" be imposed on the Fund as a result of the Transaction, or as the result of any express or implied terms, conditions or understandings applicable to the Transaction. The term "unfair burden," as defined in the 1940 Act, includes any arrangement during the two-year period after the assignment whereby the investment adviser (or predecessor or successor adviser), or any interested person of any such investment adviser, receives or is entitled to receive any compensation, directly or indirectly, from the investment company or its security holders (other than fees for bona fide investment advisory or other services) or from any person in connection with the purchase or sale of securities or other property to, from or on behalf of the investment company. The second condition specifies that, during the three-year period immediately following consummation of the change of control transaction, at least 75% of the investment company's board of directors or trustees must not be "interested persons" (as defined in the 1940 Act) of the investment adviser or predecessor adviser. If either condition is not met, the safe harbor is not available.

Consistent with the first condition of Section 15(f), Westchester and the Adviser have agreed to refrain from imposing or seeking to impose, for a period of two years after the closing of the Transaction, any "unfair burden" on the Fund.

With respect to the second condition of Section 15(f), the Board currently satisfies such 75% requirement. The Board has appointed Mr. Behren to fill the vacancy created by Mr. Green's resignation. The Adviser has agreed to use its reasonable best efforts to ensure continued satisfaction of the 75% requirement for the three-year period following the closing of the Transaction.

MANAGEMENT

Trustees and Officers

The business and affairs of the Fund are managed under the direction of the Fund's Board of Trustees. The Fund's Trustees and officers are listed below. Except as indicated, each Trustee has held the office shown or other offices in the same company for the last five years.

Name, Address and Age	Position(s) Held with the Fund	Term of Office and Length of Time Served	Principal Occupation(s) During the Past 5 Years	Number of Portfolios in Fund Complex Overseen by Trustee**	Other Directorships Held by Trustee
Interested Trustee Roy Behren* Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 51	Co-President, Treasurer and Trustee	Indefinite; since 2011	Co-Portfolio Manager and Co-President of Westchester Capital Management, LLC, the Fund's Adviser, since 2011. Co-Portfolio Manager of Westchester Capital Management, Inc., the Fund's previous adviser, from 2007 to 2010. Research analyst for Westchester Capital Management, Inc. from 1994 until 2010. Chief Compliance Officer of the Fund and Westchester Capital Management, Inc. from 2004 to 2010.	1	None
Non-Interested Trustee Michael J. Downey c/o Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 68	Independent Trustee	Indefinite; since 1995	Private investor. Consultant and independent financial adviser since July 1993.	2	Chairman and Director of The Asia Pacific Fund, Inc. Director of AllianceBernstein core mutual fund group
Non-Interested Trustee James P. Logan, III c/o Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 75	Independent Trustee	Indefinite; since 1989	Chairman of J.P. Logan & Company. Chairman of Logan-Chace, LLC, an executive search firm.	2	None
Non-Interested Trustee Barry Hamerling	Independent	Indefinite;	Managing Partner of	2	Trustee of AXA

c/o Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 65	Trustee	since 2007	Premium Ice Cream of America since 1999. Managing Partner of Let-US Creations from 1999 to 2011.		Premier VIP Trust
Officers					
Michael T. Shannon Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 45	Co-President	One-year term; since 2011	Co-Portfolio Manager and Co-President of Westchester Capital Management, LLC, the Fund's Adviser, since 2011. Co-Portfolio Manager of Westchester Capital Management, Inc., the Fund's previous adviser, from 2007 to 2010.	N/A	N/A
Bruce Rubin Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 52	Vice President, Chief Compliance Officer and Anti-Money Laundering Compliance Officer	One-year term; since 2010	Chief Operating Officer of Westchester Capital Management, LLC, the Fund's Adviser. Chief Operating Officer of Westchester Capital Management, Inc., the Fund's previous adviser, from 2010 to 2010. Chief Operating Officer of Seneca Capital from 2005 to 2010.	N/A	N/A
Jane Perl Westchester Capital Management, LLC 100 Summit Lake Drive Valhalla, NY 10595 Age: 63	Secretary	One-year term; since 2011	Operations Manager of Westchester Capital Management, LLC. Operations Manager of Westchester Capital Management, Inc., the Fund's previous adviser, from 1988 to 2010.	N/A	N/A

* Denotes a trustee who is an "interested person" (as that term is defined in Section 2(a)(19) of the 1940 Act) of the Fund or of the Fund's investment adviser. Mr. Behren is deemed to be an interested person because of his affiliation with the Fund's investment adviser, Westchester Capital Management, LLC, and because he is an officer of the Fund.

** The fund complex consists of the Fund and The Merger Fund VL.

LEADERSHIP STRUCTURE AND THE BOARD OF TRUSTEES

The Board of Trustees currently is comprised of four Trustees, three of whom are not "interested persons" (as that term is defined in the 1940 Act) of the Fund (the "Independent Trustees"). Thus, 75% of the Board is presently independent. Roy Behren, Co-President of the

Fund, acts as Chairman of the Board and is an "interested person" (as that term is defined in the 1940 Act) of the Fund. The Chairman presides at all meetings of the Board.

The Board has appointed Barry Hamerling, Chairman of the Fund's Audit Committee, to serve as Lead Independent Trustee. The Lead Independent Trustee, among other things, chairs executive sessions of the Independent Trustees, serves as a spokesperson for the Independent Trustees and serves as a liaison between the Fund's other Independent Trustees and the Fund's management, Chief Compliance Officer, service providers, auditors and counsel between Board meetings. The Fund believes this structure allows all of the Independent Trustees to participate in the full range of the Board's responsibilities with respect to its oversight of the Fund's management. The Board has determined that this leadership structure, including the role of the Lead Independent Trustee, is appropriate given the size and complexity of the Fund, the number of Trustees overseeing the Fund and the Board's oversight responsibilities, as well as the Fund's business activities.

The Board holds four regular meetings each year to consider and address matters involving the Fund. The Board also may hold special meetings to address matters arising between regular meetings. These meetings may take place in person or by telephone. The Independent Trustees also meet each quarter and additionally on an as-needed basis in executive sessions outside the presence of management. The Board has access to counsel for the Fund and independent legal counsel for the Independent Trustees for consultation concerning any issues that may occur during or between regularly scheduled Board meetings. As discussed below, the Board has established an Audit Committee and a Nominating and Compensation Committee to assist the Board in performing its oversight responsibilities.

The Board believes that, collectively, the Trustees have balanced and diverse experience, qualifications, attributes, and skills, which allow the Board to operate effectively in governing the Fund and protecting the interests of its shareholders. The Board has concluded that, based on each Trustee's experience, qualifications, attributes or skills on an individual basis and in combination with those of the other Trustees, each Trustee is qualified and should continue to serve as such.

In determining that a particular Trustee is or continues to be qualified to serve as a Trustee, the Board has considered a variety of criteria, none of which, in isolation, was controlling. Additional information about the specific experience, skills, attributes and qualifications of each Trustee, which in each case led to the Board's conclusion that the Trustee should continue to serve as a Trustee of the Fund, is provided in the table above and in the next paragraph.

Among other attributes and qualifications common to all Trustees are their ability to review critically, evaluate, question and discuss information provided to them (including information requested by the Trustees), to interact effectively with the adviser, other service providers, counsel and the Fund's independent registered public accounting firm, and to exercise effective business judgment in the performance of their duties as Trustees. Mr. Behren has experience as a portfolio manager of the Fund and two other funds advised by the Adviser; Mr. Downey has experience in the investment advisory business including as Chairman and Chief Executive Officer of a large fund complex, as director of a number of other funds and as

Chairman of a closed-end fund; Mr. Logan has experience in the investment banking industry and as an executive of a number of organizations; and Mr. Hamerling has experience as an executive of the largest financial and tax counseling firm in the United States and as a director or trustee of a number of other fund boards.

The disclosure herein of a Trustee's experience, qualifications, attributes and skills does not impose on any such person any duties, obligations, or liability that are greater than the duties, obligations, and liability imposed on such person as a member of the Board and any committee thereof in the absence of such experience, qualifications, attributes and skills.

The specific experience, qualifications, attributes or skills that led to the conclusion that each Trustee should serve as a Trustee of the Fund are as follows:

The Chairman of the Board, Roy Behren, joined Westchester, the Fund's previous investment adviser, in 1994 from the U.S. Securities and Exchange Commission. After earning a B.S. in Economics at The Wharton School, he received a J.D. degree from the University of Miami Law School and an LL.M. degree in corporate law from the New York University School of Law. He then joined the SEC's New York Regional Office, where he worked as an enforcement attorney for seven years prior to starting his investment career at Westchester. From 2004 through 2006, Mr. Behren served as a member of Redback Networks' Board of Directors and its Audit Committee. He is co-portfolio manager of the Adviser and its affiliate, Green and Smith Investment Management L.L.C., which is the manager of GS Master Trust, a master-feeder structure which consists of Hudson Valley Partners, L.P., of which Green & Smith Investment Management is the general partner, and The Merger Fund Ltd., of which Green & Smith Investment Management is investment adviser. Mr. Behren was the Chief Compliance Officer of Westchester and the Fund from September 2004 through June 2010.

Michael J. Downey has been an Independent Trustee of the Fund since 1995 and an Independent Trustee of The Merger Fund VL since its inception. Currently a private investor, Mr. Downey has significant investment experience. In 2003, Mr. Downey was appointed as an independent consultant to Bear Stearns, Inc., an investment banking and securities brokerage firm, and was responsible for the procurement of independent research according to a 2003 settlement agreement between the SEC, NASD (now FINRA), New York Stock Exchange, and ten of the largest United States investment firms to address issues of conflicts of interest within their businesses. He was Managing Partner of Lexington Capital Investments, a private investment advisory firm., from 1997 to 2003, and has been a consultant and independent financial adviser since 1993. From 1968 to 1993, Mr. Downey was employed at Prudential Securities, Inc., an investment firm, in various roles, most recently as chairman and CEO of Prudential Mutual Fund Management. Mr. Downey currently is Chairman and Director of The Asia Pacific Fund, Inc. and a Director of AllianceBernstein core mutual fund group. Formerly, Mr. Downey served as a director of Prospect Acquisition Corp. and a director of Value Asset Management LLC. Mr. Downey received an M.B.A. from Syracuse University and a B.A. in economics from Le Moyne College.

James P. Logan, III has been an Independent Trustee of the Fund since its inception and an Independent Trustee of The Merger Fund VL since its inception. Mr. Logan has been Chairman of J.P. Logan & Company, an executive search consulting firm, since 1979. J.P.

Logan & Company has been focused exclusively on the private equity business since 1980. He has been involved with aiding private equity firms in the staffing of businesses that they own or control or are contemplating owning or controlling. In 1993 he was instrumental in forming Value Asset Management, a company formed to buy asset management companies. Value Asset Management was financed by Onex Holdings, a Canadian and New York based private equity firm. Mr. Logan supplied the CEO and two key directors for Value Asset Management, and was the finder for their first acquisition of an asset management company. Mr. Logan spent 13 years in the investment banking business from 1960 to 1973 as Managing Director, Investment Banking and General Management, of White, Weld & Co. (which was purchased by Merrill Lynch & Co., Inc. in 1978). Mr. Logan received a B.A. degree from Rutgers University.

Barry Hamerling, Lead Independent Trustee and Chairman of the Audit Committee, has been an Independent Trustee of the Fund since 2007 and an Independent Trustee of The Merger Fund VL since 2007. He has been Managing Partner of Premium Ice Cream of America since 1999 and was Managing Partner of Let-US Creations (formerly Premium Salads of America) from 1999 to 2011. From 1970 to 1999, Mr. Hamerling commenced his career as a staff attorney and retired as President of The Ayco Company, L.P., the largest financial and tax counseling firm serving Corporate America in the United States which provides advice to senior executives of 200 of the Fortune 500 companies. Mr. Hamerling is a Trustee of AXA Premier VIP Trust. He also Chairman of the Ayco Charitable Foundation, a donor-advised fund. He was formerly a Trustee and member of the audit and nominating committees of Granum Value Fund, a long-short equity fund, and a Trustee of Rutgers University. Mr. Hamerling received a B.A. from Rutgers University and a J.D. from Rutgers Law School.

The Board annually performs a self-assessment on the current members, which includes a review of the composition of the Board and its committees, including diversity of trustees' age, experience and skills; trustees' service on other boards; committee structure; size of the Board and ratio of interested to independent trustees; size of the committees and ratio of interested to independent trustees; process for identifying and recruiting new trustees; qualifications for Board membership and determination of trustee independence.

The Board has adopted a mandatory retirement policy requiring each Trustee to retire from service as a member of the Board as of the December 31 next occurring after he or she attains the age of 75. Current members of the Board may, upon the approval of a majority of the Trustees then in office, be granted a one-year extension until the following December 31. In the case of Mr. Logan, the Board granted an extension until December 31, 2013.

RISK OVERSIGHT

Consistent with its responsibility for oversight of the Fund, the Board, among other things, oversees risk management of the Fund's investment program and business affairs directly and through the committee structure that it has established. The principal risks associated with the Fund's merger-arbitrage investment strategy is that certain of the proposed reorganizations in which the Fund invests may be renegotiated or terminated, in which case losses may be realized, as well as risks related to investments in foreign securities. Other risks to the Fund include those related to non-diversification, high portfolio turnover, short sales, put and call options, borrowing and corporate debt obligations. The Board, and particularly the Lead Independent Trustee, has

substantial ongoing contacts with the adviser to review its investment strategies, techniques, policies and procedures designed to manage these risks. At each quarterly Board meeting, a portion of the report of the adviser, which includes a review of the portfolio for the previous quarter, relates to any positions which may represent an undue risk to the Fund.

The Board requires the adviser and the Chief Compliance Officer of the Fund to report to the full Board on a variety of matters at regular meetings of the Board, including matters relating to risk management. The Audit Committee also receives regular reports from the Fund's independent registered public accounting firm on internal control and financial reporting matters. On a quarterly basis, the Board meets with the Fund's chief compliance officer to discuss issues related to Fund compliance. On an annual basis, the Board receives a written report from the chief compliance officer on the operation of the Fund's policies and procedures and those of its service providers. The report addresses the operation of the policies and procedures of the Fund and each service provider since the last report, any material changes to the policies and procedures since the last report, any recommendations for material changes to the policies and procedures as a result of the annual review and any material compliance matters since the date of the last report. These annual reviews are conducted in conjunction with the Board's risk oversight function and enable the Board to review and assess any material risks facing the Fund or its service providers.

In addition, at regular Board meetings, and on an as needed basis, the Board receives and reviews reports from the adviser and the administrator related to the investments, performance and operations of the Fund, as well as reports on the valuation of certain investments. The Board also requires the adviser to report to the Board on other matters relating to risk management on a regular and as-needed basis. The Lead Independent Trustee periodically meets with representatives of the Fund's service providers, including the adviser, administrator, transfer agent, custodian and independent registered public accounting firm, to review and discuss the activities of the Fund and to provide direction with respect thereto.

In the event that market quotations are not readily available or such quotations are believed to be unrepresentative of fair market value, fair value is determined in good faith by the Adviser acting pursuant to the direction of the Board of Trustees. The Adviser monitors and reviews pricing procedures and makes determinations of fair value when such procedures call for judgment and analysis. The method of pricing each type of security is described in such procedures along with any alternate methods that may be applicable in particular circumstances. The Adviser includes any fair-value pricing of securities in a written report to the Board of Trustees for their consideration and approval on a quarterly basis.

Remuneration

Management considers that Messrs. Downey, Logan and Hamerling are not "interested persons" (as defined in the 1940 Act) of the Fund or the Adviser. The fees of the non-interested Trustees ($50,000 per year for Board meetings, $6,000 per year for Audit Committee meetings, and $5,000 per year for the Lead Independent Trustee), in addition to their out-of-pocket expenses in connection with attendance at Trustees meetings, are paid by the Fund. For the three months ended December 31, 2011, the Fund paid the following in Trustees' fees:

COMPENSATION TABLE
(for the three months ended December 31, 2011)*

Name of Trustee	Aggregate Compensation from Fund	Pension or Retirement Benefits Accrued as Part of Fund Expenses	Estimated Annual Benefits upon Retirement	Total Compensation from Fund and Fund Complex Paid to Trustees**
Roy Behren	0	0	0	0
Michael J. Downey	$14,000	0	0	$14,500
James P. Logan, III	$14,000	0	0	$14,500
Barry Hamerling	$15,250	0	0	$15,750

* A deferred compensation plan for the benefit of the Trustees has been adopted by the Fund. Under the deferred compensation plan, each participating Trustee may elect in advance to defer cash compensation to be earned by the participant during the plan year. A participant may elect to receive payments in the form of a lump sum cash payment or in the form of an annual installment payout made over a specified period of two to ten years, with such payment to be made or begin on a specified date or upon a participant's separation of service as a member of the Board. Each participant's deferred fees will be invested in shares of the Fund. For the three months ended December 31, 2011, Mr. Hamerling accrued $15,250 as deferred compensation from the Fund.

** The fund complex consists of the Fund and The Merger Fund VL.

As of December 31, 2011, the Trustees and officers of the Fund and the Adviser's retirement funds, as a group, owned less than 1% of the Fund's outstanding shares. Furthermore, neither the Trustees who are not "interested persons" of the Fund, as that term is defined in the 1940 Act, nor members of their immediate families, own securities beneficially or of record in the Adviser or an affiliate of the Adviser.

Codes of Ethics

The Fund's Trustees and officers and employees of the Adviser are permitted to engage in personal securities transactions subject to the restrictions and procedures contained in the Fund and the Adviser's Codes of Ethics, which have been approved by the Board of Trustees in accordance with standards set forth under the 1940 Act. The Fund and the Adviser's Codes of Ethics are filed as exhibits to the Fund's Registration Statement and are available to the public.

Standing Committees

The Board of Trustees has appointed an audit committee (the "Audit Committee") presently consisting of Messrs. Downey, Logan and Hamerling, which met twice during the three months ended December 31, 2011. The purpose of the Audit Committee is to advise the full Board of Trustees with respect to accounting, auditing and financial matters affecting the Fund.

The Fund has a Nominating and Compensation Committee consisting of Messrs. Downey, Logan and Hamerling, which did not meet during the three months ended December 31, 2011. The purposes of the Nominating and Compensation Committee are to identify individuals qualified to become members of the Board, consistent with criteria approved by the Board; select and recommend to the Board the nomination of trustees for appointment by the Board or election by the shareholders; set any necessary standards or qualifications for service on the Board and set the fees of the Independent Trustees. The Nominating and Compensation Committee will consider, among other sources, nominees recommended by shareholders.

Stockholders may submit recommendations by mailing the candidate's name and qualifications to the attention of the President.

Trustee Equity Ownership as of December 31, 2011

Name of Trustee	Dollar Range of Equity Securities in the Fund	Aggregate Dollar Range of Equity Securities in All Registered Investment Companies Overseen by Trustee in Family of Investment Companies
Roy Behren	Over $100,000	Over $100,000
Michael J. Downey	$10,001-$50,000	$10,001-$50,000
James P. Logan, III[1]	$1-$10,000	$1-$10,000
Barry Hamerling	Over $100,000	Over $100,000

(1) Mr. Logan disclaims beneficial ownership of his wife's shares.

Proxy and Corporate-Action Voting Policies and Procedures

The Fund has adopted Proxy and Corporate-Action Voting Policies and Procedures that govern the voting of proxies for securities held by the Fund. The Adviser has full authority to vote proxies or act with respect to other shareholder actions on behalf of the Fund and The Merger Fund VL. The Adviser's primary consideration in voting proxies is the best interest of each Fund. The proxy-voting procedures address the resolution of potential conflicts of interest and circumstances under which the Adviser will limit its role in voting proxies. Where a proxy proposal raises a material conflict between the Adviser's interests and the Fund's interests, the Adviser will resolve the conflict by following the policy guidelines. The proxy-voting guidelines describe the Adviser's general position on proposals. The Adviser will generally vote against any management proposal that clearly has the effect of restricting the ability of shareholders to realize the full potential value of their investment. Routine proposals that do not change the structure, bylaws or operations of the corporation to the detriment of the shareholders will normally be approved. The Adviser will review certain issues on a case-by-case basis based on the financial interest of the Fund. When securities are out on loan, they are transferred into the borrower's name and are voted by the borrower, in its discretion. However, if the Adviser has knowledge that an event will occur having a material effect on the Fund's investment in a loaned security, the loan will be called in time to vote the proxy or the Adviser will enter into an arrangement which ensures that the proxies for such material events may be voted as the Fund desires. Information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available without charge, upon request, by calling the Fund's Transfer Agent at 1-800-343-8959 and on the SEC's website at www.sec.gov.

SERVICES AND PLANS OFFERED BY THE FUND

(See "PLANS OFFERED BY THE FUND" in the Fund's prospectus.)

The costs of services rendered to the Fund's investors by its transfer agent, U.S. Bancorp Fund Services, LLC ("U.S. Bancorp") are paid for by the Fund; however, in order to cover abnormal administrative costs, investors requesting an historical transcript of their account will be charged a fee based upon the number of years researched. The Fund reserves the right, on 60 days' written notice, to charge investors to cover other administrative costs of services provided to shareholders.

The Merger Fund IRA Plan

The Fund makes available an Individual Retirement Account ("IRA"), known as "The Merger Fund IRA Plan." The Merger Fund IRA Plan provides individuals with the opportunity to establish an IRA in order to purchase shares of the Fund. The Merger Fund IRA Plan can also be used for a transfer from an existing IRA, or for a rollover from a qualified retirement plan from which the individual receives a lump-sum distribution. The form of The Merger Fund IRA Plan meets the requirements of Section 408 of the Internal Revenue Code of 1986, as amended. U.S. Bank, N.A. acts as custodian for The Merger Fund IRA Plan, and the adoption of The Merger Fund IRA Plan by each individual is subject to acceptance or rejection by U.S. Bank, N.A. in its capacity as custodian.

The Fund also makes available to qualifying shareholders a "Roth IRA," which is a form of IRA created in 1997. Shareholders should consult with their own financial advisers to determine eligibility.

Other Retirement Plans

The Fund makes available certain prototype plans which provide opportunities to corporations, self-employed individuals and partnerships to establish defined benefit and defined contribution qualified retirement plans under which shares of the Fund may be purchased. Such plans can, in most cases, also accept a transfer or a rollover from an existing qualified retirement plan from which an individual receives a lump-sum distribution of the individual's entire account balance in such plan. A defined-benefit qualified retirement plan specifies what a participant's pension benefit will be, and the employer (including a self-employed individual) adopting the plan must then fund the plan on an actuarial basis so it can pay the promised benefit. A defined-contribution qualified retirement plan does not promise any definite benefit but instead provides for certain contributions to be made to the plan, and a participant's ultimate benefit depends on the amount that has accumulated in his account. U.S. Bancorp acts as custodian of the qualified plans. Each plan as adopted by an employer (including a self-employed individual) or partnership is subject to acceptance or rejection by U.S. Bancorp.

Systematic Withdrawal Plan

Shareholders participating in the Fund's Systematic Withdrawal Plan should note that disbursements may be based on the redemption of a fixed dollar amount, fixed number of shares, percent of account or declining balance. Any income, dividends and capital-gain distributions on shares held in Systematic-Withdrawal-Plan accounts should be reinvested in additional Fund shares. Systematic-Withdrawal-Plan payments will be made out of the proceeds realized from the redemption of Fund shares held in the account. These redemptions made to effect withdrawal payments may reduce or exhaust entirely the original investment held under the plan. A Systematic Withdrawal Plan may be terminated at any time by the shareholder or the Fund upon written notice and will be automatically terminated when all Fund shares in the shareholder's account under the plan have been liquidated.

Anti-Money Laundering Program

The Fund has established an Anti-Money Laundering Compliance Program (the "Program") as required by the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA PATRIOT Act"). In order to ensure compliance with this law, the Fund's Program provides for the development of internal practices, procedures and controls, designation of an anti-money laundering compliance officer, an ongoing training program and an independent audit function to determine the effectiveness of the Program.

Procedures to implement the Program include, but are not limited to, determining that the Fund's distributors and transfer agent have established proper anti-money laundering procedures, reporting suspicious and/or fraudulent activity, checking shareholder names against designated government lists, including those of the Office of Foreign Asset Control, and a complete and thorough review of all new opening account applications. The Fund will not transact business with any person or entity whose identity cannot be adequately verified under the provisions of the USA PATRIOT Act. (See "Anti-Money Laundering Compliance" in the Fund's prospectus.)

NET ASSET VALUE

(See "NET ASSET VALUE" in the Fund's prospectus.)

The net asset value per share of the Fund will be determined on each day when the New York Stock Exchange is open for business and will be computed by taking the aggregate market value of all assets of the Fund less its liabilities, and dividing by the total number of shares outstanding. Each determination will be made (i) by valuing portfolio securities, including open short positions, which are traded on the New York Stock Exchange and on the American Stock Exchange, at the last reported sales price on that exchange; (ii) by valuing portfolio securities, including open short positions, which are traded on the NASDAQ Global Market at the NASDAQ Official Closing Price; (iii) by valuing put and call options which are traded on the Chicago Board Options Exchange or any other domestic exchange at the last sale price on such exchange; (iv) by valuing listed securities and put and call options for which no sale was reported on a particular day and securities traded on the over-the-counter market at the mean between the last bid and asked prices; and (v) by valuing any securities or other assets for which market quotations are not readily available at fair value in good faith and under the supervision of the Trustees, although the actual calculation may be done by others. The Adviser may, subject to the supervision of the Board of Trustees, value securities, including options, at prices other than last-sale prices when such last-sale prices are believed unrepresentative of fair market value as determined in good faith.

The assets of the Fund received for the issue or sale of its shares, and all income, earnings, profits and proceeds thereof, subject only to the rights of creditors, shall constitute the underlying assets of the Fund. In the event of the dissolution or liquidation of the Fund, the holders of shares of the Fund are entitled to share pro rata in the net assets of the Fund available for distribution to shareholders.

ADDITIONAL INFORMATION ABOUT REDEMPTIONS

(See “REDEMPTIONS” in the Fund’s prospectus.)

Supporting documents in addition to those listed under “Redemptions” in the Fund’s prospectus will be required from executors, administrators, trustees, or if redemption is requested by one other than the shareholder of record. Such documents include, but are not restricted to, stock powers, trust instruments, certificates of death, appointments as executor, certificates of corporate authority and waiver of tax required in some states when settling estates.

Under the 1940 Act, a shareholder’s right to redeem shares and to receive payment therefor may be suspended at times: (a) when the New York Stock Exchange is closed, other than customary weekend and holiday closings; (b) when trading on that exchange is restricted for any reason; (c) when an emergency exists as a result of which disposal by the Fund of securities owned by it is not reasonably practicable or it is not reasonably practicable for the Fund fairly to determine the value of its net assets, provided that applicable rules and regulations of the Securities and Exchange Commission (or any succeeding governmental authority) will govern as to whether the conditions prescribed in (b) or (c) exist; or (d) when the Securities and Exchange Commission by order permits a suspension of the right to redemption or a postponement of the date of payment on redemption. In case of suspension of the right of redemption, payment of a redemption request will be made based on the net asset value next determined after the termination of the suspension.

PERFORMANCE INFORMATION

Average Annual Total Return

Average annual total return quotations which are used in the Fund’s prospectus are calculated according to the following formula:

$$P(1+T)^n = ERV$$

Where: P = a hypothetical initial payment of $1,000.
T = average annual total return.
n = number of years.
ERV = ending redeemable value of a hypothetical $1,000 payment made at the beginning of the period.

Under the foregoing formula, the time periods used in the prospectus will be based on rolling calendar quarters. Average annual total return, or “T” in the above formula, is computed by finding the average annual compounded rates of return over the period that would equate the initial amount invested to the ending redeemable value. Average annual total return assumes the reinvestment of all dividends and distributions.

The calculation assumes an initial $1,000 payment and assumes all dividends and distributions by the Fund are reinvested at the price stated in the Prospectus on the reinvestment dates during the period, and includes all recurring fees that are charged to all shareholder accounts.

The Fund may also calculate total return on a cumulative basis which reflects the cumulative percentage change in value over the measuring period. The formula for calculating cumulative total return can be expressed as follows:

$$\text{Cumulative Total Return} = \left[\frac{(ERV)}{P} - 1 \right]$$

Average Annual Total Return (After Taxes on Distributions)

The Fund's quotations of average annual total return (after taxes on distributions) are calculated according to the following formula:

$$P(1+T)^n = ATV_D$$

Where:

P	=	a hypothetical initial payment of $1,000.
T	=	average annual total return (after taxes on distributions).
n	=	number of years.
ATV_D	=	ending value of a hypothetical $1,000 payment made at the beginning of the period, after taxes on Fund distributions but not after taxes on sale of Fund shares.

Average Annual Total Return (After Taxes on Distributions and Sale of Fund Shares)

The Fund's quotations of average annual total return (after taxes on distributions and sale of Fund shares) are calculated according to the following formula:

$$P(1+T)^n = ATV_{DR}$$

Where:

P	=	a hypothetical initial payment of $1,000.
T	=	average annual total return (after taxes on distributions and sale of Fund shares).
n	=	number of years.
ATV_{DR}	=	ending value of a hypothetical $1,000 payment made at the beginning of the period, after taxes on Fund distributions and sale of Fund shares.

Other Information

The Fund's performance data quoted in the prospectus represents past performance and is not intended to predict or indicate future results. The return and principal value of an investment in the Fund will fluctuate, and an investor's redemption proceeds may be more or less than the original investment amount.

Comparison of Fund Performance

The performance of the Fund may be compared to data prepared by Lipper Analytical Services, Inc., Morningstar, Inc. or other independent services which monitor the performance of investment companies, and may be quoted in advertising in terms of its ranking in each

applicable universe. In addition, the Fund may use performance data reported in financial and industry publications, including Barron's, Business Week, Forbes, Fortune, Investor's Business Daily, IBC/Donoghue's Money Fund Report, Money Magazine, The Wall Street Journal and USA Today.

The Fund may from time to time use the following unmanaged index for performance comparison purposes:

S&P 500 Index — the S&P 500 is an index of 500 stocks designed to mirror the overall equity market's industry weighting. Most, but not all, large-capitalization stocks are in the Index. There are also some small-capitalization names in the Index. The Index is maintained by Standard & Poor's Corporation. It is market-capitalization weighted. There are always 500 issuers in the S&P 500. Changes are made by Standard & Poor's as needed.

TAX STATUS

(See "TAX STATUS, DIVIDENDS AND DISTRIBUTIONS" in the Fund's prospectus.)

The Fund has qualified and elected to be treated as a regulated investment company under the Internal Revenue Code of 1986, as amended (the "Code"), and intends to continue to so qualify, which requires compliance with certain requirements concerning the sources of its income, diversification of its assets, and the amount and timing of its distributions to shareholders. Such qualification does not involve supervision of management or investment practices or policies by any government agency or bureau. By so qualifying, the Fund will not be subject to federal income or excise tax on its net investment income or net capital gain which are distributed to shareholders in accordance with the applicable timing requirements. Net investment income and net capital gain of the Fund will be computed in accordance with Section 852 of the Code.

The Fund intends to distribute all of its net investment income, any excess of net short-term capital gains over net long-term capital losses, and any excess of net long-term capital gains over net short-term capital losses in accordance with the timing requirements imposed by the Code and therefore will not be required to pay any federal income or excise taxes. Required distributions, if any, of net investment income and net capital gain will be made once each fiscal year. Both types of distributions will be in shares of the Fund unless a shareholder elects to receive cash.

The Fund is subject to a 4% non-deductible excise tax on certain undistributed amounts of ordinary income and capital gain under a prescribed formula contained in Section 4982 of the Code. The formula requires payment to shareholders during a calendar year of distributions representing at least 98% of the Fund's ordinary income for the calendar year and at least 98.2% of its capital gain net income (i.e., the excess of its capital gains over capital losses) realized during the one-year period ending October 31 during such year plus 100% of any income that was neither distributed nor taxed to the Fund during the preceding calendar year. Under ordinary circumstances, the Fund expects to time its distributions so as to avoid liability for this tax.

Net investment income is made up of dividends and interest less expenses. Net capital gain for a fiscal year is computed by taking into account any capital loss carryforward of the Fund.

To be treated as a regulated investment company under Subchapter M of the Code, the Fund must, among other things, (1) derive at least 90% of its gross income in each taxable year from dividends, interest, payments with respect to securities loans, net income from certain publicly traded partnerships and gains from the sale or other disposition of stock, securities or foreign currencies, or certain other income (including, but not limited to, gains from options, futures and forward contracts) derived with respect to the business of investing in stock, securities or currencies; and (2) diversify its holdings so that at the end of each quarter of its taxable year the following two conditions are met: (a) at least 50% of the market value of the Fund's total assets is represented by cash, U.S. Government securities, securities of other regulated investment companies and other securities (for this purpose such other securities will qualify only if the Fund's investment is limited in respect to any issuer to an amount not greater than 5% of the Fund's assets and 10% of the outstanding voting securities of such issuer) and (b) not more than 25% of the value of the Fund's assets is invested in securities of any one issuer (other than U.S. Government securities or securities of other regulated investment companies).

If the Fund fails to qualify as a regulated investment company under Subchapter M of the Code in any fiscal year, it will be treated as a corporation for federal income tax purposes. As such, the Fund would be required to pay income taxes on its net investment income and net realized capital gains, if any, at the rates generally applicable to corporations. Shareholders of the Fund generally would not be liable for income tax on the Fund's net investment income or net realized capital gains in their individual capacities. Distributions to shareholders, whether from the Fund's net investment income or net realized capital gains, would be treated as taxable dividends to the extent of current or accumulated earnings and profits of the Fund.

The following discussion of tax consequences is for the general information of shareholders who are subject to tax. Shareholders that are IRAs or qualified retirement plans are generally exempt from income taxation under the Code except to the extent their shares are debt-financed property under Section 514(b) of the Code.

Distributions of taxable net investment income are taxable to shareholders as ordinary income and treated as dividends for federal income tax purposes, but may qualify for the 70% dividends-received deduction for corporations and as qualified dividend income for non-corporate shareholders to the extent discussed below. Distributions of the excess of net short-term capital gains over net long-term capital losses are taxable to shareholders as ordinary income. For tax years beginning after December 31, 2012, a 3.8% Medicare tax will apply to net investment income of an individual taxpayer earning over $200,000 ($250,000 for a joint return). Net investment income will include gross income from interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business). Net investment income will be reduced by deductions properly allocable to such income.

A portion of the dividends from the Fund's taxable net investment income may be eligible for the 70% dividends-received deduction generally available to corporations. The

eligible portion may not exceed the aggregate dividends the Fund receives from domestic corporations. However, the alternative minimum tax applicable to corporations may reduce the value of the dividends-received deduction.

A portion of the dividends from the Fund's taxable net investment income earned on or before December 31, 2012 and received by non-corporate shareholders may be eligible to be treated as qualified dividend income that is currently subject to tax at a maximum rate of 15% to the extent of the amount of qualifying dividends received by the Fund from certain domestic and foreign corporations. A non-corporate shareholder would also have to satisfy a more than 60-day holding period and other requirements with respect to any distributions of qualifying dividends in order to obtain the benefit of the lower rate. This 15% rate on qualified dividend income is currently scheduled to expire after December 31, 2012, after which time such dividends would be taxable to non-corporate shareholders at ordinary income tax rates.

Distributions of net capital gain ("capital-gain dividends") are taxable to shareholders as long-term capital gain, regardless of the length of time the shares of the Fund have been held by such shareholders. Capital-gain dividends are not eligible for the dividends-received deduction. Under current law, a non-corporate shareholder's net capital gains in tax years ending on or before December 31, 2012 will be taxed at a maximum rate of 15% and at a maximum rate of 20% thereafter.

A redemption of Fund shares by a shareholder will result in the recognition of taxable gain or loss depending upon the difference between the amount realized and the shareholder's tax basis in the Fund shares. Such gain or loss is treated as a capital gain or loss if the shares are held as capital assets. In the case of a non-corporate shareholder, if such shares were held for more than 12 months at the time of disposition, such gain will be long-term capital gain currently taxed at a maximum rate of 15% and at a maximum rate of 20% after December 31, 2012; and if such shares were held for one year or less at the time of disposition, such gain will be short-term capital gain currently taxed at a maximum rate of 35% and at a maximum rate of 39.6% after December 31, 2012. Capital gains of corporate shareholders will be long-term or short-term depending upon whether the shareholder's holding period exceeds one year, and are not subject to varying tax rates. However, any loss realized upon the redemption of shares within six months from the date of their purchase will be treated as a long-term capital loss to the extent of any distributions of capital-gain dividends with respect to such shares during such six-month period. All or a portion of any loss realized upon the redemption of shares may be deferred to the extent shares are purchased (including shares acquired by means of reinvested dividends) within 30 days before or after such redemption.

All distributions will be included in the individual shareholder's alternative minimum taxable income and in the income which may be subject to tax under the alternative minimum tax for corporations.

Distributions of taxable net investment income and net capital gain will be taxable as described above, whether received in shares or in cash. Shareholders receiving distributions in the form of additional shares will have a basis for federal income tax purposes in each share so received equal to the net asset value of a share on the reinvestment date.

All distributions of taxable net investment income and net capital gain, whether received in shares or in cash, must be reported by each taxable shareholder on his or her federal income tax return. Redemptions of shares are also subject to these reporting requirements. Dividends or distributions declared in October, November or December as of a record date in such a month, if any, will be deemed to have been received by shareholders of record of such month on December 31, if paid during January of the following year.

Distributions by the Fund result in a reduction in the net asset value of the Fund's shares. Should a distribution reduce the net asset value below a shareholder's basis, such distribution would nevertheless be taxable to the shareholder as ordinary income, qualified dividend income, or capital gain as described above, even though, from an investment standpoint, it may constitute a partial return of capital. In particular, investors should consider the tax implications of buying shares just prior to a distribution. The price of shares purchased at that time includes the amount of the forthcoming distribution. Those purchasing just prior to a distribution will then receive a partial return of capital upon the distribution, which will nevertheless be taxable to them.

If the Fund makes a "constructive sale" of an "appreciated financial position," the Fund will recognize gain as if the position were sold at fair market value on the date of such constructive sale. Constructive sales include short sales of substantially identical property, offsetting notional principal contracts with respect to substantially identical property and futures and forward contracts to deliver substantially identical property. However, transactions that otherwise would be treated as constructive sales are disregarded if closed within 30 days after the close of the taxable year and the Fund holds the position and does not hedge such position for 60 days thereafter. In addition, to the extent provided in regulations (which have not yet been promulgated), a constructive sale also occurs if a taxpayer enters into one or more other transactions (or acquires one or more positions) that have "substantially the same effect" as the transactions described above. Appreciated financial positions include positions with respect to stock, debt, instruments or partnership interests if gain would be recognized on a disposition at fair market value. If the constructive sale rules apply, adjustments are made to the basis and holding period of the affected financial position.

Equity options (including call and put options on stock) and over-the-counter options on debt securities written or purchased by the Fund will be subject to tax under Section 1234 of the Code. The character of any gain or loss recognized (i.e., long-term or short-term) generally will depend, in the case of a lapse or sale of the option, on the Fund's holding period for the option, and in the case of an exercise of the option, on the Fund's holding period for the underlying security. The purchase of a put option may constitute a short sale for federal income tax purposes, causing an adjustment in the holding period of the underlying security or a substantially identical security in the Fund's portfolio. If the Fund writes a put or call option, no gain is recognized upon its receipt of a premium. If the option lapses or is closed out, any gain or loss is treated as short-term capital gain or loss. If a call option is exercised, the character of the gain or loss depends on the holding period of the underlying security. The exercise of a put option written by the Fund is not a taxable transaction for the Fund.

Any listed non-equity options written or purchased by the Fund (including options on debt securities) will be governed by Section 1256 of the Code. Absent a tax election to the contrary, gain or loss attributable to the lapse, exercise or closing out of any such position will be

treated as 60% long-term and 40% short-term capital gain or loss, and on the last trading day of the Fund's fiscal year, all outstanding Section 1256 positions will be marked to market (i.e., treated as if such positions were closed out at their closing price on such day), with any resulting gain or loss recognized as 60% long-term and 40% short-term capital gain or loss.

Ordinarily, gains and losses realized from portfolio transactions will be treated as capital gain or loss. However, all or a portion of the gain or loss from the disposition of non-U.S. dollar denominated securities (including debt instruments, certain financial forward, futures and option contracts, and certain preferred stock) may be treated as ordinary income or loss under Section 988 of the Code. In addition, all or a portion of the gain realized from the disposition of market discount bonds may be treated as ordinary income under Section 1276 of the Code. Generally, a market discount bond is defined as any bond bought by the Fund after its original issuance at a price below its face or accreted value. If the Fund purchases a debt obligation that was originally issued at a discount, the Fund is generally required to include in gross income each year as interest income the portion of the original issue discount which accrues during such year. Finally, all or a portion of the gain realized from engaging in "conversion transactions" may be treated as ordinary income under Section 1258 of the Code. "Conversion transactions" are defined to include certain forward, futures, option and straddle transactions, transactions marketed or sold to produce capital gains, or transactions described in Treasury regulations to be issued in the future.

Offsetting positions held by the Fund involving certain financial forward, futures or options contracts (including certain foreign currency forward contracts or options) may constitute "straddles." "Straddles" are defined to include "offsetting positions" in actively traded personal property. The tax treatment of "straddles" is governed by Sections 1092 and 1258 of the Code, which, in certain circumstances, override or modify the provisions of Sections 1256 and 988. If the Fund were treated as entering into "straddles" by reason of its engaging in certain forward contracts or options transactions, such "straddles" would be characterized as "mixed straddles" if the forward contracts or options transactions comprising a part of such "straddles" were governed by Section 1256. The Fund may make one or more elections with respect to "mixed straddles." Depending on which election is made, if any, the results to the Fund may differ. If no election is made to the extent the "straddle" rules apply to positions established by the Fund, losses realized by the Fund will be deferred to the extent of unrealized gain in the offsetting position. Moreover, as a result of the "straddle" rules, short-term capital loss on "straddle" positions may be recharacterized as long-term capital loss, and long-term capital gains may be treated as short-term capital gains.

The Fund is permitted to invest in foreign equity securities and thus may invest in stocks of foreign companies that are classified under the Code as passive foreign investment companies ("PFICs"). The application of the PFIC rules may affect, among other things, the character of gain, the amount of gain or loss and the timing of the recognition and character of income with respect to PFIC stock. In addition, the Fund may be subject to tax on certain income from PFIC stock. For these reasons, the amount that must be distributed to shareholders, and which will be taxed to shareholders as ordinary income or long-term capital gain, may be affected by the Fund's ownership in PFIC stock. Distributions from a PFIC are not eligible to be treated as qualified dividend income.

Income received by the Fund from sources within foreign countries may be subject to withholding and other taxes imposed by such countries. Tax treaties and conventions between certain countries and the U.S. may reduce or eliminate such taxes. If more than 50% of the value of the Fund's total assets at the close of its taxable year consists of securities of foreign corporations, the Fund may be able to elect to "pass through" to its shareholders the amount of eligible foreign income and similar taxes paid by the Fund. If this election is made, a shareholder generally subject to tax will be required to include in gross income (in addition to taxable dividends actually received) his or her pro rata share of the foreign taxes paid by the Fund, and may be entitled either to deduct (as an itemized deduction) his or her pro rata share of foreign taxes in computing his or her taxable income or to use it as a foreign tax credit against his or her U.S. federal income tax liability, subject to certain limitations. In particular, a shareholder must hold his or her shares (without protection from risk of loss) on the ex-dividend date and for at least 15 more days during the 30-day period surrounding the ex-dividend date to be eligible to claim a foreign tax credit with respect to a gain dividend. No deduction for foreign taxes may be claimed by a shareholder who does not itemize deductions. Each shareholder will be notified within 60 days after the close of the Fund's taxable year whether the foreign taxes paid by the Fund will "pass through" for that year.

Generally, a credit for foreign taxes is subject to the limitation that it may not exceed the shareholder's U.S. tax attributable to his or her total foreign source taxable income. For this purpose, if the pass-through election is made, the source of the Fund's income will flow through to shareholders of the Fund. With respect to the Fund, gains from the sale of securities will be treated as derived from U.S. sources and certain currency fluctuation gains, including fluctuation gains from foreign currency-denominated debt securities, receivables and payables will be treated as ordinary income derived from U.S. sources. The limitation on the foreign tax credit is applied separately to foreign source passive income, and to certain other types of income. A shareholder may be unable to claim a credit for the full amount of his or her proportionate share of the foreign taxes paid by the Fund. The foreign tax credit can be used to offset only 90% of the revised alternative minimum tax imposed on corporations and individuals and foreign taxes generally are not deductible in computing alternative minimum taxable income.

Under the Code, the Fund will be required to report to the Internal Revenue Service ("IRS") all distributions of taxable net investment income and net capital gains as well as gross proceeds from the redemption or exchange of Fund shares, except in the case of certain exempt shareholders. Under the backup withholding provisions of Section 3406 of the Code, distributions of taxable net investment income and net capital gain and proceeds from the redemption or exchange of the shares of a regulated investment company may be subject to withholding of federal income tax at the rate of 28% (scheduled to increase to 31% for amounts paid after December 31, 2012) in the case of non-exempt shareholders who fail to furnish the investment company with their taxpayer identification numbers and with required certifications regarding their status under the federal income tax law, or if the Fund is notified by the IRS or a broker-dealer that withholding is required due to an incorrect TIN or a previous failure to report taxable interest or dividends. If the withholding provisions are applicable, any such distributions and proceeds, whether taken in cash or reinvested in additional shares, will be reduced by the amounts required to be withheld. Any amount withheld under the backup withholding provisions from payments made to a shareholder may be refunded or credited against such

shareholder's U.S. federal income tax liability, if any, provided that the required information is furnished to the IRS.

A 30% withholding tax will be imposed on dividends paid after December 31, 2013, and redemption proceeds paid after December 31, 2014, to (i) foreign financial institutions including non-U.S. investment funds unless they agree to collect and disclose to the IRS information regarding their direct and indirect U.S. account holders and (ii) certain other foreign entities, unless they certify certain information regarding their direct and indirect U.S. owners. To avoid withholding, foreign financial institutions will need to enter into agreements with the IRS that state that they will provide the IRS information, including the name, address and taxpayer identification number of direct and indirect U.S. account holders, comply with due diligence procedures with respect to the identification of U.S. accounts, report to the IRS certain information with respect to U.S. accounts maintained, agree to withhold tax on certain payments made to non-compliant foreign financial institutions or to account holders who fail to provide the required information, and determine certain other information as to their account holders. Other foreign entities will need to provide the name, address, and taxpayer identification number of each substantial U.S. owner or certifications of no substantial U.S. ownership unless certain exceptions apply.

Shareholders of the Fund may be subject to state and local taxes on distributions received from the Fund and on redemptions of the Fund's shares.

Each distribution is accompanied by a brief explanation of the form and character of the distribution. In January of each year the Fund issues to each shareholder a statement of the federal income tax status of all distributions.

The Fund is organized as a Massachusetts business trust and generally will not be liable for any income or franchise tax in the Commonwealth of Massachusetts. If the Fund qualifies as a regulated investment company for federal income tax purposes and pays no federal income tax, it generally will also not be liable for New York State income taxes, other than a nominal corporation franchise tax (as adjusted by the applicable New York State surtaxes).

The foregoing discussion is a general summary of certain of the material U.S. federal income tax consequences to U.S. persons (as defined below) of owning and disposing of shares in the Fund. This summary is based on the provisions of the Code, final, temporary and proposed U.S. Treasury Regulations promulgated thereunder, and administrative and judicial interpretations thereof, all as in effect on the date hereof, and all of which are subject to change, possibly with retroactive effect.

The foregoing discussion of U.S. federal income tax law relates solely to the application of that law to U.S. persons; i.e., U.S. citizens and residents and U.S. domestic corporations, estates the income of which is includible in its gross income for U.S. federal income tax purposes without regard to its source, or trusts if either: (i) a U.S. court is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all the substantial decisions of the trust or (ii) the trust was in existence on August 20, 1996 and, in general, would have been treated as a U.S. person under rules applicable prior to such time, provided the trust elects to continue such treatment thereafter. Each shareholder who

is not a U.S. person should consider the U.S. and foreign tax consequences of ownership of shares of the Fund, including the possibility that such a shareholder may be subject to a U.S. withholding tax at a rate of 30% (or at a lower rate under an applicable income tax treaty) on amounts constituting ordinary income received by him or her. For distributions made or deemed made after December 31, 2011, a nonresident alien individual or a foreign corporation may be obligated to pay U.S. tax and file a U.S. tax return with respect to gains attributable to "U.S. real property interests" that are distributed or deemed distributed by the Fund if they are attributable to distributions received by the Fund from real estate investment trusts, and the Fund may be required to withhold on such amounts.

This summary does not deal with all aspects of U.S. federal income taxation that may be relevant to particular shareholders in light of their particular circumstances. Accordingly, shareholders should consult their tax advisers about the application of the provisions of tax law described in this Statement of Additional Information in light of their particular tax situations.

ORGANIZATION AND CAPITALIZATION

General

The Fund is an open-end management investment company established under the laws of the Commonwealth of Massachusetts by a Declaration of Trust dated April 12, 1982, as amended and restated on August 22, 1989 (the "Declaration of Trust"). Previously known as the Risk Portfolio of The Ayco Fund, the Fund commenced doing business as The Merger Fund on January 31, 1989. The Fund's name was formally changed to The Merger Fund on August 22, 1989.

The Fund's activities are supervised by its Trustees, who are elected by the Fund's shareholders. The Declaration of Trust permits the Trustees to issue an unlimited number of full and fractional shares. The Trustees are also empowered by the Declaration of Trust and the By-Laws to create additional series of shares, or portfolios.

As permitted by Massachusetts law, there will normally be no meetings of shareholders for the purpose of electing Trustees unless required by the 1940 Act. In such an event, the Trustees then in office will call a shareholders' meeting for the election of Trustees. Except for the foregoing and unless removed by action of the shareholders in accordance with the Fund's By-Laws, the Trustees shall continue to hold office and may appoint successor Trustees. The Trustees shall only be liable in cases of their willful misfeasance, bad faith, gross negligence or reckless disregard of their duties.

Shares of the Fund's common stock entitle their holders to one vote per share. Shares have non-cumulative voting rights, which means that holders of more than 50% of the shares voting for the election of Trustees can elect all Trustees and, in such event, the holders of the remaining shares voting for the election of Trustees will not be able to elect any person or persons as Trustees. Shares have no preemptive or subscription rights, and are transferable. Each share represents an equal proportionate interest in the Fund.

Control Persons and Principal Shareholders

A principal shareholder is any person who owns of record or beneficially 5% or more of the outstanding shares of the Fund. A control person is one who owns beneficially or through controlled companies more than 25% of the voting securities of a company or acknowledges the existence of control.

The following entities each hold of record 5% or more of the Fund's outstanding common stock as of January 31, 2011:

NAME AND ADDRESS	PERCENT HELD
National Financial Services Corp. P.O. Box 3908 New York, NY 10008-3908	42.81%
Charles Schwab & Co. Inc. 101 Montgomery Street San Francisco, CA 94104-4151	16.15%
Wells Fargo Bank, N.A. P.O. Box 1533 Minneapolis, MN 55480-1533	13.43%

Shareholder and Trustee Liability

The Fund is an entity of the type commonly known as a "Massachusetts business trust." Under Massachusetts law, shareholders of such a trust may, under certain circumstances, be held personally liable as partners for the obligations of the trust. The Declaration of Trust contains an express disclaimer of shareholder liability for acts or obligations of the Fund and provides for indemnification out of Fund property of any shareholder held personally liable for the obligations of the Fund. Thus, the risk of a shareholder incurring financial loss on account of shareholder liability is limited to circumstances in which the Fund itself would be unable to meet its obligations. Management believes that, in view of the above, the risk of personal liability of shareholders is remote. The Declaration of Trust does not require the Fund to hold annual meetings of shareholders. However, the Fund will hold special meetings when required by federal or state securities laws. The holders of at least 10% of the Fund's outstanding shares have the right to call a meeting of shareholders for the purpose of voting upon the removal of one or more Trustees, and in connection with any such meeting, the Fund will comply with the provisions of Section 16(c) of the 1940 Act relating to shareholder communications.

The Declaration of Trust further provides that the Trustees will not be liable for errors of judgment or mistakes of fact or law, but nothing in the Declaration of Trust protects a Trustee against any liability to which he would otherwise be subject by reason of willful misfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of his office.

PORTFOLIO MANAGERS

The following table shows information regarding other accounts managed by each portfolio manager as of December 31, 2011.

Name of Portfolio Manager	Category	Number of Accounts	Total Assets in Accounts	Number of Accounts Where Advisory Fee is Based on Account Performance	Total Assets in Accounts Where Advisory Fee is Based on Account Performance
Roy Behren	Registered Investment Companies	2	$139,664,361	1	$139,664,361
	Other Pooled Investment Vehicles	2	$103,747,975	2	$103,747,975
	Other Accounts	0	$0	0	$0
Michael T. Shannon	Registered Investment Companies	2	$139,664,361	1	$139,664,361
	Other Pooled Investment Vehicles	2	$103,747,975	2	$103,747,975
	Other Accounts	0	$0	0	$0

Mr. Behren and Mr. Shannon are compensated by the Adviser.

Each of Messrs. Behren and Shannon receives compensation in the form of salary and bonus. In addition, each of Messrs. Behren and Shannon has entered into a services agreements with the Adviser under which he receives distributions in his capacity as a principal of a limited liability company that is a member of the Adviser. Their compensation is not linked by formula to the absolute or relative performance of the Fund, the Fund's net assets or to any other specific benchmark. Because Mr. Behren and Mr. Shannon are members of the Adviser, their bonus compensation is determined in large part by the Adviser's overall profitability, an important component of which is the level of fee income earned by the Adviser. Pursuant to investment advisory agreements between the Adviser and the Fund and between the Adviser and The Merger Fund VL, the Adviser is paid a fixed percentage of the net assets of each fund and, therefore, its fee income will vary as those assets increase or decrease due to investment performance and subscription and redemption activity. The term of each services agreement is for at least four years.

Messrs. Behren and Shannon also receive compensation from their interests in an affiliated non-registered investment adviser which manages an investment trust and, from time to time, other non-registered investment accounts that engage in merger arbitrage. For its services, the affiliated adviser receives both a management fee and a percentage of the profits, if any, generated by such accounts.

The fact that Messrs. Behren and Shannon serve both as portfolio managers of the Fund and The Merger Fund VL and as portfolio managers of other institutional and non-registered investment accounts creates the potential for a conflict of interest, since receipt of a portion of any profits realized by the non-registered accounts could, in theory, create an incentive to favor such accounts. However, the Adviser does not believe that Mr. Behren's and Mr. Shannon's overlapping responsibilities or the various elements of their compensation present any material conflict of interest, for the following reasons: (i) the Fund, The Merger Fund VL and the other institutional and non-registered investment accounts all engage in merger arbitrage and are managed in a similar fashion; (ii) the Adviser follows strict and detailed written allocation procedures designed to allocate securities purchases and sales among the Fund, The Merger Fund VL and the other institutional and non-registered investment accounts in a fair and equitable manner; and (iii) all allocations and fair-value pricing reports are subject to review by the Adviser's Chief Compliance Officer and subject to additional oversight by a senior officer of the Adviser.

As of December 31, 2011, Mr. Behren beneficially owned over $1,000,000 of equity securities in the Fund and Mr. Shannon beneficially owned over $1,000,000 of equity securities in the Fund.

ALLOCATION OF PORTFOLIO BROKERAGE

Subject to the supervision of the Trustees, decisions to buy and sell securities for the Fund are made by the Adviser. The Adviser is authorized by the Trustees to allocate the orders placed by it on behalf of the Fund to broker-dealers who may, but need not, provide research or other services to the Fund or the Adviser for the Fund's use. Such services may include litigation analysis and consultants' reports on regulatory and other matters. Such allocation is to be in such amounts and proportions as the Adviser may determine.

In selecting a broker-dealer to execute any given transaction, the Adviser will take the following into consideration: the best net price available; the reliability, integrity and financial condition of the broker-dealer; the size and complexity of the order; the broker-dealer's order flow in the security to be traded; the broker-dealer's willingness to commit capital to facilitate the transaction; the Adviser's soft-dollar arrangements for third-party research; and the value of the expected contribution of the broker-dealer to the investment performance of the Fund on a continuing basis.

Broker-dealers executing a portfolio transaction on behalf of the Fund may receive a commission in excess of the amount of commission another broker-dealer would have charged for executing the transaction if the Adviser determines in good faith that such commission is reasonable in relation to the value of brokerage, research and other services provided to the Fund.

In allocating portfolio brokerage, the Adviser may select broker-dealers who also provide brokerage, research and other services to other accounts over which the Adviser or its affiliate exercises investment discretion. Some of the services received as the result of Fund transactions may primarily benefit accounts other than the Fund, while services received as the result of portfolio transactions effected on behalf of those other accounts may primarily benefit the Fund.

The Adviser is unable to quantify the amount of commissions set forth below which were paid as a result of such services because a substantial number of transactions were effected through broker-dealers which provide such services but which were selected principally because of their execution capabilities. When the Fund and the other accounts over which the Adviser or its affiliate exercises investment discretion are engaged in the simultaneous purchase or sale of the same securities, the Adviser may aggregate its orders. Shares are allocated among the various accounts pro rata or in some other equitable manner consistent with the investment objectives and risk profile of each account, except where in the judgment of the Adviser the amounts are immaterial.

For the three months ended December 31, 2011 and the fiscal years ended September 30, 2011 and September 30, 2010, the Fund paid brokerage commissions of approximately $4,058,194, $18,926,736 and $11,586,708, respectively. For the three months ended December 31, 2011, the Fund paid brokerage commissions of $186,990 to one broker-dealer with respect to research services provided by third parties, an amount equal to approximately 4.61% of the brokerage commissions paid by the Fund during the period. However, the Fund paid $116,767 for research services with soft-dollar credits.

PORTFOLIO TURNOVER

The portfolio turnover rate may be defined as the ratio of the lesser of annual sales or purchases to the monthly average value of the portfolio, excluding from both the numerator and the denominator (1) securities with maturities at the time of acquisition of one year or less and (2) short positions. For the three month period ended December 31, 2011 and the fiscal year ended September 30, 2011, the Fund's portfolio turnover rate was 48.13% and 292.79%, respectively. The Fund will invest portions of its assets to seek short-term capital appreciation. The Fund's investment objective and corresponding investment policies can be expected to cause the portfolio turnover rate to be substantially higher than that of the average equity-oriented investment company.

Merger-arbitrage investments are characterized by a high turnover rate because, in general, a relatively short period of time elapses between the announcement of a reorganization and its completion or termination. The majority of mergers and acquisitions are consummated in less than six months, while tender offers are normally completed in less than two months. Liquidations and certain other types of corporate reorganizations usually require more than six months to complete. The Fund will generally benefit from the timely completion of the proposed reorganizations in which it has invested, and a correspondingly high portfolio turnover rate would be consistent with, although it would not necessarily ensure, the achievement of the Fund's investment objective. Short-term trading involves increased brokerage commissions, which expense is ultimately borne by the shareholders.

Fund management believes that the portfolio turnover rate of 48.13% for the three month period ended December 31, 2011, when annualized, and the portfolio turnover rate of 292.79% for the fiscal year ended September 30, 2011 is within the range to be expected for a merger-arbitrage fund, and anticipates that the 2012 rate will be within the same range.

INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Fund has selected PricewaterhouseCoopers LLP, 100 East Wisconsin Avenue, Suite 1800, Milwaukee, Wisconsin 53202, as its independent registered public accounting firm.

CUSTODIAN, TRANSFER AGENT, DIVIDEND-PAYING AGENT, ACCOUNTING SERVICES AGENT AND ADMINISTRATOR

U.S. Bancorp Fund Services, LLC, P.O. Box 701, Milwaukee, Wisconsin 53201-0701 is the Fund's transfer agent and dividend-paying agent. U.S. Bank, N.A. ("U.S. Bank"), Custody Operations, 1555 N. RiverCenter Drive, Suite 302, Milwaukee, WI 53102, acts as the Fund's custodian. U.S. Bancorp and U.S. Bank are affiliated companies.

The custody services performed by U.S. Bank include maintaining custody of the Fund's assets, record keeping, processing of portfolio securities transactions, collection of income, special services relating to put and call options and making cash disbursements. U.S. Bank is also custodian for The Merger Fund IRA Plan and qualified retirement plans made available by the Fund. U.S. Bank takes no part in determining the investment policies of the Fund or in deciding which securities are purchased or sold by the Fund. The Fund pays to U.S. Bank a custodian fee, payable monthly, based on a percentage of the value of the Fund's assets, plus a fee for each transaction with respect to the Fund's portfolio securities, which varies depending on the nature of the transaction. For the three months ended December 31, 2011, the Fund paid U.S. Bank a custodian fee of $103,366.

U.S. Bancorp is the Fund's transfer agent and dividend-paying agent. The transfer agent services provided by U.S. Bancorp include: performing customary transfer agent functions; making dividend and distribution payments; administering shareholder accounts in connection with the issuance, transfer and redemption of the Fund's shares; performing related record keeping services; answering shareholders correspondence; mailing reports, proxy statements, confirmations and other communications to shareholders; and filing tax information returns. U.S. Bancorp's annual transfer agent fee is equal to a maximum of $15.00 per shareholder account. For the three months ended December 31, 2011, the Fund paid U.S. Bancorp transfer agent and shareholder servicing agent fees of $234,290.

U.S. Bancorp also serves as the Fund's accounting services agent and Fund Administrator. As such, U.S. Bancorp provides a variety of administrative and accounting services to the Fund, such as accounting relating to the Fund's portfolio and portfolio transactions, the determination of net asset value and pricing of the Fund's shares of beneficial interest, and maintaining the books of account of the Fund. Accounting services for the Fund are provided pursuant to a separate agreement with U.S. Bancorp. The Fund pays U.S. Bancorp a percentage of the value of the Fund's assets. For the three months ended December 31, 2011, the Fund paid U.S. Bancorp accounting fees of $103,698.

Under the Fund Administration Servicing Agreement, U.S. Bancorp maintains the books, accounts and other documents required by the 1940 Act; prepares the Fund's financial statements and tax returns; prepares certain reports and filings with the Securities and Exchange Commission; furnishes statistical and research data, clerical, accounting and bookkeeping

services and office supplies; and generally assists in all aspects of the Fund's operations. U.S. Bancorp, as Administrator, furnishes office space and all necessary office facilities, equipment and executive personnel for performing the services required pursuant to the agreement. For the foregoing, the Fund pays U.S. Bancorp a fee, payable monthly, based on a percentage of the Fund's average daily net assets. For the three months ended December 31, 2011, the Fund paid U.S. Bancorp administration fees of $381,172. The Fund also reimburses U.S. Bancorp for all out-of-pocket expenses.

The fees charged to the Fund by U.S. Bancorp for custody, transfer agent, fund accounting and administration services are competitive with fees charged by other providers of such services within the investment company industry.

COUNSEL

The firm of Fulbright & Jaworski L.L.P. is counsel to the Fund.

EXPERTS

The financial statements of the Fund have been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, which serves as the Fund's experts in accounting and auditing. Such financial statements are incorporated herein by reference to the Annual Report of the Fund dated December 31, 2011.

FINANCIAL STATEMENTS

The statement of assets and liabilities, including the schedules of investments, of options written and of securities sold short, as of December 31, 2011, the related statement of operations for the three months ended December 31, 2011 and the fiscal year ended September 30, 2011, statements of changes in net assets for the three months ended December 31, 2011 and the fiscal years ended September 30, 2011 and 2010, financial highlights, and notes to the financial statements and the independent registered public accounting firm's report to the Trustees and shareholders of the Fund dated February 29, 2012 (included in the Fund's Annual Report) are incorporated herein by reference. A copy of the Fund's Annual Report may be obtained without charge from U.S. Bancorp by calling 1-800-343-8959.

APPENDIX

Some of the terms used in this Statement of Additional Information and the Fund's prospectus are described below.

Money-Market Instruments

Money-market instruments are liquid, short-term, high-grade debt instruments, including United States Government obligations, commercial paper, certificates of deposit and bankers' acceptances.

Repurchase Agreements

Repurchase agreements are agreements by which a person purchases a security and simultaneously commits to resell that security to the seller (a member bank of the Federal Reserve System or recognized securities dealer) at an agreed upon price on an agreed upon date within a number of days (usually not more than seven) from the date of purchase. The resale price reflects the purchase price plus an agreed upon market rate of interest which is unrelated to the coupon rate or maturity of the purchased security. A repurchase agreement involves the obligation of the seller to repurchase the securities at the agreed upon price, which obligation is in effect secured by the value of the underlying security. The Fund may enter into repurchase agreements with respect to obligations in which the Fund is authorized to invest.

Short Selling

A short sale is a transaction involving the sale of a security that is not owned by the seller, the security having been borrowed from a third party by the seller in order to make delivery to the buyer. In a transaction of this type, the seller has a continuing obligation to replace the borrowed security; and until such replacement, the broker-dealer typically retains the proceeds from the sale and the seller is required to pay to the lender any dividends or interest due to holders of the security. However, the Fund may use all or a portion of the cash proceeds of short sales to purchase additional securities or for any other Fund purpose. When the Fund does this, it is required to pledge to the broker replacement securities as collateral. The Fund may use securities it owns to meet any such collateral obligations. Although the seller's obligation to the lender can be met by purchasing the security in the open market and delivering it against the short position, the Fund will effect short sales only in anticipation of replacing the borrowed security with an identical security received upon the successful completion of a merger, acquisition or exchange offer. (This strategy is illustrated by the following example: Company A proposes to acquire Company B through a merger in which each outstanding common share of Company B is exchanged for two shares of Company A. Assume that following the announcement of the merger terms, Company A's stock is trading at $20 while Company B's shares are trading at $35, or $5 below the market value of Company A's offer (2 x $20 per A Share). Believing that the proposed merger represents an attractive arbitrage opportunity, but wanting to protect against a decline in the market price of Company A's stock prior to the completion of the acquisition, the Fund purchases 1,000 shares of Company B at a total cost of $35,000 plus commissions, and, at approximately the same time, borrows and sells short 2,000 shares of Company A, yielding proceeds of $40,000 less commissions. The Fund is now hedged;

that is, a decline in the market price of Company A's stock will not reduce the Fund's potential profit should the deal go through. Upon completion of the merger, the 1,000 shares of Company B held by the Fund are exchanged for 2,000 shares of Company A. These shares are then delivered to the lender, thereby satisfying the Fund's obligation to replace the borrowed shares, and the proceeds from the short sale become available to the Fund. In this example a profit of $5,000 less commissions and any other expenses is realized.) However, should the merger, acquisition or exchange offer be terminated or otherwise not completed, the Fund will be required to satisfy its obligation to the lender by making an open-market purchase, and to the extent the price paid exceeds the proceeds from the short sale, the Fund will incur a loss on the transaction. The amount of any such loss will be increased by the amount of any dividends or interest the Fund may be required to pay in connection with the short sale.