BlackRock's Minar On How The Firm Is Changing Discount Plays

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Stephen Minar, Managing Director and Head of Closed-End Funds at BlackRock. Read the Q&A below as Stephen and Chuck discuss a contemporary conundrum in the closed-end fund industry: How discounts drive money flows into closed-end funds but also attract activist investors whose actions may be harmful to long-term individual investors. To address this, Minar notes that BlackRock has launched initiatives in a series of new funds that can reduce discounts, thereby making a fund less likely to attract activists while increasing consistency in distributions.

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

All financial advisors, please take AICA's 2024 Advisor Survey on closed-end funds. Take the full survey and be entered to win a one-year free daily alerts email from CEF Data partners. With this survey we will learn more about the current opinions, trends, and needs of financial advisors. We believe this perspective could help with future development of investment products at your firm, go to AICAlliance.org/survey. This has been developed in partnership with XA Investments and Destra.

CHUCK JAFFE: Stephen Minar, managing director and head of closed-end funds at BlackRock is here, we're talking discounts, new products, innovations and more now on The NAVigator.

Welcome to 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 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 will point you in the right direction. And today we're going in the direction of BlackRock with Stephen Minar, he's managing director and head of closed-end funds, and when it comes to the closed-end fund space or investing in general, BlackRock really doesn't need much of an introduction, but if you do want to learn more about the firm and their closed-end fund offerings, you want to go to BlackRock.com. If you want to learn more about closed-end funds, interval funds, and business-development companies generally, then check out AICAlliance.org, the website for the Active Investment Company Alliance. Stephen Minar, welcome to The NAVigator.

STEPHEN MINAR: Thanks for having me, Chuck.

CHUCK JAFFE: Anytime I talk with guys who manage closed-end funds, they typically are going to say that they don't pay attention to the discount on their funds, like they kind of feel that discounts happen. But that's about market sentiment, it's not about management, at least until an activist shareholder comes up. But right now we're looking at discount levels for the industry that are near records, so what does what does that say to you about the state that we're in? And internally at BlackRock, what's the general take on discounts?

STEPHEN MINAR: Let's start with the factors that drive premiums and discounts for closed-end funds. At the request of our board, we performed an in-depth analysis of factors affecting how closed-end funds trade in the secondary market, the results of which, as you mentioned, are on BlackRock.com. Chuck, you rightly point out that closed-end funds trade cyclically, over time we see large shifts in discounts coinciding with periods of either market stress such as the Global Financial Crisis, or regime changes like the one we're experiencing today with the Fed raising rates from zero to over 5%, a pace of rate hikes that many investors have not experienced in their lifetime. Now that covers how groups of funds may trade from discounts to premiums over time, but then we drilled down to assess what impacts valuations among funds with similar investment objectives. At the peer group level we found three factors impacting relative valuations. Number one, performance, funds that exhibit consistent outperformance over time and that trade at higher valuations. Number two, distribution levels, investors reward funds not just with the highest distribution rates, but also that offer consistency of those distributions over time. Number three, funds that are larger and more liquid, particularly in the equity space, generally see greater demand. Now this research is critical to informing how the board and BlackRock manage discounts over a full market cycle. The final point I'll make is that we listen closely to our shareholders, both individuals who tend to be buy-and-hold investors seeking consistent monthly distributions and access to strategies that they can't get in a mutual fund or ETF, but also institutional investors who maybe have a different perspective.

CHUCK JAFFE: The discount level obviously drives demand, et cetera, it makes closed-end funds in many cases a relative bargain. But beyond discount, what is it that's making closed-end funds good investments?

STEPHEN MINAR: I agree that certain closed-end fund investors are opportunistic and look to buy when valuations are cheap. Who doesn't love a bargain? That said, I'll go back to my earlier point, which is most individual investors own closed-end funds for that consistent monthly distribution that is typically higher than other investment products like mutual funds and ETFs. Additionally, that closed structure means we could provide unique exposure, such as access to private markets, which many of our investors can't do on their own. All of our recent IPOs have been focused on democratizing access to private markets in a more efficient wrapper with lower fees, including no performance fees, simplified tax reporting, and daily liquidity on the New York Stock Exchange. Importantly, investors have to understand that those private investments are long-duration assets, meaning to realize that illiquidity premium that has historically generated higher returns relative to public assets investors have to be patient, that is why these funds were structured with 12-year limited terms. I mention this because certain investors in this space are really focused on forcing destructive liquidity events to realize a quick profit. Not only does that harm all shareholders in terms of shrinking the funds, increasing costs, and foregoing that future growth potential, but as noted, these illiquid investments don't trade freely like stocks on an exchange. If a closed-end fund is forced to sell these private assets, the price received would be at a significant discount to where they are currently valued.

CHUCK JAFFE: That helps us understand that there is the potential for harm in open-ending CEFs, but from you as you're developing products and you're trying to serve the investing community with both the folks who are driven by liquidity events and those who are long term, what's it doing for you in terms of product development? What does it have you looking at in terms of what you can develop and how you can innovate to maybe find the best of all worlds?

STEPHEN MINAR: You know we started this discussion, Chuck, with the factors that drive premiums and discounts. One of the most effective measures we've implemented at BlackRock is what we call managed distributions that allow our funds to deliver that high and consistent level of distributions our shareholders are seeking. So for example, back in 2019 we implemented managed distributions for eight of our taxable fixed-income funds. Today, six of those funds trade at a premium, the other two funds are at narrow discounts. Earlier this week we implemented similar policies for our recent IPOs, going forward ECAT and BCAT will target distribution rates of 20% of net asset value. BIGZ, BMEZ and BSTZ will target a distribution rate of 12% of net asset value. We've seen an immediate impact with most funds up 3-4% the day those announcements went out, creating over $270 million in value for shareholders. We expect this momentum to continue as more investors become aware of these significant distribution increases. Away from our recent IPOs, we've also taken decisive actions to directly target discounts by implementing what we call a discount management program, that's across all of our equity and allocation books. Under these programs, what we do is we look at the average discount over a calendar quarter, if that discount is greater than 7.5% during the quarter we will issue a tender offer for up to 2.5% of shares at the end of the quarter. Finally, within our leveraged municipal closed-end funds that have been negatively impacted by higher borrowing costs in this higher-rate environment, we announced fee waivers across all 24 funds, that will ultimately increase the tax-exempt income paid to our shareholders consistent with the fund's investment objective of paying out that tax-exempt income. And so again, we look at these actions as ways to improve how these funds trade in the market, create real value for our shareholders that ultimately lead to a better experience over the long term.

CHUCK JAFFE: A quick follow up on one of those areas, which is the tender-offer feature that you were talking about. My assumption, but I want to hear it from you, is that a big part of that is that if not necessarily narrowing discounts, it will make those funds less attractive to an activist investor to want to move in. So in other words, the things that you were talking about that harm an open-ended closed-end fund when we get an activist investor, they're less likely to be attracted to those funds because those funds are routinely handling the problem and not letting it build to where it's particularly attractive. Is that correct?

STEPHEN MINAR: That's right. We're looking to keep discounts below a certain level because we think that that'll end up benefiting all shareholders. As you rightly point out, activist investors in this space tend to focus on certain levels of discounts, but again this is not just about appeasing the activists, this is about creating actions that benefit all shareholders over time. This is a way to again mitigate that volatility of the market price throughout a market cycle regardless of market conditions.

CHUCK JAFFE: I've been covering the fund industry for a long time, like over three decades at this point, quite honestly there was a time when I think everybody thought closed-end funds would go away, right? They were this esoteric whatever that nobody was paying attention to. Now they've never been getting more attention. And I'm curious, is this just a quirky thing? Or in your side of the business where you're developing products, is it like, "Wait, hold it." There's not just investors always looking for yield and closed-end funds help them deliver it, or they want a bargain, but there's a real reason why investors are suddenly finding this old line product that they ignored for so long and now they like it?

STEPHEN MINAR: The closed-end fund market has been around for over a century at this point, and it has shown that has continued to evolve with the times. What we're seeing here more recently, again going back to those comments I made about private markets, this is a democratization of getting access to those private markets. At one time it was very difficult to get exposure to emerging market equities, that was the point of the wrapper back in the late nineties and early 2000s, but again we've seen that displaced by ETFs over time. Here this is a true use of that closed structure to provide access to things that individual investors again can't get access to on their own. One of the other developments that I think we should just maybe highlight real quick here for you, is since 2019 we've reinvented how these products are also offered. What I mean by that is, historically closed-end fund IPOs were somewhat expensive. Think about an A-share mutual fund that has a front-end sales load, about 5% of the NAV would come out on the IPO. That led to these funds trading down after the IPO. So what did we do? We reinvented the structure, we took out all those fees, now BlackRock and other issuers are covering those upfront fees so that investors can get in at NAV, so your $20 IPO price is equal to the $20 NAV at IPO, and that has improved how these funds have traded post-IPO. We've also added what I mentioned earlier, a limited term, so investors are getting access to NAV at the end of the term, but again I think it's really important to focus on the need for that term and that closed structure to get the benefits of that closed structure through long-duration assets like private investments.

CHUCK JAFFE: Stephen, really interesting. I know there's more to develop down the line, as you develop it, I look forward to chatting with you again on The NAVigator.

STEPHEN MINAR: Thanks for the time, Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, I am Chuck Jaffe, I'd love it if you'd check out my hour-long weekday show by going to MoneyLifeShow.com or by searching for it wherever you find your favorite podcasts. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, that's the website for the Active Investment Company Alliance, which is on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Stephen Minar, the managing director and head of closed-end funds at BlackRock, go to BlackRock.com for more about the firm and its closed-end funds. The NAVigator podcast is new every Friday, and we hope you'll follow along or subscribe on your favorite podcast app so that you don't miss an episode. And if you liked this podcast, we'd love it if you'd leave a review and tell your friends about us. We'll be back next week, until then, have a great Memorial Day weekend and happy investing everybody.

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