# NAVigator Bonus: Herzfeld's Paylor On How CUBA Became A CLO Fund

Monday, December 1, 2025

The Active Investment Company Alliance held its annual Fall Round Table in New York City on November 19th, and NAVigator host Chuck interviewed Ryan Paylor, Portfolio Manager at Thomas J. Herzfeld Advisors, which recently converted a closed-end fund from a focus on companies located in the Caribbean Basin, ticker Symbol CUBA, to one focused on collateralized loan obligations. Paylor explains the thinking behind the move and how shareholders reacted to the fund's drastic makeover.

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

**CHUCK JAFFE:** Hi, it's Chuck Jaffe, host of The NAVigator podcast from the Active Investment Company Alliance. One of the best parts of being involved with AICA is that I attend the group's events and talk to the experts there face to face. Those conversations are always interesting, and we don't want you to miss them, so here's a chat I had at AICA's Fall Round Table event in New York City on November 19th, with Ryan Paylor, portfolio manager at Thomas J. Herzfeld Advisors, which recently converted a closed-end from a focus on companies located in the Caribbean Basin to focus instead on collateralized loan obligations, enjoy!

Welcome back Money Life at the Active Investment Company Alliance Fall Round Table, I'm joined right now by Ryan Paylor, he's portfolio manager with Herzfeld Advisors, Thomas Herzfeld Advisors, manager of the Herzfeld Credit Income Fund, which is ticker symbol

HERZ. But that's a new ticker symbol, and this is one of the most interesting stories in the closed-end fund space, and you know if you listen to the show or you listen to The NAVigator, that I geek out on all the interesting stuff, this is one of those geeky things, I'm super excited for this. Because Herzfeld Credit Income Fund is an old fund with an entirely new purpose, because Thomas Herzfeld Advisors created the Herzfeld Caribbean Basin Fund, CUBA was the ticker symbol, in 1992, but it changed into the Herzfeld Credit Income Fund, HERZ, back in July. The new fund pursues a total-return strategy that invests mostly in collateralized loan equity and in junior debt, and I should point out for anybody who's here to talk about collateralized loan obligations, CLOs, they are portfolios of secured investments typically below investment grade. Ryan Paylor, great to have you here on Money Life at AICA.

**RYAN PAYLOR:** Thanks, Chuck, I'm glad to be here. You know, it's really interesting, the etymology of the fund, it's not really a surprise that we ended up converting the Herzfeld Caribbean Basin fund solely based on the fact that over the last couple of years, and really since the first Trump administration, we had a fund that was out of favor, there wasn't really a huge investment mandate for many investors into the Caribbean Basin as an investment mandate. So with that, and then also with the fact that I joined the firm in 2012, we've had a couple portfolio managers join on, including Erik Herzfeld in 2008 to join his father, and our backgrounds were mostly fixed income, [inaudible 0:02:42] rates, and Alex Knapp joined the firm in 2019, his background was more in alternative income and the like, so we were building this fixed income shop and yet we had this Caribbean Basin fund, closed-end fund, that we were dedicating time and effort to it but it was one of the only things that was actually investing in equity of the whole entire business, yet it was our most public facing product that we had. It's the only one that was listed, it's the one that a lot of people knew of, but unfortunately, or maybe fortunately, it kind of saw an end to that. We recently converted the fund, as of July 1st, it was voted on by shareholders, it's now a closed-end fund focusing, instead of just growth and appreciation, capital appreciation, it's more of a total-return strategy with a secondary focus on high income. One of the ways we're going to be investing to generate that high income is through CLO equity, debt, and then other structured credit products that, from our mandate standpoint is just with 50% exposure to CLO equity and debt, we have a little bit more flexibility on the other 50% potentially, where if CLO equity or debt is out of favor, we have the ability to look at other structured credit products. That's kind of where we're at.

**CHUCK JAFFE:** But in that process you had something really interesting, which is you knew, as you said, that CUBA was not going to continue, fundamentally what you had was something of a buggy whip. Now I don't actually need a buggy whip, but if I did, or if I felt I needed one, I'd only go to a buggy whip manufacturer. There were not a lot of funds doing what you were doing, so how did investors take the news? You talked about that they voted on it, and certainly they could see the smarts in making the change from an asset standpoint and investing in Caribbean Basin, but they didn't have to prove it and they could have taken their money to anyone, so how did the investors react?

**RYAN PAYLOR:** So when we announced it back, I think it was May, I don't have the exact date, but back in May, what you immediately saw is actually the discount narrow. At the time, the fund had been struggling at close to a 20% discount, the board had put in a discount management policy of returning capital, 15% of NAV a year, contingent tender offers of 5% if the discount was wider than 10% in a fiscal year, and also cut the management fee. Although that did generate some better opportunities for exits for our shareholders, unfortunately the discount was pretty stubborn. So with the election in November and the fact that we were looking at Trump 2.0 and the possibility of the discount widening back to the levels we saw the first Trump administration, we thought it was time to make the conversion. I would like to think it was well received since more than 90% of the people supported it that voted, and on top of that our discount actually, we actually briefly went to a premium shortly thereafter the vote in July. It was a very brief premium, but the fact going from a 20% discount to a brief premium, we can think that the shareholders seem like they liked the idea.

**CHUCK JAFFE:** So let's talk about that idea further, because having made this change, as you point out, you guys come from a fixed-income background, so it was not like you were going to jump in and go, "Oh, let's do the next AI fund," or something along those lines. But you could have picked any part of the fixed-income side to go to, and your shareholders might have been pretty happy and okay with it anyway, what you did was pick CLOs, so why collateralized loan obligations? Because if you didn't think that was going to be a sweet spot, you would have gone somewhere else.

**RYAN PAYLOR:** Yeah, it was one of the things where the CLO equity closed-end fund space, for the better part really of the last five to 10 years, had been a space that all the previous entrants had typically traded at premiums, they paid high distributions, which obviously is very attractive to closed-end fund investors, and we just kind of saw one of the things we didn't necessarily like about some of the other funds was the fee structures. A lot of them were charging 2% on managed assets, which means put a turn of leverage on, your management fee can be upwards of 3-4%, they also had income incentive fees, where some of the hurdles were as low as 7% or 8%, paying 20% of any income above that hurdle, at the end of the day, the management fees might be in excess, or at least the fees to the manager might be in excess of 6%. For that reason, and one of the many reasons, we always thought they were great trading vehicles, not necessarily great investment vehicles, and as we learned more about the space, we actually have a joint venture where we launched a CLO back in 2022, so we had some experience managing a CLO, we thought maybe we could build around the team and bring in some people with some expertise. So we hired some people, and we're at a state right now where we thought, if we can come in with a little bit more flexibility than the peers, come in at a fee structure that I think is more fair to shareholders, and us being one of the larger insider shareholders of the fund, obviously we believe in that, so we came in at 1.25% on total assets and a 10% with a 9% hurdle, so 10% fee on over the 9% hurdle, so our model, we model ourselves, once we're fully levered, to be somewhere about close to half of what the management fee you would see on some peer funds. Our goal is to build something that we think is more of a long-term investment, buy and hold, that we can hold alongside our SMA strategies.

**CHUCK JAFFE:** Let me interrupt there as well, because when you're talking buy and hold in CLOs, buy and hold, every investor gets, CLOs, they still don't understand the expectation. I know you can't give us too much because no fund manager's ever going to say, but as you point, you've got certain targets to meet. So what would you expect, especially in a rate environment that is changing and we expect rates to continue falling, what are you expecting CLOs to be able to generate for that portion of your portfolio, acknowledging that the rest of the portfolio will be invested differently?

**RYAN PAYLOR:** Yeah, so if you look at peer funds, you're seeing distributions right now at price, not NAV, anywhere from 15 to, on the high side we're approaching 40% for the largest

CLO equity closed-end fund, we'd be happy with a mid-teen type distribution. The goal though is, we announced in a recent press release that we're going to be moving to monthly distributions starting in 2026, now that the portfolio's been turned over and we started investing in some of the CLOs and other structured products that we guided. Sometimes it takes a little while for a new issue CLO to turn on to get that first equity, sometimes it's upward of six months, but it's our goal to try to target that teen-type return that some of the peers are. But one of the things we're going to try not to do is pay significant return of capital, we would rather recycle that back into better deals and try to avoid significant price or NAV deterioration over the year, where we don't want to be setting our investors up for potential a tax-loss selling situation in the latter half of the year because we've returned too much capital and the NAV's eroded.

**CHUCK JAFFE:** It's a really interesting approach at a time when we're not seeing much shareholder activism. I've been watching that name going, "Are we going to see it there with CUBA?" Instead we saw you guys become activist managers and make the change. Ryan, thanks so much for joining me to talk about it.

**RYAN PAYLOR:** I appreciate it, Chuck. Thanks so much.

**CHUCK JAFFE:** That's Ryan Paylor, he's a portfolio manager with Herzfeld Advisors. You can learn more about the firm and the fund, it's ticker symbol HERZ, by going to Herzfeld.com.

*Recorded on November 19th, 2025*

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