



## Skadden's DeCapo Says SEC Rules Changes Won't Stop Closed-End Activism

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Chuck Jaffe, in The NAVigator podcast, interviewed Thomas DeCapo, securities attorney with Skadden Arps. Read the Q & A below as Thomas and Chuck discuss control shares statutes that critics have said will reduce activist challenges to closed-end funds. DeCapo says that the rules will protect investors, result in more closed-end funds being brought to market, and that it won't stop real activism—where investors are looking for real change and improvement rather than



boosting a price and grabbing a quick profit—and he describes the actions as consumer-friendly and democratic for small shareholders.

Thomas DeCapo

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

**CHUCK JAFFE:** Securities attorney Thomas DeCapo from Skadden Arps is here, and we're talking about what recent rules changes in the closed-end fund industry mean for investors now on 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, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, the NAVigator's going to point you in the right direction. Today, highlighting the fact that the Active Investment Company Alliance has folks from all walks of life in the closed-end fund industry, well, we're talking with an attorney. Thomas DeCapo is a partner in the investment

management practice at Skadden Arps, the full name Skadden, Arps, Slate, Meagher & Flom, he represents financial services firms on a wide range of investment management industry type stuff. Tom and I were actually on the AICA Summer Summit, which was held recently and you can get more information about that and closed-end fund investing at AICAlliance.org, but we were there talking about activist investors and that's where we're going again today. If you want to learn more about Tom and the practice go to Skadden.com. Thomas DeCapo, thanks for joining me on The NAVigator.

**THOMAS DeCAPO:** Chuck, great to be here. Appreciate you having me on.

**CHUCK JAFFE:** We have seen some rules changes in closed-end funds, but one that we've talked about on the show previously with Phillip Goldstein from Bulldog Investors, who was on our panel at the AICA Summer Summit, is an SEC situation. I don't want to get bogged down in the jargon of it but it's something that has raised concern among activist investors. Now of course if it raises concern and Phil's an activist investor, he's going to say this isn't good for shareholders. But you're on the other side of this, you're looking at it for who does this work for and why. So explain the rule change that we're talking about, and how you think it affects closed-end fund investors.

**THOMAS DeCAPO:** I'll do that. Let me first say that my views here expressed are those of my own, they're not necessarily those of Skadden Arps or necessarily those of my clients. It's an important rule change and it's actually a change through an SEC staff position. And so in 2010, the staff took the position that a closed-end fund utilizing a state control share statute potentially violated a section of the Investment Company Act. A control share statute is where shareholders who acquire more than a certain percentage of the fund's outstanding shares are not allowed to vote the excess shares unless there's a shareholder vote of the entire company deciding that they should be able to vote those shares. What these control share statutes do is they make it more difficult for any single shareholder or any group of related shareholders to cause the fund to do what that large shareholder wants it to do. Over the past decade or so since that has been in effect, there's been a lot of activist activity that has resulted in some funds being liquidated or some funds shrinking in size by being forced to conduct tender offers, and many believe that that is to the disadvantage of investors in closed-end funds.

What are closed-end funds? Closed-end funds are opportunities for smaller retail investors to be able to get access to the investment techniques that they otherwise cannot get access to, namely the ability to invest in private equity or private debt that tends to have better returns than more liquid public securities, or to have professionally managed portfolios using borrowing and leverage. Those things can really only be accessed by smaller retail investors in a closed-end fund format. And when those funds are forced to liquidate or shrink due to tender offers, those opportunities for retail investors to participate in those types of investment strategies are taken away. Furthermore, when you have an uncertain environment as to whether those funds will continue, sponsors are less likely to spend the money in time and effort to bring them. So the investment choices for smaller retail investors to be able to access those strategies have been fewer both because there have been fewer brought to market and because those that are already existing are shrinking due to activist activity. So I think this development where the staff has now said that they're not going to take any action against a fund that opts into one of these statuses is very good for retail investors because it means that more closed-end funds will survive and be available as investment alternatives to provide these other strategies. And more closed-end funds are likely to be brought as sponsors feel more comfortable putting their resources into the closed-end fund product.

**CHUCK JAFFE:** That makes sense to me, but it also therefore makes sense to me that as an activist investor they would look at these situations and say, "We're not bringing these cases willy nilly. We're not buying things that we don't think there's something happening where the market is kind of saying, 'This is a discrepancy that could be closed.' or whatever it is. So we had Phillip Goldstein here talking about how he thinks this will have a chilling effect on activism, and how he thinks it will make it also that fund boards are more entrenched. How do you respond to those criticisms of this rule?"

**THOMAS DeCAPO:** A couple of things. One, activism in this space, at least in some people's minds, is almost a misnomer. I think of activism as an effort by investors to seek to try and improve the performance and operations of a company. Where activism in this space is almost never about trying to change what the company does in order to improve its earnings capability, but rather it is to close the product down either through an immediate liquidation or through a slow effective liquidation of doing tender offers that shrink the fund and make

it less efficient, and make it more likely than that it's going to underperform and thus have another tender offer, so a prolonged liquidation. It's very rarely about saying, "How do we make this fund perform better?" So I'm not even sure I would call it activism. And in terms of board entrenchment, the SEC over the course of the last two decades at least has been very focused on making sure that boards have very strong independent directors that must consist of more than a majority of the directors who are there for the purpose of protecting shareholders. That's not to say that in some cases you can't find a situation where the shareholder base at large becomes discontent with management, but this change in the SEC position does not interfere with the ability of the shareholder base at large to take action when that happens. Rather this prevents one or a small handful of large investors from being able to come in and in the short-term acquire a large stake for the purpose of forcing some result on the fund and on the remainder of the shareholders. So I actually view this change as very shareholder-friendly and very democratic in that it levels the playing field and recognizes the voice of smaller retail investors more than was the case beforehand.

**CHUCK JAFFE:** Frequently the folks who are listening to this are smaller retail investors, who in some cases like the idea of, "I'm going to buy a closed-end fund, and if the discount widens enough somebody will step in and make things right." You're also saying that that's still going to happen. They shouldn't be hearing this and going, "Okay, well that means I'll be able to own the closed-end fund but I won't have that significant market force underlying what I do."

**THOMAS DeCAPO:** It hasn't gone away. It has changed and I think it will be a little more difficult for activist investors to be able to influence the trading value or cause a liquidation than has historically been the case, but it hasn't gone away. That being said, I think many closed-end fund investors are investors for the long-term and not for those short-term deviations in the comparison of market price to net asset value, but they're rather interested in the long-term strategies that closed-end funds can deliver that open-end funds cannot deliver. For those investors, I think this is a particularly positive development.

**CHUCK JAFFE:** Tom, thanks for explaining it to us. Thanks for joining us, I look forward to talking with you again on The NAVigator.

**THOMAS DeCAPO:** My pleasure. Thank you, Chuck.

**CHUCK JAFFE:** The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I am Chuck Jaffe and you can check out my show

on your favorite podcast app or at MoneyLifeShow.com. To learn more about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. On Facebook and LinkedIn @AICAlliance. Thanks to my guest Thomas DeCapo, securities attorney with Skadden Arps, learn more about him and the firm at Skadden.com. The NAVigator podcast is available every Friday, please subscribe on your favorite podcast app. And until we do this again next week, stay safe everybody.

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