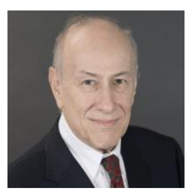
November 2023 Live Event-AICA Fall Roundtable Industry Track Panel #6; “Current State of Activism in CEFs”

Wednesday, November 15, 2023

John Cole Scott, CIO at Closed-End Fund Advisors and Founder of CEFData.com, moderates the sixth panel of the AICA November 15th, 2023 live event; “Current State of Activism in CEFs”. Read the transcript below to hear the discussion among Mr. Scott and panelists Tom DeCapo, Retired Partner and Attorney with Skadden, Arps, Slate, Meagher & Flom, Phillip Goldstein, Managing Member with Bulldog Investors, and Michael He, Vice-President with EQ Fund Solutions.

John Cole Scott

Thomas A. DeCapo



Phillip Goldstein

Michael He

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John Cole Scott: Pleased to have a wonderful group of well-known participants in the sector in different aspects to have a really thoughtful discussion. So please introduce yourself, some of you may not need introduction but it’s always helpful for the few that may not know the each of you.

Thomas A. DeCapo: I’m Tom DeCapo, I’ve been involved in the closed-end industry for over 30 years. Until recently I was a partner at the law firm of Skadden Arps in the investment management industry. I retired from law at the end of the year and talking to people about pursuing some of my own ideas in the industry.

Phillip Goldstein: I'm Phil Goldstein of Bulldog Investors, co-founder. I think we're just about finishing our, let's see, 31st year. Been investing in closed-end funds since 1974 and been an activist since about 1995, primarily in closed-ends but also somewhat in operating companies.

Michael He: My name is Michael He, I work at EQ Fund Solutions. We are a mutual fund proxy solicitation firm, and for the past 15 years or so working in this space with solicitation as well as shareholder identification.

John Cole Scott: Great. So where have you guys seen activism historically for the closed-end fund structure? And if you want to add to that, where you think five to 10 years ago versus where it is today. I'd love to see that bridge of perspective. Let's start with Phil.

Phillip Goldstein: Well, when we first became active, prior to the mid-90s there was very little activism, it was pretty sporadic. I remember one or two cases where somebody tried to take over a fund for various reasons, so I think Bulldog, most people would say that Bulldog was the originator of modern activism. It's difficult to generalize, to give a general answer to your question about five years ago versus today. That's a very difficult question because the main difference now is that the big player in the space I think is Saba, primarily because they have so much capital, that they're able to have a greater influence than Bulldog or any other activist.

But as far as the opportunities, it ebbs and flows. To tell you the truth, I don't remember five years ago. It's hard to remember, I'm getting like Biden, right? But today I could say for sure that there's a pretty good opportunity set for activism and you can just see that especially with Saba and us, and a handful of others that either support us or free ride our activities depending on how you want to characterize it.

John Cole Scott: Michael, do you want to add some perspective from your role?

Michael He: So one thing I would say I noticed since the past five, 10 years is that prior to this period we see activists mainly engaging in two kinds of tactics. One is to go after board seats, to get on the board and try to influence the fund that way, and another one is submit shareholder proposals to either convert the fund from a closed-end fund to an open-end fund or to have some other sort of liquidity event like a tender offer. Within the past few years we've seen sometimes a divergence of that tactic or addition. Saba namely, will go after the assets of the fund and become the manager of the fund instead of either liquidating the fund or just being on the board. Also most recently they've been engaged in activities that are more, I guess on the surface corporate action orientated, where they seek to go after governance issues.

So that's not something that happened before, especially in instances where they hold very little percentage of the fund. Normally activists would establish a significant position in the fund to make sure that they carry some voting power, but in some of the most recent instances they've shown to hold less than 1% of the outstanding shares. Normally, traditionally at that level it's not something that we consider a significant amount, but because of the contested elections or contested proxy, they'll have different rules than non-contested proxy events, they do have an outsized influence due to that.

Phillip Goldstein: Can I comment?

John Cole Scott: Of course.

Phillip Goldstein: Not that I speak for Saba at all, but just to comment on what I see as a distinction between us and them, other than that they have a lot more capital to throw their weight around. Bulldog has always had a history of, when we do go activist on a fund, if we're successful in getting control of the board, that it's always been our practice to allow shareholders to substantially exit their position at or very close to NAV. The primary goal is not to take over and run the fund, we have done that, but that was only after we offered an exit in a couple of cases.

So whereas with Saba, they haven't always done that, they have had some exit opportunities but they weren't as substantial as Bulldog. And with all due respect, I think that's why anybody that follows activists and relies on them to unlock value, sees us as a more trustworthy advocate if their goal is to maximize the value of their investment.

Thomas A. DeCapo: I would agree that if we go back many years, activism was quite sporadic. I think the first campaign that I was involved in was in 1996, and I'd only see a couple before that. The big change, as was indicated, is driven I think by the fact that more and more capital has been allocated to activism, and closed-end fund activism in and of itself has in essence become an investment strategy. And so we have a team of players who from time to time will take the lead in a campaign, and then we have a large group of followers who then get involved behind those campaigns. And when you add them all up, it's a significant amount of capital.

What has happened is that has progressed, not only have the campaigns become much, much more frequent, but there's enough capital to go after in essence any fund. And so there was a time when people thought if you got your fund up to a billion dollars you were safe, that was quickly proved wrong. And the campaigns have gotten much more sophisticated and much more aggressive, involving simultaneously proxy fights, litigation. Whereas litigation used to be typically used only as a tactic to force a negotiated resolution, we're now seeing litigation often taken all the way to the end and to a decision. I suspect that we will continue to see changes to the way activism is executed, in particular if the capital sticks with it and the opportunities in closed-end funds that are easier pickings get slimmer.

John Cole Scott: Thank you, Tom. I actually have a question as well for you. On the preparatory call we had talked about the importance of the closed-end fund structure, and you had some thoughts and perspective on differences between the retail ownership of the fund and institutional. I thought you could maybe embellish that a little bit with your perspective.

Thomas A. DeCapo: Sure, as I said, I've been involved in the closed-end fund industry for over 30 years. It's a unique product, to my knowledge it is the only product out there that can be offered on a wide basis to retail investors that allows for significant investment in private asset classes and a significant amount of professionally run leverage. And so I think it's very important, from a policy point of view, a very important vehicle to give retail investors the ability to access those two things for long-term returns.

One of my concerns about activism that is designed, I'm not saying all of this is designed to do this, but activism that is designed to liquidate funds, is that it removes from the investment options a vehicle that I think retail investors need. We had several panelists in earlier panels point out how you need to be in those private markets these days in order to achieve long-term returns because of the way that the public markets have evolved. And so to the extent retail investors lose those options, they're missing out on those opportunities.

John Cole Scott: Thank you. And Phil, another big part of our prep call is you had shared what are the types of details needed for activism to occur in a listed closed-end fund, and you said you might even share some secret sauce.

Phillip Goldstein: Well look, again it's difficult to generalize, but I would say certainly activism, the one filter that it has to pass, it has to be a discount, otherwise there's no point in being active. Nobody's becoming active on a fund like the Gabelli Utility fund which trades at a 100% premium, I don't know what there is to complain about. So you have to have a discount, it takes time to accumulate the shares of the discount, sometimes you wind up in what I call no-man's land. You have to accumulate enough shares to make it worthwhile to launch an activist campaign.

So if you accumulate some shares, let's say at a 15-16% discount, and then the discount narrows to 9%, what do you do? You really don't want to buy more shares at that level. Do you sit and wait for it to widen out? Maybe it will, maybe it won't, or maybe you just move on. It's very difficult to generalize, but certainly one thing you got to say is that there's got to be a discount. The next thing is, if you look at it, what are my chances to win if we do become active? That refers to the shareholder base. What kind of shareholder base is there?

I can give you my own opinion, which I shared with my co-director Moritz, that Saba is going after a fund, ADX, Adams, I forgot what they changed the name to, Adams Express Equity or something, it's basically an S&P 500 fund. Fund's been around a hundred years, the shareholder base, these are people who've owned the stock for 30-40 years, I don't think they're going to find a lot of success in pressing management, but maybe I'm wrong. Again, if you have enough capital, you can move mountains. So the answer to your question is those are the two primary factors. I would like to, as the politicians say, answer a question that you didn't ask.

John Cole Scott: It's your stage too.

Phillip Goldstein: You didn't ask this question but I've been thinking about it since we had the pre-conference call last week, and it sort of refers to what Tom was talking about, about the closed-end fund being a unique investment structure, which is absolutely true. That doesn't mean that every closed-end fund deserves to live in perpetuity regardless of performance, regardless of discount, regardless of what the shareholders want.

Just to preface my conclusion, there are times when the board of a closed-end fund, without any activists at all says you know what, "We're going to open-end this fund," or "We're going to liquidate this fund." So what came to me as I was drifting off to sleep one night is these decisions about, what do you do about a fund let's say that's trading at a 20% discount, it's been persistent, it's been out there for a year and a half? Maybe management's tried some measures to alleviate it, maybe they haven't. But the bottom line question, and maybe Tom can answer this, who makes that decision?

Who should make that decision as to whether the fund should be liquidated, open-ended or stay as it is or something else, convert to an interval fund or an ETF or whatever? And I think philosophically, I think I'm on the high moral ground by saying that's for the shareholders to decide, it's their money that's at risk. I think that's the question that management most times doesn't answer, is who should make that decision? Should it be a free and fair shareholder vote or should it be the board of directors or the manager who may in fact have undue influence over the board? I think that really cuts to the philosophical question, and apply it to any publicly traded company really, not just closed-end funds, who can decide?

I'll just finish up by saying, I remember once, going back maybe 30 years, I was at a closed-end fund conference and Barry Oliff who was running the City of London once, told me a story about talking to a director of a UK investment trust, which is similar to a US closed-end fund. And he said, "Well, what if there was a shareholder vote and 100% of the shareholders voted to open-end the fund or liquidate the fund? Would you support that?" And the guy said, "Maybe."

John Cole Scott: Tom, I'm sure you have some comments there, as Phil's taken over the panel.

Phillip Goldstein: Sorry.

Thomas A. DeCapo: No, I take Phil's point, that there are circumstances where activism plays an important role. Like all corporate governance, the day-to-day oversight of the fund falls to the board of directors, and in my experience most boards of directors take that obligation conscientiously and do consider whether changes should be made structurally, and sometimes usually as a result of a failure of the underlying investment premise, whether to liquidate a fund.

But that's I think where we get to the difference between the policy and the practicality. As a practical matter, Phil is right that shareholders ultimately make the decision, and is that the right approach when shareholders include institutional activist investors who have often the ability to run the money, to run the investment strategies on their own if they chose to do so, but aren't in it for that, they are in it for the short-term gain of liquidating the fund and closing the discount. And from a policy point of view, when that's the objective and when that results in the elimination of investment options for retail investors, then I think there's a policy problem.

That doesn't mean that I don't think that institutional investors who as a practical matter have the ability and power to do it shouldn't pursue it, it's the free market thing to do. But I do think it is a policy issue to be eliminating those long-term investment options because institutional activist investors have simply the power to do so.

John Cole Scott: So we haven't forgotten you, Michael. We'd like to ask you a two-part question. Could you cover your work with both contested and non-contested proxy campaigns, as well just the broader strategies that you encourage your clients to do to work with their investors or shareholders before, during, and potentially after a campaign?

Michael He: Sure. So in an uncontested campaign it's just standard practice to really get an understanding of the shareholder base and then really solicit the shares based on the response level that's needed. Now a lot of the what we call non-routine items that require a certain level of participation, a lot of the challenge is just to get shareholders to respond and achieve the quorum needed, usually support of the proposal is not an issue, that people when they generally vote will vote along with the board's recommendation. So the real focus is just to make sure that there are enough shares participating at the meeting to pass the proposals.

And in a contested election, it's now very difficult to do that. Mainly because one of the main tools that we have access to, which is phone calls to the unvoted shareholders and get them to vote over the phone, and then really just add to the quorum level. That tool is shut off, that phone voting is not a tool that's available, so only way for shareholders to participate in the meeting is now either voting by mailing back the proxy cards they received or online.

We find that when there's less convenience for shareholders to vote, the more difficult it is to get people to participate. At this point, which is a development over recent years, is that the activist will use that, and instead of really maybe trying to liquidate the fund or threaten the fund's existence, is that they will use that as a tool to prevent the fund from their normal operating initiative. So in the event of a merger, in the event of a reorganization or some sort of change of control process, they can deny the fund from achieving its initiative by making it much harder for the proposals to pass.

John Cole Scott: Thank you. I'm looking at the time, I'm not going to let myself go over, that'd be really rude. I'd like to now cover, first with Phil, thinking about two things we had on the call, expense ratios, both the management fees and other expenses, as you consider those at a fund, as well as distribution policies. Are they paying out what they earn? Is it level? Tell me how you look at those strategies and features as you consider activism.

Phillip Goldstein: I think that those are not what would drive the activist to launch a campaign, I think that those things, to be blunt about it, are things that you can use to paint management as not worthy of controlling the fund. If the expense ratio is high, obviously that's a weak point for management. And if the performance is not so great, that's another thing you pointed to. But as we all know, what is it they say, past performance does not guarantee future results? How many times have I read that? Those are not what I think drives somebody to become active. What drives somebody to become active is you see a disparity between the market price and the intrinsic value. That's true for any activist, whether it's Bulldog or Saba or Carl Icahn or anybody. You see a disparity between what the market is saying the price is and what you think the liquidating value or sale value of the company would be. Those other issues you talked about, dividends and so forth, are things that you would use in an activist campaign.

I will say that one of the things that you could use is if a fund has a high-dividend payout, it should be very, very, very reluctant to cut that dividend, because we all know what happens is that the stock, the people that are in it, those small investors that Tom worries about, they start bailing out. "Whoa, you cut the dividend! It was eight cents a month, now it's only five cents." They're selling. Well, who do you think's buying? Because now the discount blows out and the buyers are the activists.

And by the way, to say a good thing about activism, if it wasn't for activists discounts would probably be a lot wider, so activism in itself I think keeps discounts under control. When I first started investing in closed-ends in the mid-70s, I mean, there were funds like Tri-Continental, which was a plain vanilla closed-end fund, low expense ratio, it's trading at a 25% discount. There was no activism. The fact that there is activism, I think keeps management on its toes and hopefully proactive in controlling it.

John Cole Scott: Thank you. I know we always call that the activist [inaudible], and not always covered thoroughly. Again, I want to make sure we have time for questions, I assume there's more than a few. And so I really would just like each of you to give a last prepared thought on activism, where it is and what's going on. I want to give you a choice to speak what's top of mind for you. We would not get to all these questions without that, so I'll first start with Tom.

Thomas A. DeCapo: As I alluded to earlier, I think activism will continue to evolve, and with the amount of capital that's committed to it presently, and if more continues to be committed to it, I think we'll see a diversification of strategies, which we've begun to see and I think will continue. We've seen the strategy of open-ending or liquidating now move on to include taking over funds and continuing to manage them, presumably because there's better value long term in the value of those management contracts than a quick liquidation. We've seen an expansion beyond the US market now into the UK market of raising capital specifically for activist campaigns with respect to listed investment funds.

This will probably sound odd but I think in addition to seeing both of those continue, I think the time will come when we see activism actually move into interval funds and potentially even, and I know this sounds really crazy, open-end funds. Not because we're closing the discount but because we're looking to take over management contracts. And so if the capital is there and needs to be deployed to make a return, at some point buying to liquidate isn't going to cover it, at least for all the capital that there is, and that capital's going to have to find another way to make returns.

John Cole Scott: That was not expected. That wasn't on the prep call.

Phillip Goldstein: He's predicting way beyond what I would say. I think Yogi Berra said once, he said, "It's very hard to make predictions, especially about the future." I will join in, and actually it's interesting, the panels before us, mostly about interval funds, and they're living in a world where, "Hey, everything's working out fine, we do these 5% tender offers." And we've seen a few of them, but what's going to happen when you tender for 5% of the shares every quarter and every quarter you get 50-60% of the shares tendered? Well, we've seen what happens. What happens is they say, "Well, let's convert it to a closed-end fund, then you can have liquidity every day." Yeah, liquidity every day, but it's like all those shareholders, it's like they're released from prison, you know? And there's a brothel next door.

So what happens is you wind up with a fund at a 30-40% discount, who do you think going's to be buying that? Activists. Yogi is in his grave but I will make the prediction that at some point interval funds will, not as interval funds themselves, but if they convert to closed-end funds, they're in a bind. I don't know what to do because, yeah, they're going to provide liquidity but it's going to be at a big discount because everybody wanted to get out at the tender offer. They want to get out and they don't care about the price.

I'm dubious about the open end, I just don't see it. The only way I could see an activist trying to take over an open-end fund is if they actually put money into the fund. Which is possible, you'd have to say, "Well, look, we're going to put in a couple million dollars into the fund and make us the manager," maybe they could do that but I'm not going to predict that.

John Cole Scott: Michael, the last word of the prepared remarks are yours.

Michael He: Yeah, so one of the things that we're interested in to see what's going to happen is some of the tactics that our activists have engaged in, namely soliciting shares, and then withholding those shares at the meeting in order to prevent quorum from being reached. Now one would never think it would be legal, say in a contested election where the board solicited a number of shares and then not show up at the shareholder meeting in order to say that a quorum was not reached, therefore the incumbent board would carry over.

So if it's required for the board to present their shares, and when an activist do not show up at the shareholder meeting to do the same thing to prevent the quorum level from being reached so that a proposal does not pass, it doesn't seem like the two sides are being treated the same. We want to see if there's any sort of development in that regard, so that this practice, whether it'll continue or it'll be maybe weaponized to a larger degree, so that's something that we want to keep an eye on.

John Cole Scott: Thank you very much. And just so for people who watch the replay, we are in New York City. All right, questions from the audience, was I correct there would be a few? Yes, Bill?

Audience Question: For Phil, it seems like you have conviction on the ability to influence discounts. What happens if you don't have conviction [inaudible], do you hedge that? Or do you only pursue funds with discounts where you have conviction about the [inaudible]?

John Cole Scott: Questions about discounts and conviction on it, and the ability to hedge potentially if not.

Phillip Goldstein: I assume you're talking about a fund that would have a significant percentage of its portfolio in fair value securities, right?

Audience Question: Right.

Phillip Goldstein: Yeah, that's a deterrent. And that in itself, and I think the previous panels alluded to that, that can cause discounts itself because people don't have confidence in the valuation. Let’s face it, any time you fair value something, it’s subjective. It’s something we take into consideration. On the other hand, if the discount’s big enough, it’s something to consider. Look, there’s a fund out there, one of the Destra funds, it’s trading at a 40% discount, we think the NAV is fairly close to what they’ve stated but a lot of people doubt it. So yeah, it’s something you consider, certainly.

Audience Question: So if you generally believe the NAV [inaudible]?

Phillip Goldstein: Our practice is we don’t hedge. Now there are others that would hedge. In one case we went after a fund, we teamed up with another group, Ancora, to go after petroleum and resources, the other Adams fund. We formed a 13D group, we did not hedge, they did. We don’t find hedging the underlying assets generally to be a good strategy in the long run, but other people could disagree.

Audience Question: Why’s that?

Phillip Goldstein: Because hedging costs money and it’s subject to risk of being bought in, and it depends how easy it is to hedge it. Because let’s face it, you don’t know exactly what’s in the portfolio of a closed-end fund every day of the week. It can change and you really don’t get to see the portfolio. You can try to estimate it. So there’s a lot of risks with it, especially the buy-in risks, and the cost of borrowing is sometimes very high. It depends on what the portfolio is.

Audience Question: Hi, Phil. [inaudible]. If you had an unlevered closed-end fund at a 15% discount and they said, “Hey, Phil, we’re going to take a first stab at it to narrow this discount,” do you recommend using the capital for share repurchases, return capital of capital through a higher distribution rate, or a commitment to provide 5% annual tender offer?

Phillip Goldstein: And there are other things too. I think again it’s hard to generalize just without knowing the fund and how easy it is for them to do those things, but all those are on the table. We negotiated a settlement with two MFS funds, where they did a small, actually they just completed the 10% tender offer, and then effectively agreed to a two-year term trust structure, where if the discount doesn’t get to 7.5% in two years, that they would somehow or other wind it up.

Sometimes it’s a combination of those things, but that’s subject to negotiation, all those things are on the table. They’re all worthwhile considering but it’s hard to give an answer without a specific fund. The other thing is you got to get somebody to agree to that on the other side. When somebody says, “Oh, you’re only in it for the short-term profit,” and I say, “It’s never short enough for me.” I mean, if I owe you $10,000, when do you want me to pay it? Tomorrow or in five years?

John Cole Scott: I’ll take either.

Phillip Goldstein: It’s not a trick question.

John Cole Scott: I know. All right, well, that is it.

Recorded on November 15, 2023.

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