

CLOSED-END FUND ACTIVISM: 2024

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EXECUTIVE SUMMARY

Shareholder activism in the marketplace for closed-end mutual funds has reached heights that we have never seen. The number of funds being acquired by known activists, the number of activist & follower firms participating, and the size of positions/concentration by activists are all at unprecedented levels. This elevated level of activism has created a record number of opportunities for investors to capitalize on shareholder-friendly initiatives. Potential initiatives may include increased distributions, tender offers, open-end conversions, liquidations, or actions that may otherwise narrow the discount between a fund's market price and net asset value. There are two main factors contributing to the elevated shareholder activism: 1) persistently wide discounts, and 2) court rulings finding that closed-end fund managers' enactment of Control Share Provisions to be in violation of the Investment Company Act of 1940 (the '1940 Act').

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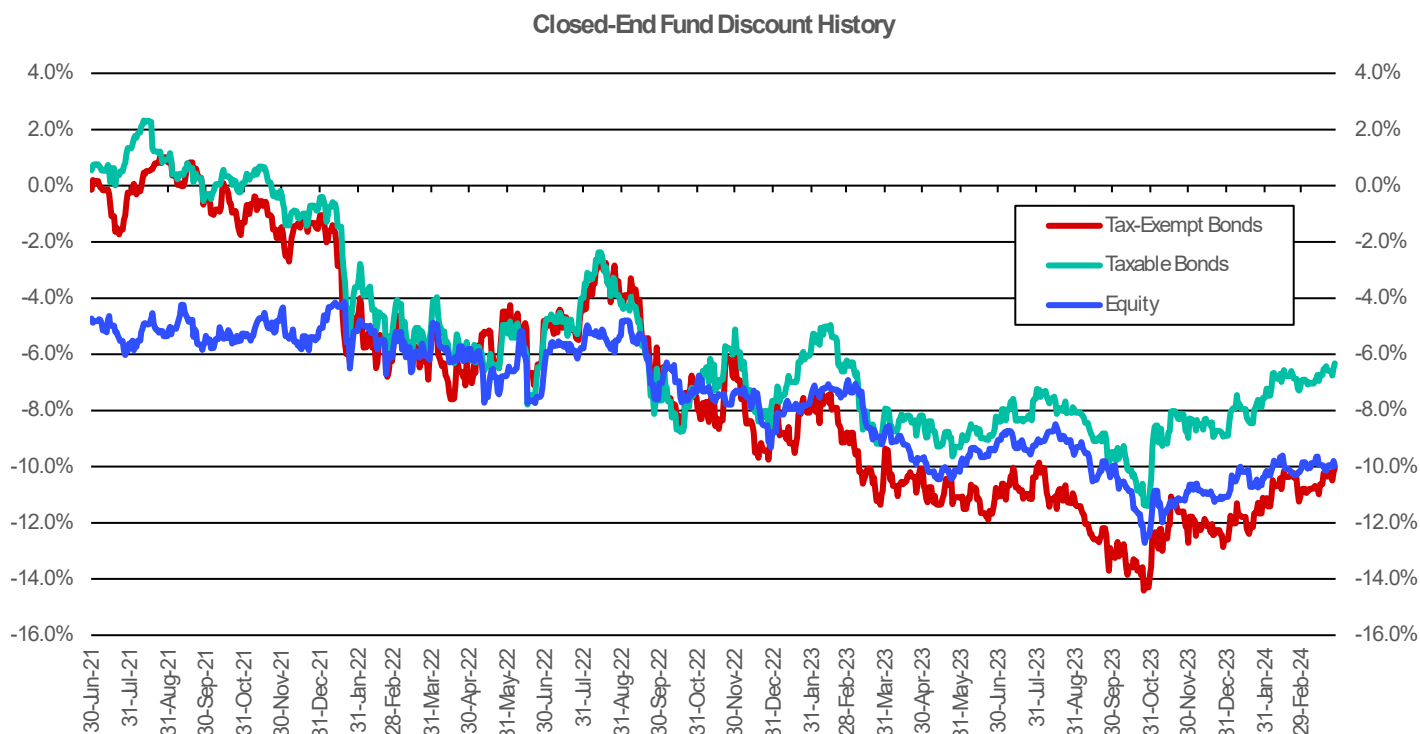
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CLOSED-END FUNDS – ATTRACTIVE DISCOUNTS

In 2021, closed-end bond fund price discounts relative to their underlying net asset value had reached all-time tight levels as massive pandemic related expansionary fiscal and monetary policies pushed interest rates to all-time lows. Income starved retail investors aggressively purchased closed-end funds due to the attractive income advantage the sector provided relative to other sectors of the bond market. To prop up the economy as the pandemic raged on, policy makers repeatedly expressed their intention to keep interest rates low for an extended period, giving retail investors confidence to add to levered closed-end bond fund positions with little concern for potential price declines from rising interest rates.

Excessive pandemic related stimulus eventually forced the Federal Reserve's hand, and in January of 2022 it finally conceded that generational high inflation readings were not in fact "transitory" as they had previously argued. This drove interest rates higher and bond prices lower, producing bond returns in 2022 that were 4 times worse than the previous worst year in bond market history. Retail investors were caught off guard by the shift in Fed policy, and as markets became less certain they indiscriminately sold their closed-end bond fund positions. The yield curve quickly inverted, with shorter maturity treasury yields rising above that of longer maturity yields. Because of their fixed underlying capital base, closed-end bond funds are permitted to use leverage through borrowing at normally low short rates and investing in higher yielding securities out the curve to boost their income. Given this levered position, the inverted curve was particularly harmful to closed-end bond funds. While shorter duration unlevered fixed income investments were seeing their income generation potential soar, closed-end bond funds were being forced to reduce their income distributions to account for the fact that their borrowing costs had risen to a level that exceeded the income earned on the bonds they had purchased with the proceeds of the borrowings.

The yield curve remains inverted in early 2024, which has resulted in almost 2 years of below-trend income generation from closed-end bond funds. This dynamic, combined with the fact that other fixed income securities are at present offering yields not seen since prior to the great financial crisis, the closed-end bond fund sector is out of favor with retail investors and trading discounts to net asset values have persisted.



Source: Bloomberg, 3/31/24

ILLEGAL CONTROL SHARE PROVISIONS

Control Share Provision* – Generally, control share statutes provide a company with the right to prevent or restrict certain changes in corporate control by altering or removing voting rights when a person acquires, directly or indirectly, the ownership of, or the power to direct the vote of, control shares as defined in the specific state control share statute. Control shares are shares of stock that are equal to or exceed specified percentages of the company's total voting power. Once holders of control shares lose their voting rights, such holders cannot vote their control shares unless the company's stockholders vote to approve the restoration of voting rights by an affirmative vote of a specific proportion (e.g., two-thirds of the votes entitled to be cast at a special meeting called for such purposes, excluding "all interested parties").

*Excerpt from 'Control Share Acquisition Statutes,' SEC Staff Statement, May 27, 2020

In May 2020⁽¹⁾, the SEC withdrew a Staff Letter from 2010, known as the Boulder Letter, which stated that its staff believes that if a closed-end fund opted-in to the provisions of the Maryland Control Share Acquisition Act (the 'MCSAA') it would be in violation of the 1940 Act. The 2020 about-face by the SEC led to a wave of closed-end fund sponsors opting funds into the control share provisions of the MCSAA. The boards or directors/trustees from fund companies including, but not limited to, Nuveen, BlackRock, Eaton Vance, First Trust, Western Asset, and Tortoise unilaterally, without shareholder consent, modified fund bylaws to incorporate control share provisions that restrict institutional shareholders' voting rights.

The control share provisions eliminate the system of checks and balances between a fund's shareholders and the management of the fund. Shareholders who hold a quantity of shares more than a specified percentage ('Control Shares') are not allowed to vote those shares against management proposals, including the nomination of directors or trustees; entrenching poor performing managers and directors/trustees. Poor performing funds' trading discounts widen as investors wishing to sell their shares seek liquidity at lower prices. Prior to the implementation of control share provisions, fund sponsors would need to be mindful of trading discounts as institutional shareholders were able to accumulate shares and overthrow management or seek a liquidity event such as a tender offer or open-ending. The control share provisions hurt all shareholders as fund sponsors could ignore the trading discounts, resulting in discounts reaching ever wider levels while also allowing poor performing managers to stay in power in perpetuity.

Following the withdrawal of the Boulder Letter, the SEC solicited feedback from investors, but ultimately did not change its decision. Challenges to the legality, under the 1940 Act, of closed-end funds not giving equal voting power to all shareholders began in 2021.

On January 14, 2021⁽²⁾, Saba Capital Management filed a lawsuit in the United States District Court for the Southern District of New York (the 'SDNY') against Nuveen and fund trustees claiming that their 'vote stripping' control share provisions violated the 1940 Act. On February 17, 2022⁽³⁾, the SDNY issued a summary judgement in favor of Saba and invalidated the control share provisions enacted by Nuveen and fund trustees. On November 30, 2023⁽⁴⁾, the U.S. Court of Appeals for the Second Circuit affirmed the SDNY decision on the basis that the control share provisions violate the 1940 Act.

1. Staff Statement, Control Share Acquisition Statutes, *U.S. Securities and Exchange Commission*, <https://www.sec.gov/investment/control-share-acquisition-statutes>, May 27, 2020.

2, 3. Business Wire, US Court Rules That Nuveen and its Fund Trustees Violated Federal Law by Stripping Shareholders' Voting Rights, *Business Wire*, <https://www.businesswire.com/news/home/20220222005528/en/US-Court-Rules-That-Nuveen-and-its-Fund-Trustees-Violated-Federal-Law-by-Stripping-Shareholders%E2%80%99-Voting-Rights>, February 22, 2022.

4. Business Wire, U.S. Court of Appeals for the Second Circuit Upholds that Nuveen-Advised Closed-End Funds Violated the Investment Company Act of 1940, *Business Wire*, <https://www.businesswire.com/news/home/20231201056166/en/U.S.-Court-of-Appeals-for-the-Second-Circuit-Upholds-that-Nuveen-Advised-Closed-End-Funds-Violated-the-Investment-Company-Act-of-1940>, December 1, 2023.

On January 21, 2023⁵, the Suffolk County Superior Court in Massachusetts ruled in favor of Saba and invalidated the control share provisions that were adopted by four funds managed by Eaton Vance. Agreeing with the SDNY, the Suffolk County court ruled that the Control Share Provisions were in violation of the 1940 Act.

On December 5, 2023⁶, the SDNY ruled in favor of Saba in a lawsuit filed on June 29th, 2023, against BlackRock and the trustees of sixteen BlackRock closed-end funds. SDNY ruled that BlackRock and the trustees had violated federal law as the control share provisions enacted by the funds were in violation of the 1940 Act.

CURRENT OPPORTUNITY

With discounts for closed-end funds at wide levels throughout 2023 combined with the increasing speculation that all closed-end funds will be forced to abandon their control share provision bylaws; activist investors began accumulating shares of closed-end funds. With several activist campaigns in full swing, the double whammy against the control share provisions in Nov/Dec 2023 was the final death blow that resulted in a wave of closed-end funds suspending their control share provisions. Shareholder activism increased through year-end and remains strong as proxy battles for board seats or other measures to enhance shareholder value are numerous. When including funds that have pending tender offers or terminations due to recent shareholder activism, there are 54 closed-end funds (SIA Estimate as of 3/31/2024) being accumulated by and/or targeted by known activist investors. Institutional investors are upset with the fund sponsors' illegal attempt to strip shareholders of their rights and now that the control share provisions are no longer protecting the boards of these funds, activist shareholders have embarked on campaigns against several fund sponsors.

In the fall of 2023, Sit began to raise concerns regarding the imprudent use of leverage harming shareholders, particularly by funds investing in tax-exempt municipal bonds. Most closed-end bond funds are authorized to use leverage to achieve their investment objective of providing a high level of current income. Municipal bond funds saw the incremental income generation potential of their leverage disappear in the inverted yield curve environment, and in fact, the leverage generated negative carry, actually reducing distributable income. Additionally, the advisory fee that these funds charge is based on managed assets. Rather than selling securities to reduce/eliminate the reduction to income from negative carry on the leverage, several fund sponsors instead chose to maintain leverage, propping up their advisory fees despite the resulting shareholder value destruction. To the extent that fund sponsors were paid advisory fees on borrowed assets while borrowing costs exceeded income earned on underlying investments, we believe the fund sponsors may have engaged in illegal self-dealing. We have to cease self-dealing, refund fees, and provide liquidity through a tender offer to re-instill confidence in these funds' managers. Our efforts to reclaim shareholder value are ongoing and can be monitored through our public filings on EDGAR.

This article contains the collective opinions of our analysts and portfolio managers and is provided for informational purposes only. While the information is accurate at the time of writing, such information is subject to change at any time without notice. This information is provided without regard to any particular user's investment objectives, risk tolerances or financial situation and does not constitute investment advice, nor should it be considered a solicitation or offering to sell securities or an interest in any fund. Investments in closed-end funds are subject to risk, including the possible loss of principal.

5. Business Wire, Massachusetts Court Rules that Eaton Vance and its Fund Trustees Violated Federal Law by Stripping Shareholders' Voting Rights, *Business Wire*, <https://www.businesswire.com/news/home/20230125005602/en/Massachusetts-Court-Rules-that-Eaton-Vance-and-its-Fund-Trustees-Violated-Federal-Law-by-Stripping-Shareholders%E2%80%99-Voting-Rights>, January 25, 2023.

6. Business Wire, U.S. District Court for the Southern District of New York Rules That Certain Closed-End Funds, Including Funds Advised by BlackRock, Violated the Investment Company Act of 1940, *Business Wire*, <https://www.businesswire.com/news/home/20231207608236/en/>, December 7, 2023.