



K&L GATES

2016 INVESTMENT MANAGEMENT CONFERENCE

Special Issues for Closed-End Funds

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AGENDA

- Closed-End Fund Basics
- Taking Advantage of Trading Premiums: Shelf Offerings
- Managing Trading Discounts
 - Tender Offers for Preferred Shares
 - Distribution Rates
 - Open Market Share Repurchases
 - Tender Offers for Common Shares
- Activist Investor Issues
- Recent SEC Developments



CLOSED-END FUND BASICS

- Hybrid of a mutual fund and operating company
- Third-party underwritten IPOs
- Stable pool of assets – no redemptions – great for investing in certain instruments (e.g., fixed income)
- Traded on an exchange (most often NYSE or MKT)
- NAV of underlying portfolio is not anchored to market trading price
- This presents challenges (discounts) and opportunities (premiums)
 - Most significant result of this is that the fund may trade at either a premium or a discount to its market value
 - Example – a fund with 10 million shares outstanding and a portfolio worth \$100 million would be expected to trade around \$10/share
 - Shares may be trading for a discount (e.g., \$8) or premium (e.g., \$12) to NAV



TAKING ADVANTAGE OF TRADING PREMIUMS: SHELF OFFERINGS

- Permits issuance of additional shares generally into existing trading market
- Generally employed where shares are trading at a significant premium
- General no-action relief facilitates funds relying on general shelf registration rule without additional reporting requirements
- Issuer-specific no-action relief permits annual updating under Rule 486(b)
- 1933 Act Rule 415
 - Fund must be reporting for at least one year
 - Permits delayed or continuous offering of Shares
 - “At the market” offering must be on delayed basis
 - Need to file shelf registration statement (every three years)
 - “Take downs” reflected in supplements to shelf registration statement



TAKING ADVANTAGE OF TRADING PREMIUMS: SHELF OFFERINGS (CONT'D)

- Underwriting
 - Overnight Deals – third party brokers will underwrite – for a price
 - At-the-Market Offerings – generally use an affiliated broker (typically mutual fund distributor) – third-party broker typically used as sales agent
 - Must be FINRA qualified to underwrite closed-end offerings
 - May require amendment to FINRA membership agreement
 - If there is no affiliated broker, a third-party broker may be used – generally involves a more significant closing
- Sales Loads
 - Typically varies based upon amount of trading premium
 - Section 23(b) prohibits issuance at below NAV
 - Revenue Sharing -- some brokers will seek trail payments from Adviser in addition to load



TAKING ADVANTAGE OF TRADING PREMIUMS: SHELF OFFERINGS (CONT'D)

- NYSE/Other Listing
 - Shares sold in shelf offerings must be subject to supplemental listing application
 - May be done once covering all shelf shares -- not required for each take down
 - FINRA filings
 - All SEC shelf filings must be made with FINRA
 - Same-day clearance
- Board Considerations
 - Board must conclude that benefits of program through additional assets outweighs possible impact on premium



MANAGING TRADING DISCOUNTS

- Problem:
 - Many closed-end funds' market prices trade at a discount to net asset value

- Consequences:
 - Shareholder value diminished
 - Attracts activist shareholders seeking to arbitrage discount
 - Presents difficulties in attracting underwriters for future offerings



METHODS FOR MANAGING DISCOUNTS

- Enhancing competitive distribution rates
- Open market share repurchases
- Tender offers for outstanding common shares
- Tender offers for preferred shares



ENHANCING DISTRIBUTION RATES

- Closed-end funds very often marketed and purchased for income produced
- Closely monitoring distribution rates relative to competitors is very important
- Section 19(a) disclosures
- Section 19(b) limitations
- 19(b) exemptive orders: managed distribution plans
- Possible uniform exemptive rule



OPEN MARKET SHARE REPURCHASES

- 1940 Act Section 23(c) permits
- Must be conducted under 1934 Act Rule 10b-18 safe harbor
 - Single broker
 - Time - near close of primary trading
 - Price
 1. Maximum highest bid or last transaction
 2. Special provisions for share where no bids or transactions
 3. Generally not applicable to CEFs



OPEN MARKET SHARE REPURCHASES (CONT'D)

- 1940 Act Section 23(c) permits
 1. Volume
 - Maximum 25% of average daily trading volume
 - Exception for once weekly block purchase
 2. Notice of program
- Repurchased shares generally must be retired
- Governing instruments determine
- Resale or reissuance requires re-registration
- Affiliates of fund may also make open market purchases



TENDER OFFERS FOR COMMON SHARES

- 1940 Act Section 23(c) permits
- Must comply with 1934 Act Rule 13e-4 governing issuer self-tenders
 - Volume -- no limit - Board determines
 - Series tenders -- typically small amounts 5% - 10%
 - One time tenders
 - Amounts may be larger
 - Impact may be time limited
 - Filing of Schedule TO
 - Dissemination
 - Long form publication
 - Mailing to shareholders -- most common
 - Short form publication



TENDER OFFERS FOR COMMON SHARES (CONT'D)

- Period -- must be open for 20 business days
- Price -- not prescribed -- typically 95% to 98% of NAV depending on current discount
- Valuation -- based upon NAV at expiration date
- Amended Schedule TO reflecting results must be filed with SEC
- Related communications -- all must be filed
- Tenders by affiliates -- generally subject to same requirements
- Resale of purchased shares -- must be re-registered



TENDER OFFERS FOR PREFERRED SHARES

- Redeem auction rate preferred shares through tender offers
- Typically done in connection with refinancing transactions (i.e., issuances of private preferred shares, debt or tender option bonds) in order to give liquidity to ARPS holders and maintain the fund's leveraged capital structure
- Conditions on tender offers:
 - Tender offer at some percentage below par
 - Minimum participation percentage



FACTORS IMPACTING TENDER OFFER PRICES FOR PREFERRED SHARES

- Reasons why tender offers vary by fund:
 - Variety of leverage options available (taxable funds have more)
 - Degree to which portfolio can support leverage expenses
 - Existence of a credit facility (reducing transactional expenses)
 - Extent to which the offer is subscribed



ACTIVIST INVESTOR ISSUES

- Activists continue their interest in closed-end funds.
- Activists often engage in proxy fights with closed-end funds.
- Activists often seek seats on closed-end fund boards.
- Goals of activists:
 - Force a Fund Tender Offer
 - Liquidate the fund
 - Open-end the fund
- SEC has often sided with activist investors under rubric of shareholder democracy.



RECENT DEVELOPMENTS

- SEC Auditor Independence Rules in the context of loans and investments.

