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Managers Now Offering Term CEFs to Minimize Premium Discounts

By Jennifer Banzaca

While closed-end funds (CEFs) have traditionally been perpetual offerings, more CEFS have term offerings that allow investors to liquidate at net asset value and minimize premium discounts.

CEFs are now being offered at terms between seven and 15 years.

Neil Sullivan, managing director and partner with Vision 4 Fund Distributors, said during the Future of the CEF Structure: From Creation to How They Trade In The Secondary Market panel at the Active Investment Company Alliance's (AICAlliance.org)'s Summer Summit on August 13th, said another term change is that all of costs associated with the offering are now being born by the investment management organization rather than the shareholders.

"These offerings are coming out at net asset value as opposed to having a spread associated with them. This is a material change from a few years ago when there was an initial spread and the commission and other associated costs were paid by the client, so not all of the investments went to work immediately," Sullivan explained.

William Meyers, Senior Managing Director in Nuveen's Global Product Group, said he has seen the closed-end structure starting to embrace other income related, nonbond-like investments, such as REITs and preferred stock.

"The closed-end structure then moved to more equity based approaches with things like utility stocks or maybe an equity with a covered call type approach. We're also seeing some income-producing equity vehicles with some private equity or non-liquid positions in there as a way to differentiate it from open-ended funds," Meyers added.

Sullivan said his firm has been working with a lot of managers moving towards income-producing equity vehicles with some private equity or non-liquid positions as a way to differentiate from open-ended counterparts.

"I'm also seeing a bit of a flight to safety, so there are certain people who are a bit leery of leverage so they are utilizing other mechanisms in order to generate the appropriate amount of yield. Such as covered call writing, level or manage distributions."

Going forward, Sullivan also stated that it would be healthy for the industry to see more equity offerings with less focus on the traditional fixed-income.

"On the fixed-income side we have seen a lot of filings right now that are using more esoteric fixed-income vehicles including a lot of synthetic products in the forms of CLOs and CDOs in order to generate the 6-6.5% yields that the market is seeming to strive for in a very low-interest rate environment.

Despite the volatility in the market and the overall economic downturn, the IPO market during this past year and a half has been pretty robust as sponsors seek to come to market.

According to Andrew Hall, Managing Director at NASDAQ, the exchanges has had 118 IPOs with total proceeds raised of $29.8 billion in the first eight months, compared to last year where 188 IPOs had total proceeds of $34.4 billion.

In the first eight months of this year, the NYSE has had 47 IPOs with $26 billion proceeds raised, as compared to 53 in 2019 and $25 billion raised.

Going forward, Sullivan noted that there could be at least one offering per month for the rest of 2020 and that after the presidential election in November managers will decide whether or not to go forward with any new offerings in 2021.

As for what's coming down the line, Sullivan said, there are a number of fixed-income offerings, as well as a lot of high-yield, CLOs and CDOs.

"On the other side of the ramp we're seeing a couple of preferred offerings that are looking to come out. We see a couple of potential equity offerings that are going to inorganically look to enhance yield by utilizing some option writing strategies. And we're also seeing a couple of offerings where they are putting a sleeve of privates in, which has so far proven to be very popular," Sullivan observed.

Sullivan said aside from more IPOs, there are also more financial advisers willing to take a closer look at the product.

"Prior to what we'll call NAV pricing or 2.0, we had a substantial spread of about four and a half points which was paid by the advisors, so the NAV was effectively $19.06 on a $20.00 offering price. A lot of advisors shied away from that. Now that all of those fees are being incurred by the advisor and the NAV is coming out at 20, people are taking a renewed interest in the overall value proposition."

In discussing what is driving the successful trading of closed-end funds, Marc Loughlin, a Director at WallachBeth said it depends on the asset class and types of investors.

"I think institutional investors are still driven by discount, but if we go outside of that, generally it's yield, total return, and the lowest sort of risk point on that X curve that you can get that yield. So, people in the space do gravitate toward yield, and generally they're quite asset ambivalent," Loghlin explained.