How Activism In Britain Holds Lessons For American Closed-End Investors

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Richard Stone, Chief Executive Officer for the Association of Investment Companies, the British equivalent to the Active Investment Company Alliance. Richard discusses the similarities and differences in the closed-end fund industry between the two countries, and how activist investors, most notably U.S. based closed-end powerhouse Saba Capital, have struggled to gain traction in boardroom battles.

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: We're talking with Richard Stone, chief executive for the Association of Investment Companies to learn about the closed-end funds scene in Great Britain and how lessons there might apply in the US, welcome to The NAVigator. This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, which is a unique industry organization representing the full spectrum of the closed-end fund business, from investors and users to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. And today, we're pointed across the pond, as I am joined by Richard Stone, chief executive officer for the Association of Investment Companies, which is the British counterpart to the Active Investment Company Alliance, and if you want to dig into more details of any of the things we discuss, there's plenty of good information available at TheAIC.co.uk. You can learn more about closed-end funds, interval funds, and business-development companies generally by visiting AICAlliance.org, it's the website for the Active Investment Company Alliance. Richard Stone, welcome to The NAVigator.

RICHARD STONE: Hi Chuck, good to speak to you.

CHUCK JAFFE: The mutual fund and closed-end fund scene in Great Britain is a lot older than the one here, even though the one here has now been around for a century, I think everything's a little older in Great Britain, but it's going through a lot of the same sorts of governance challenges and other things there that we've been seeing here; with one significant difference, which it seems like the funds and the consumers are winning the consumer issuers there more than they have been here. So give us a quick overview, they are largely similar industries but they're not identical, so help us understand a little bit about the industry there, and then the challenges that you've been seeing that the industry has been beating back.

RICHARD STONE: Yeah, of course, Chuck. So the industry over here, as you say, has been around a long time, I think 150 plus years now, the first investment company here, as we call them, or listed closed-end fund, were set up back in 1868, so yeah, been around a long time. I think in the UK, relative to the US, what we've seen is in recent years the sector evolved particularly into more alternative assets, so real assets in spaces like infrastructure, renewable energy, the net-zero transition, et cetera. The vehicle is particularly good for giving access for investors to diversify a portfolio of less liquid assets, which might be small cap listed equities, but it might be real assets, it might be private equity, private capital as well. And so the sector here has grown successfully over recent years, we've got 260 billion sterling in assets roughly in the sector, over 300 companies where more than a quarter of the 350 largest companies listed in London now are listed closed-end funds. But in the last couple of years, particularly when we saw the interest rate cycle turn, obviously through Covid we had the very low interest rates, as that turned, and turned very quickly, companies went to a discount, particularly those companies where they were offering what were very attractive yields, which obviously with higher base rates, higher interest rates, suddenly don't look like they're so attractive, so we've seen a lot of the companies go to relatively wide discounts, and those discounts have been persistent for some time. So over here now, the average closed-end fund company discount is about 13%, 13-14%, and it's been at that level for a couple of years, which is sort of unusual over here. Split slightly differently, the equities mandates are those companies invested in other listed equities, probably nearer 10% for companies invested in what one might describe at more alternative real assets, et cetera, they're at wider discounts, but that's opened up the opportunity for activists and it's clearly attracted some attention from the other side of the pond, as you put it earlier. So yeah, we're seeing some of that activity, and one activist in particular, take a number of positions and then try to execute on those, but there are a number of reasons which we can perhaps explore as to why the sector over here is different.

CHUCK JAFFE: Let's explore first the similarities, because the one investor you're talking about, we can name them.

RICHARD STONE: Yep.

CHUCK JAFFE: It's Saba Capital Management, which is the 800-pound gorilla, if you will, when it comes to buyouts and let's go in and take things over and eliminate discounts.

RICHARD STONE: And has recently done a big deal with BlackRock obviously in the US as well.

CHUCK JAFFE: Right. So you've got Saba, which has been fighting to narrow discounts here, one of its primary tools is let's get in and open end a fund, we'll then capture the discount, and that's what they've been doing there as well. They've been in repeated fights, and as you point out, some of the big players there are much bigger companies, where closed-end funds here are a small piece of a very big industry, there are very big players there. So they've been making these fights, but they haven't been winning them there, where here they've had more traction.

RICHARD STONE: Yeah, I think there's a couple of reasons for that. Governance over here is slightly different, and we can explore some of the specifics on that, the other is that I think the approach that they've taken, certainly in the very recent past, some of the meetings and things that we've seen where they've been defeated, they appeared to investors to be looking for control of the fund rather than just closing the discount and seeking a capital return or to open end the fund. Their proposals were to effectively fire the board of the company, appoint two directors onto the board, one Saba employee and one other person that they'd identified, and then they had an express intent to change the mandate of the fund to then potentially invest in other closed-end funds and to appoint Saba as the asset manager of the fund, potentially then wrapping them all into one vehicle. But effectively it appeared to be an attempt to take control of the capital and then run that as their own vehicle, which obviously as you say, investors have rejected. They've come back now with their plan B, which appears to be more akin to the playbook you're talking about in terms of trying to open end the fund, but again I think that may face some challenges in the UK market, we'll see how that plays out.

CHUCK JAFFE: Here it is super hard to get investors to vote their proxies and to vote with management, you're going to close the discount, I'm going to make a quick profit, which is a reason why a lot of folks go into closed-end funds here. Is there a fundamental reason why the British investors in closed-end funds are different? Or is it a playbook that if we like closed-end funds here and we don't want to see that kind of play, we just have to pay attention and vote?

RICHARD STONE: I think there's a number of things to that. First of all over here, every closed-end fund has a separate board that's independent, so you don't have a kind of unitized board sitting across a whole range of closed-end funds, each company has its own separate board so requires those kind of separate votes. As you say, you've seen retail shareholders in particular over here turn out in large number. Now we have a rule under what's called the "Takeover Code" here, that you can't acquire more than 30% of the equity of a listed company without then making an offer for the whole company, so effectively the proportion of equity that the activists can own is capped at 29.9% or whatever, because if they tip over that, they have to make an offer for the whole, that caps their interest potentially. We've got significant retail participation in the share registers of particularly the seven companies that Saba requisitioned meetings for originally, but over here I think relative to the US, you've probably got a more concentrated retail base using a smaller number of platforms, so therefore they're easier to get to. They all theoretically have a vote and the platforms can pass on those voting rights, and we wrote to both the regulator in the UK and the major platforms, they wrote to all of their customers, told them what was coming up, what was happening, that they could vote their shares. The companies did an awful lot of work in terms of getting that message out there to their underlying investor bases, you can do something over here where you basically can ask for the names and addresses of all your beneficial shareholders sitting within the platform holdings, so you can get literally the name and address of Mr. and Mrs.

Miggins who are on your share register and you can write to them and tell them, so the companies did that. So you had a lot of direct coms going out from the companies to the shareholders, some of the platforms there allow you to vote your shares in app, this stuff is becoming simpler to do from an investor's perspective, and so we saw record levels of turnout. With one of the major platforms, it was 55% of their shareholders, retail shareholders, in one of their trusts voted their shares, 69% of the shares held in that trust on that platform were voted, that's huge.

CHUCK JAFFE: That would be absolutely unheard of here.

RICHARD STONE: And historically it would be here. You've got a general meeting over here, you'd normally see probably less than 10% vote would be normal. I think it was the fact that there was that much communication, that it's easier here than it is in the US, I know, to communicate directly with those beneficial holders. It's a smaller market geographically, and so all of this action was in the UK press quite heavily as well, so all of the main national media, printed media, et cetera, all the finance publications that investors might read were covering this. So yeah, it would be difficult to live in the UK and not know that this was going on if you're an investment company closed-end fund investor, so that kind of agitated that interest.

CHUCK JAFFE: Exactly. In the United States, plenty of investors have no idea what the closed-end fund space, and is that the thing that people need to remember here, the lesson? Because here you're going to have far fewer active closed-end fund investors, and I'm just talking about ordinary individuals, I'm not talking about the Saba Capitals of the world. Here, if you are an individual investor, knowing that we don't have that kind of participation, is it you have to be that much more diligent because you're dealing with a different closed-end fund space? Or you have to say, you know what, in the United States, if they want it hard enough, they're going to win it, so get what you can out of the ride and don't fight it that much?

RICHARD STONE: Maybe. I think over here as well you can't underestimate the extent to which the retail investor base particularly buys into the story around an investment company, the nature and character of its managers. I mean, one of the seven companies has a very long-serving manager who's very well respected in her field, and you have a degree of, I wouldn't call it sentimentality, but people have bought into that story, and they've bought into that story for the long term. And allied to that as well is this move into alternative assets, so one of the trusts for example has a particular holding in SpaceX, if you're a UK investor and you want to gain access to SpaceX, how do you do that? Well, here, through this investment trust you can get access to that. So they give access to assets that investors might not necessarily be readily available or very easily able to access, and investors value that. So why, if you've bought in because you're attached to the investment thesis, you like the investment manager, you're there for the long term, so even if short-term performance hasn't been what you would like, you see it very much as a long-term investment; it's giving you access to investment exposure and diversification that you can't get elsewhere, why would you swap that for management by a US activist who you've never heard of until this point in time and he's going to do something completely different with it? I think that becomes quite a hard sell, and activating and agitating that retail base to vote, they came out and they voted, and shareholder democracy is very much alive and kicking.

CHUCK JAFFE: Well, we hope that it stays that way here. For it to stay that way here, people have to adopt that level of thinking. Richard, thanks so much for bringing it to us, really appreciate you joining me on The NAVigator.

RICHARD STONE: That's great, Chuck. Thanks very much, really good to join you.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and yes, I'm Chuck Jaffe and I'd love it if you'd check out my hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about closed-end funds, interval funds, and business-development companies, go to AICAlliance.org, it's the website for the Active Investment Company Alliance. Thanks to my guest Richard Stone, he's chief executive officer for the Association of Investment Companies, which is the British counterpart to the Active Investment Company Alliance. You can dig into the association and get news and details on the stories we were discussing at TheAIC.co.uk. The NAVigator podcast is new every Friday, make sure you don't miss an episode by subscribing or following along on your favorite podcast app. We'll be back next week with more closed-end fund fun, happy investing, everybody.

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