

CEF Boards Should Brace for Heightened Activism

The current landscape makes it more important than ever for directors of closed-end funds to educate and prepare themselves and senior management for potential proxy contests, the author writes.

By Steve Messinger | April 19, 2022

Proxy contests at closed-end funds jumped dramatically in 2019 and 2020 before sharply declining last year. It is unclear whether this decline is an aberration or signals the start of a new trend.

The leverage and structure of closed-end funds make attractive targets for institutional fund activists, as prices often diverge between the market price and the net asset value of the fund's underlying holdings. That means boards need to be aware of price divergences and think through proactive plans to counter activists.

Closed-end funds may also be more susceptible after a U.S. District Court judge struck down the control share provisions in Nuveen's bylaws earlier this year. The Securities and Exchange Commission staff had changed its stance on such provisions in 2020, clearing the way for funds to adopt them.



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Monitoring activity before a contest begins

It is often hard to predict whether a fund will become a target. Activists may start buying into one closed-end fund with an 8% discount while a sister fund with a 14% discount remains unaffected. Because no one can predict which fund will become the next target, proactive monitoring of shareholder activity in at-risk funds is the best way to understand what is happening and to be prepared to engage different shareholder groups and the critical proxy advisors, ISS and Glass Lewis.

There is an art to monitoring shareholder activities, and the established surveillance many fund boards rely on is not sufficient. Directors should project how different shareholder groups may vote to understand the depth of a challenge and the strategies available to defeat an activist.

Further to the quantitative projections, fund boards need to look ahead to see how actions of one activist may impact another. Firms such as Wolverine and Matisse Capital rarely launch shareholder proposals independently, but these firms are more opportunistic in closed-end fund contests they join. A common strategy for them is to piggyback on a challenge that Saba Capital or Bulldog Investors may launch. Closed-end funds activist Saba made history last year, replacing the board and taking over a Voya closed-end fund in June.

Analyzing the implications of shareholder demographics

To get a full picture of potential closed-end fund activism, it is important that fund boards understand the makeup of their shareholder base. They should investigate the split between retail and institutional investors, as well as what specific types of institutions are invested in the fund. Some institutions are not a cause for concern. Unit investment trusts, for example, frequently purchase closed-end fund shares. They normally mirror their vote along with the full shareholder base. However, other institutions, such as Wolverine or Matisse, can join with an activist to try to drive up the share price when they think an activist is targeting a fund. If directors understand their shareholder base, they can often thwart activist proposals before they become contests at shareholder meetings.

Communicating a forward-looking plan

Even before a contest begins, fund boards should begin communicating and building relationships with institutional and large retail shareholders, in-

cluding dissidents, as well as proxy advisors. By providing a steady cadence of information and transparent dialogue, directors can convey their dedication to protecting all shareholders.

While it's common practice for fund managers to send quarterly updates to their investors, these communications normally focus just on the performance of the fund. Boards can enhance the dialogue by further contextualizing fund performance and providing a glimpse into plans for the future, ensuring investors that management will protect the unique nature of closed-end funds that attracted shareholders in the first place.

Developing board processes for longevity

Oftentimes, activists will first try to defeat incumbent board members as a way to then make more serious changes, such as a rights offering or conversion to an open-end fund. Directors therefore need to take a critical lens to examine their governance processes.

On a regular basis, they have to examine their composition, the terms of their board members, and the procedures for director elections and retirement dates. These prophylactic measures can help fend off activist advances or encourage them to move on to the next vulnerable target.

Ensuring fund board effectiveness in 2022

While it's hard to say for certain whether fund activism will increase again in 2022, the challenge to control share provisions and Saba's takeover of the Voya fund seem to indicate that the risk from activists is changing. This serves as a call to action for fund boards to demonstrate to shareholders that management, rather than activists, are the ones pursuing the long-term interests of all shareholders.

The current landscape makes it more important than ever for directors to educate and prepare themselves and senior management for potential proxy contests. Shareholder monitoring, vote projections, transparent communication and effective board processes will be critical factors in the success of closed-end fund boards in the months and years ahead.