Goldstein Says New SEC Ruling Puts A Chill On Shareholder Activism

Friday, June 5, 2020

Chuck Jaffe, in The NAVigator podcast, interviewed Phillip Goldstein, co-founder of Bulldog Investors and a leading activist in closed-end funds. Read the Q & A below as Phillip discusses a recent Securities and Exchange Commission decision that he says protects the fund operators at the expense of shareholders, and which he believes will widen discounts and make closed-end funds less attractive in the future.

Phillip Goldstein

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

CHUCK JAFFE: Legendary activist investor Phillip Goldstein is here. He's co-founder of Bulldog Investors, and we're going to discuss how a recent rules change could have a very serious impact on closed-end fund shareholders. This is The NAVigator. Welcome to The NAVigator, which covers all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator's brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry, from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction. Joining me today, it is a distinct pleasure and privilege to talk with Phillip

Goldstein, co-founder and portfolio manager at Bulldog Investors, and if you want more information, BulldogInvestors.com. But to say he's a legend in the closed-end fund space may actually understate the case. Now before we get in there, just a quick reminder. If you want to learn more about everything that's going on in the closed-end fund space, go to AICAlliance.org, the website of the Active Investment Company Alliance. Phillip Goldstein, great to chat with you again.

PHILLIP GOLDSTEIN: Good to talk to you, Chuck.

CHUCK JAFFE: Now the last time you and I spoke, it was last fall, AICA was holding its first ever conference, and you made a point there of saying that you felt that regulators were trying to take most of the activism out of the closed-end fund space. And in the middle of the pandemic economy and with everything else that's going on, the SEC passed a rule that -- well, it's a tool that allows closed-end funds to fight activist investors. Is this the turning point and the end of activist investing as you know it?

PHILLIP GOLDSTEIN: Well Chuck, it's a little early to tell that. I think that's overstating it, but it's certainly a milestone and not a good one.

CHUCK JAFFE: Explain a little bit about how the SEC's action is set up, and why it would discourage folks like you from doing your job.

PHILLIP GOLDSTEIN: Okay, so let me give you a little background. Under the Investment Company Act, there's a section that states that every share of stock issued by a registered investment company shall be a voting stock and have equal voting rights with every other outstanding voting stock. Certain states like Maryland have set up a law, a statute called the control share statute. And what these statutes do, is if a company opts into the statute, it prohibits a shareholder that acquires more than 10% of the company's outstanding shares, from voting any shares above that amount. Those two things seem to conflict. And back in 2010, the SEC wrote a letter addressing that control share statute, and it's called the Boulder Letter. It was issued by the Division of Investment Management, and they analyzed the legislative history, the congressional intent behind Section 18(i), and they concluded that closed-end funds would violate Section 18(i) if they opted into a control shares statute. So May 27th, the staff issued a bombshell statement in which it announced that it was withdrawing the Boulder Letter, and that from now on funds could opt into a control share statute as long as the board believed it was fulfilling its fiduciary duty. The staff didn't say that anything in the Boulder Letter was incorrect, but by withdrawing the Boulder Letter, the way I see it, it's effectively said to the fund boards, "You can go ahead and violate the Investment Company Act as long as you have a good reason." It's shocking because that's as far as I know, the first time the SEC has ever said to anyone that you can go ahead and violate a federal securities law without obtaining an exemptive order. To give you an analogy, it's as if like the Traffic Department issued an announcement saying that from now on, anyone can park in a no parking zone if you have a good reason to park there.

CHUCK JAFFE: Also at the core of this is what activist investors do. Quite honestly, I paint activist investors as heroes. I'm a journalist, I've covered the industry for a long time. You guys go in where you find a massive discount, where the firm doesn't seem to be willing to do anything to help shareholders realize value, and you put pressure on them to recognize that value. To open-end the mutual fund if that's what it takes, and help everybody realize the value that's there. But in this, if you're reading the SEC's letter, and you're reading things like the Investment Company Institute's support for it, they are talking about activist investors as if it's a bad thing, they call you profiteers. So is there any scenario where you, as an activist investor, kind of go, "Hey, you have to be protected from some kind of bad activism," as opposed to what has historically been seen as activism good for consumers?

PHILLIP GOLDSTEIN: Look, activists have a handful of tools, but the ultimate tool is the shareholder vote. It's a proxy contest. And it's expensive to run a proxy contest, so nobody's going to undertake a proxy contest if they can't acquire a significant stake in the company. And by limiting your ownership to 10% of a fund, for example let's say it's a $100 million fund for $10 million dollars, and saying, "Well, if you go over that, you can't vote your shares," is effectively deterring the proxy contest. Whether boards and activists agree as to what's good or bad, that's really a matter of opinion. Ultimately we have to leave it to a shareholder vote. Look, I've been involved in a lot of proxy contests. We've lost a lot. We've won some too. What this position that the SEC is taking effectively means is that the boards are not going to be held accountable to shareholders because it's going to put a significant impediment in the ability to run a proxy contest because it's not economically sensible to do it. So there's really no accountability. And the reason it's so shocking is that the SEC is supposed to protect investors, not fund managers. And let's face it, the fund managers claim to be looking out for the shareholders, but many of the actions that we advocate for would adversely impact their fees. And we believe that's the real reason. This is actually a perfect example of what's called 'regulatory capture', which is when a government's agency, whose job is to protect the public from abuses by a particular industry, become sympathetic to that industry. There's really nothing in the SEC's most recent letter that indicates any benefit to shareholders. It's obviously designed to protect managers. I mean, let's face it, management and activists in closed-end funds are almost natural enemies, and it's rather shocking that the SEC seems to have lost sight of who it's supposed to be protecting. It's very disheartening to see the SEC take the side of the industry over investors.

CHUCK JAFFE: If we get to a spot where activism is not active, where it is wiped out as you suggested it may be when we talked back last fall.

PHILLIP GOLDSTEIN: Right.

CHUCK JAFFE: Does that make closed-end funds dramatically less attractive for average investors?

PHILLIP GOLDSTEIN: The problem is, this may be the camel's nose under the tent, because they may pursue other anti-takeover revisions that are also of dubious legality. If these things take hold and the SEC sits on its hands, and it does deter activism as you suggest, I think the result will be wider discounts across the board. So I would be cautious about buying now, because I think you're going to see wider, like 20% plus discounts. And with no activism to prod managers to do anything about it, that could be a permanent situation. I've been investing in closed-end funds since the 70s, and in the 70s when there was no activism, you saw plain vanilla closed-end funds that invested in S&P 500 type portfolios that were trading at a 25% discount. And with no catalyst to do anything about it, that's where they stayed until the 80s and 90s, when activism started to evolve. I don't think shareholders having to sell those shares at a 25% discount is good for investors, and I don't know why the SEC doesn't see that. Other than as I said, regulatory capture. They get lobbied by the ICI and the industry, they don't really pay attention to investors. It's very sad.

CHUCK JAFFE: Phil, thank you so much for sharing your perspective, I look forward to chatting with you again down the line.

PHILLIP GOLDSTEIN: Thank you Chuck.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. I'm Chuck Jaffe and you can learn more about my work and my show at MoneyLifeShow.com. To learn more about closed-end funds and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest, Phillip Goldstein, co-founder and portfolio manager of Bulldog Investors. Learn more about him and the firm at BulldogInvestors.com. The NAVigator podcast is available every Friday, please subscribe where you find all your favorite podcasts. We hope you'll join us again next week, and until then, please stay safe everybody.

Recorded on June 4th, 2020

To request a particular topic for The NAVigator podcast please send an email to:

TheNAVigator@AICalliance.org

Click the link below to go to the home page of Active Investment Company Alliance to learn more:
https://AICalliance.org/

Disclosure: *Listed closed-end funds and business development companies trade on exchanges at prices that may be above or bellow their NAVs. There is no guarantee that an investor can sell shares at a price greater than or equal to the purchase price, or that a CEF's discount will narrow or be eliminated. Nonlisted closed-end funds and business development companies do not offer investors daily lliqudity: often on a small percentage of share on a quarterly or semi-annual basis. CEFs often use leverage, which can increases a fund's risk or volatility. The actual amount of distributions may vary with fund performance and other conditions. Past performance is no guarantee for future results.*