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Closed-Enders Face Tougher Battles With Activists

By Peter Ortiz January 30, 2014

Shareholder activists will have greater firepower in challenging closed-end fund directors and pushing through their proposals after a change from Institutional Shareholder Services takes effect after Feb. 1.

The proxy advisory firm could support proposals that receive more than 50% of the votes cast, rather than whether they receive support from 50% of shares outstanding. This change lowers the bar for activist investors to gain ISS's support.

Persistent discounts to a closed-end fund's net asset value are strong drivers for shareholders to pressure the funds to narrow the discount. If the funds' directors fail to act on their own, shareholders could put forward proposals to further push them into action.

The number of funds with wide discounts suggests there will be a busy proxy voting season ahead, experts say.

Apathy has resulted in most shareholders' not exercising their voting rights. This presents a huge challenge for activists to obtain a majority vote of the outstanding shares, industry sources say.

But unhappy investors may be more motivated to vote, and the lower ISS threshold "will give them disproportionately more clout when measured against only the shares voted," says Cecilia Gondor, executive VP at Thomas J. Herzfeld Advisors.

"The ISS change will encourage activist investors to make shareholder proposals because in the future it could help them get ISS support in a proxy battle," Gondor says.

Nearly all proposals are non-binding, leaving it up to the board to decide whether to act or not.

While 2013 saw very little dissident activity due to closed-end funds' strong valuations, premiums evaporated and discounts widened in the summer and fall, Gondor says. Some activists urged funds to take action to narrow discounts and threatened to seek to oust directors.

Gondor's firm notes that last year AllianceBernstein Income Fund received written notice from shareholder activist Karpus Investment Management to present a proposal to open-end the fund as a way to address a wide discount to NAV.

Another shareholder group, Bulldog Investors, expressed concerns about a wide discount to NAV of the American Strategic Income Portfolio II and III and urged management to narrow the gap. The group took further action in urging shareholders to hold off on voting for director candidates and to vote against an executive compensation proposal for Equus Total Return citing poor performance.

Bulldog also notified shareholders that it was trying to oust a portfolio manager at the Firsthand Technology Value Fund. And it threatened to put forward a proposal if the management of the Swiss Helvetia Fund did not act promptly in narrowing a wide discount. The Swiss Helvetia fund has since announced a tender offer for up to 15% of its outstanding shares, which expires Feb. 11.

Shareholder group Brigade Leverage Capital Structures Fund managed to get its own candidate elected to the board of the Pimco Income Strategy Fund II last year and succeeded in doing the same with another candidate in 2012.

Wider prevailing discounts going into the New Year point to a busy proxy season ahead, Gondor says.

“We generally advise funds that have persistent wide discounts to be proactive in managing the discounts,” she says. “Some shareholder proposals are stronger than others; for instance, shareholder proposals to terminate the advisory agreement are binding. If passed, the manager will lose its job.”

Brett Gardner, senior corporate governance analyst with Karpus Investment Management, says the ISS change is significant for shareholder activists. While it is costly to put forward proposals, if discounts are not addressed proactively then Gardner expects to see more proposals this year.

The ISS change allows shareholders to express their concerns “more loudly and clearly versus the past where they could be ignored,” Gardner says.

Warren Antler, senior vice president of **AST Fund Solutions**, says activists will now know that directors are vulnerable. Antler’s firm represents proxies on behalf of closed-end funds.

If ISS recommends against voting for directors who do not support a shareholder proposal, then it may force more funds to come to terms with the activists, he says.

But Artie Regan, president of **Regan & Associates**, a proxy solicitor, is not convinced ISS will work in the best interests of shareholder activists. He says the change amounts to the “appearance of putting up a higher bar, but is more lip service.”

ISS can still decline to recommend votes against directors even if a shareholder proposal passes the vote threshold under the new change, Regan says.