Activism in Closed-End Funds: The Sector's Hottest Topic

Activism in closed-end funds (CEFs) is the sector's hot topic, and it has only become hotter as discounts for CEFs have gotten wider. CEFs often trade at a discount to their NAV. It's what makes them appealing to their investors.

But as markets change and potentially become more volatile, CEF discounts can widen considerably, creating opportunities for active investors willing to buy shares well below NAV. As AICA Chairman John Cole Scott will tell you, this could be a unique play for some.

But most investors don't have the patience to wait for discounts to narrow again; they're hungry for returns. In response, many CEFs have successfully reduced their discounts and enhanced performance through a combination of share repurchases and/or periodic tender offers at or near NAV. And then some funds just aren't as excessively concerned about discounts. Enter the activist.

Activist investors are typically hedge funds or institutional investors that buy large stakes in CEFs and try to influence how they are run. Sometimes they are successful in narrowing discounts, but they can also "kill" funds, too — either by changing the fund's fundamental structure from close-ended to open-ended, or liquidating it through cash disbursements to shareholders. According to a May 2024 Investment Company Institute report, a record number of traditional CEFs in 2023 were under pressure from activists compared with any year going back to 2000.

John Cole Scott's thoughts on activism in CEFs have been covered in these pages before. At AICA's 2024 Fall Roundtable in New York City, a final panel featuring four subject matter experts dived into a discussion that, at the start, explored how we should think of activism. Here is some of what they had to say:

What Do We Mean By 'Activism'?

Some panelists put forward the idea that today's brand of CEF activism is different from what it has been historically, saying that it has devolved into a series of arbitrage plays.

Mike Taggart, closed-end fund specialist at abrdn, likened activism to a spectrum:

“On one end of the spectrum you have longer-term investors who make suggestions to management. Then you have long-term investors who perform due diligence on funds. Then on the other extreme you have large investors who may hedge out their underlying positions, and once they achieve their objectives they’re out of the fund in three months.

There’s a wide range of what the fund industry calls activists, and I think there are nuances in there... and maybe the industry should be careful of labeling people with a broad brush.”

Ron Mass, Managing Principal, Chief Investment Officer, and Founder of RIA firm Almitas Capital, aligned with the idea that activists today are mostly “arbitragers” that urge fund managers to change their calculus. “That’s the way an activist thinks: ‘What’s that profitability, what are the odds, what are the legal costs … what’s the timeframe?’”

He said clients try to push his firm into activism after seeing activists’ results elsewhere.

Are Activists ‘Good’ or ‘Bad’?

Brian Schaffer, Partner at international media firm Prosek Partners, said that while there may be some nuance to the phenomenon, most activism is really only practiced by a small number of firms that, while engaged in arbitrage, are causing “long-term harm” to the industry due to their one-note activist vision.

To drive the point home, he noted that Saba Capital Management had to date filed over 230 13D filings and amendments — filings that typically presage a hostile takeover. Schaffer said in light of that, it’s no surprise that new offers for CEFs have completely dried up.

Aaron Morris, a Partner at the law firm Morris Kandinov, was more forgiving, describing activists as virtuous, “vocal shareholders” looking to hold management accountable. “In the U.S., fund boards are weak in most cases,” he said. “If you don’t have a fund board that’s actively looking at discount, actively looking at performance, and actually doing something … you need someone to show up at their door.”

Schaffer countered, calling that “a little bit of a misnomer.” Fund boards “get blocked” by activists from mergers and other initiatives, he said. More than that, Schaffer added, activists nominate weaker board members, including family members with no experience and CEOs of former competitors. "We're just not seeing [accountability]," he said.

…and that was just the conversation's first ten minutes! Visit AICA's website to view the 2024 Fall Roundtable agenda, interviews, and panel videos.

Resources

Learn more about:

- Mike Taggart and closed-end funds at abrdn
- Ron Mass and Almitas Capital
- Brian Schaffer and Prosek Partners
- Aaron Morris and Morris Kandinov