Industry Track Panel #8: Future of CEFs, BDCs and Interval Funds: Product Development & Secondary Market Support

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MODERATOR:
Amy Charles, Managing Director CEF Research - Raymond James

SPEAKERS:
Stephen Minar, Managing Director - BlackRock
Andrew Hall, Senior Managing Director - Nasdaq
Stephen Davis, Product Specialist, CEF – Nuveen

Due to compliance we had to remove the public replay comments from Finbar Ward at Morgan Stanley from the panel session.

AMY CHARLES: All right, good afternoon, my name is Amy Charles, I'm from Raymond James and I'm the head of closed-end fund research with Raymond James. I've been there for 29 years, I think this week, so I'm a franchise player is how I put it, and I know a lot of my colleagues have been all over the place but my card still says Raymond James. I'm going to have each of our panelists give themselves a quick little commercial and then we're get started.

STEPHEN MINAR: Stephen Minar, I'm at BlackRock, I head up our closed-end fund product team. I've been there for a little over nine years, and I've also spent pretty much entire career in closed-end funds, previously at Morgan Stanley, both as a research analyst and as a banker launching new funds.

STEPHEN DAVIS: Hello, everyone, my name is Stephen Davis, I'm a closed-end fund product specialist at Nuveen. I work with our internal wealth, US wealth sales teams, and I assist them in their conversations with their clients on all things related to closed-end funds trading in the secondary market. Relatively new to Nuveen, I've been at Nuveen for about two and a half years, but I've spent most of my career in closed-end funds. I worked in London as an investment companies analyst in the UK trust market, and then before Nuveen I was responsible for the sales and trading of all US listed closed-end funds at Cantor Fitzgerald.

ANDREW HALL: Andy Hall with NASDAQ, I've been with NASDAQ since 2004. I've been on the new listings team since 2007, and I work with all manner of new listings to NASDAQ equity listings, which includes closed-end funds and BDCs. Thanks.

AMY CHARLES: Great. I think this is a very closed-end fund heavy panel versus BDC, but if you guys have questions, Andy can answer it, the rest of us can't.

ANDREW HALL: I'll try.

AMY CHARLES: We'll figure out some kind of answer. The first thing that as an analyst I'm always looking at and I like to think of is aftermarket research, and where you guys think that the importance of aftermarket research. I think probably Stephen and Stephen, our twin Stephens there, can answer that probably best. So Minar, we'll start with you.

STEPHEN MINAR: Oh, thank you. Yeah, no, I think the aftermarket research is really critical because there's a huge push when you launch these products to drive demand at the IPO, and then in the secondary market you need to drive additional demand for those shares. We try to do that from our side through our wholesalers and through my team that supports these products, but I think it's really critical, especially at those large banks that are underwriters on these offerings, that they're out there providing that research to their financial advisors in terms of the ongoing performance, and then special considerations around discounts, taxes, et cetera, just to keep people updated on the funds. Unfortunately I would say in the recent past, since really the 2.0 structure, and we can get into what that means, but since basically 2019 a lot of those IPOs are not being covered at some of these firms, and that's left the void again on basically the asset managers to provide that research. And so we provide things like quarterly commentaries on all of our funds that we've launched since 2019, but again we'd love to see an increased support of these products in the secondary market from individuals like Amy.

STEPHEN DAVIS: Yeah, I would just say that at Nuveen we believe it's vital to support closed-end funds in the secondary. I work with a number of colleagues and other product specialists, as I said in my intro, we are on call and we support our US sales teams in their conversations. I keep our team, our US sales teams abreast of what's going on in the market in an internal weekly piece, and we also produce a monthly commentary to keep advisors aware of what's going on. I'd agree with Stephen, we need to support all closed-end fund investors, not just at the IPO primary stage but throughout. It's been a quiet market obviously in the last couple of years, and we've put resources into supporting our clients and help them navigate the market, and that's where we've been putting our resources.

AMY CHARLES: Great, speaking of 2.0--

So we talked about, Steve mentioned 2.0, so with the new issues, that's always been a big question I keep getting, "Are there going to be new issue closed-end funds?" "And if so, will they ever go back to perpetual or we'll stay with the 2.0 with the terms?" And so I think that Andy I'm going to get you in on here too to see what you see in the marketplace.

ANDREW HALL: Yeah, no worries.

STEPHEN MINAR: Sure, I'll jump in here. So just to explain it for those who may not be familiar with it, the 2.0 IPO structure just basically references the time when we changed a few things. One, we added limited terms to these funds, typically closed-end funds had historically been perpetual vehicles. The other major change was how the fees were charged up front, typically in the old 1.0 structure those were removed from the fund at the IPO, so your $20 market price or IPO price was about $19.06 NAV on the first day, again that 4.5% or 4.7% spread was coming out of the fund to pay the selling concession for the advisor, the underwriting fees, et cetera. So now today in the 2.0 structure, all of those fees have been removed, so your $20 IPO price is also a $20 NAV at the start, that has significantly improved how these funds have traded out of the gate, but I think to maybe differ a little bit from Finbar, I don't necessarily disagree with you, I think that we are in a healing period, I think we might need to start where we left off, but I also challenge the fact of what is the term really providing to the end client? I think when we've launched these funds, one of the other things that we've tried to do is really democratize access to private markets, and if you're putting illiquid assets in this vehicle, you also have to think about the liquidity constraints when it comes to that term. If the term is there to manage the discount, well, honestly I don't think we're necessarily seeing that in the market today either. I think some of the things that we've been trying more recently are ideas like discount management programs where you have a conditional tender offer on the discount, and so in our case we do that on a quarterly basis, if the discount's greater than 7.5% during that calendar quarter, that triggers a tender offer. I think something like that, maybe not necessarily quarterly, maybe it could be annually, but that could be more interesting in the new, what we'd call maybe 3.0 wrapper, that are at least some of the things we're considering on our end.

STEPHEN DAVIS: Yeah, I'll just add to that. I think Stephen's right, I think the term structure has become something that has become somewhat accepted. It does have a role and it can help investors match a liability if that suits the asset class in which the fund is investing. It can help narrow the discount, although you only tend to see that towards the end of the term. And I agree with Stephen, we might be in a situation where we see the structure evolve to incorporate some other liquidity measures, be they tenders or some sort of trigger at a certain discount level. It's tough to say, I would say that we might see some more term funds, but only if they suit what the asset class is trying to do.

STEPHEN MINAR: Yeah, sorry not to extend it.

AMY CHARLES: No, I was going to just chime in here.

STEPHEN MINAR: I think when it comes to terms, there are certain types of products that a term makes sense, right? There I think a term certainly makes sense because there's a defined life and there's an objective associated with it. But if it's meant to again mitigate the discount or manage the discount, well, then you need to see proof that it actually works, and I'm not seeing that in the market today.

AMY CHARLES: I'll just punch in here real quick. I think the funds that have term or defined term in the name tend to trade a little bit tighter than the ones that don't, because if it doesn't have it in the name, and I know closed-end fund names are extremely long as it is, your normal advisor or your normal investor doesn't realize that it's a 2.0, so I do think that. I think that it's also a very big marketing tool when you're trying to sell closed-ends, or on my side when I'm researching them, okay, this is at a 6% discount, it's going to liquidate in three years, that's a nice little thing that I can recommend to advisors. Andy, I'm going to get you involved here.

ANDREW HALL: Sure.

AMY CHARLES: I told you I would. So when you're listening to this, especially with the new issues, have you gotten any kind of feel of where the market's tipping towards? Are they going to go more towards NASDAQ, are your fees cheaper?

ANDREW HALL: Right.

AMY CHARLES: Can that help alleviate some of the fee constraints with the funds themselves and now with the fund companies having to outlay that initial money?

ANDREW HALL: Sure, so the listing fees on NASDAQ for closed-end funds and BDCs are quite low, it's actually lower than our normal common stock listing fee schedule, the initial listing fee is only $5,000, and then the annual fee is either $35,000 on the low end or $112,000 on the high end. That includes families, so you could have a hundred closed end funds and they're listed on NASDAQ and you pay $112,000. Of course that's reducing your costs from a fee standpoint, from a trading standpoint we all trade each other's stocks, we all have unlisted trading privileges, obviously closed-end funds, it's a big retail product, maybe only 25% institutionally held on average. So you've got a level of volume that trades in these closed-end funds which might trade 10,000 shares a day or up to 150 or into the hundreds of thousands of shares a day, about 60% of that volume is being internalized, so the market makers are matching at their own desks, so 100 shares to buy, 100 shares to sell, they'll internalize it within Morgan Stanley or they'll match it via dark pool. So then the other 40% of that volume is going to the exchanges, and if you look at the limit order book or level two quotes, you can see NASDAQ and the NYSE are equally trading that volume that's going to the exchanges regardless of listing location. A listing is a license, you need a transfer agent, if you want to be a public security in the US you have to be listed on NASDAQ or the NYSE, after that it doesn't matter. So yes, fees come into the subject, and then we also have some support services, no-cost IR services that we provide to the BDCs and closed-end funds for the first three or four years.

AMY CHARLES: Great. I'm constantly getting questions from retail [inaudible 0:15:49] who I talk to, I talk to advisors all the time, and they want to know where the trends are. And so I always look at inflows to open-ends or ETFs about where the inflows are going, or outflows conversely to see where things are coming out of which are going to be out of favor because inflows into the open-end funds equals more narrow discounts or even premiums, and vice versa. So do you guys have any themes that you think are coming for the next, if the window opens in 2025, what you're seeing, whether it be inflows, outflows, or just things you're hearing from your own teams?

STEPHEN DAVIS: I would just say I think whatever comes to market in 2025 is going to be to a certain extent dipping the toe back in, right? It's been a very quiet market, I think there's been a lot of healing to be done, but the market has improved, we've seen significant inflows into closed-end funds this year, renewed interest in the closed-end fund market. As interesting as that sounds, discounts have really, really tightened in this year, so the scene is set and I think we will see some issuance next year. I think it's going to be something that investors are comfortable with, I don't think this is the market where we launch a triple levered equity CLO tranche closed-end fund, I think it might be something a little bit more vanilla.

AMY CHARLES: Simple sauce.

STEPHEN DAVIS: Yeah, but I think that even within asset classes where there's already a closed-end fund, there's always a niche, there's always a different play on an asset class, and the structure can also evolve as well just as an asset class can. So

I think the market looks better, I know I would say that, but I think we're in a much better--

AMY CHARLES: We're not dead yet.

STEPHEN DAVIS: The closed-end fund structure is definitely not dead.

AMY CHARLES: That's good to know.

STEPHEN MINAR: I think flows is certainly a great place to look, I also think you need to focus on where are the valuations in the market? And I say valuations because we too often say discount, but not all funds trade at discounts, a lot of funds are actually trading at premiums today, and I think that's something that a lot of, particularly driven by the media that are focused on discounts and activism in this space, there's a ton of bright spots in the closed-end fund market as well. I think again some of this stuff goes unnoticed just because of a lot of the negativity that you hear in the media around the closed-end fund product, but like I said, there are a lot of bright spots.

AMY CHARLES: Great. All right, where am I at here? I feel like I got to get Andy back involved here. You were talking about trends. The equity trends versus BDCs and closed-end fund trends, what are you seeing on the equity side that could parlay into closed-ends and BDCs?

ANDREW HALL: From a BDC standpoint for new listings?

AMY CHARLES: Yeah.

ANDREW HALL: There were four last year, closed-end funds, and four so far this year. I mean, 2021 was an absolutely banner year off the charts for the broad equity market, in the US, $285 billion in offering raised for almost 1,000 listings. It was also a good year for closed-end funds at 12 or a little bit more than that, and that's what we've seen in terms of the trend of the closed-end funds. In the early 2000s when you had a low interest rate market, you had two dozen closed-end funds or more listing on the market, and then if there's headwinds in the market or interest rates went up, then that made it more challenging. Now we're seeing more like a handful every year of closed-end funds listing on the exchanges.

AMY CHARLES: Okay. All right, great. As far as going back to some of that aftermarket issues, consolidation, either making them into interval funds or consolidating similar funds, do you see this as a trend going forward? Probably the Stephens again.

STEPHEN MINAR: So this is something that's been a trend I think for probably the past decade now, and I think part of it is driven by just how products are launched in this market, right? You need a new IPO to raise new assets, raising in the secondary market is fairly limited given the constraints there, and so you end up with funds that have somewhat similar strategies. So there's a lot of reasons to continue the mergers where you do have that overlap, simplify your lineup, make it easier for people to make decisions. If you're choosing a BlackRock muni fund, you should only have one or two or three choices, not necessarily I think today we have 13 of the same strategy, right? So that's something that we've been focused on consolidating. I think one other thing, again going back to the topic around discounts, because it is a very common thing that's focused on in this market, we've been trying additional tools to manage those discount over time. I think if you just look back historically, a lot of this is just driven by rates, we've been in a very difficult part of the market here with rates going up. If you just look at the fed funds rate over the last 25 years and you track discounts, there's a pretty high correlation between those two things, but that doesn't mean that we shouldn't try to mitigate those discounts when they do widen out.

AMY CHARLES: Great. Do you want to add? Go ahead. You have plenty of time.

STEPHEN DAVIS: Yeah, the consolidation, if anyone was at ICI yesterday will remember that you've only got to go back 10 years and we had over 600 closed-end funds, we're right around 400 now, and if you look at why that's happened, a lot of it is to do with mergers and that's been something that the product teams have tried to do for the reasons Stephen explained, lots of benefits of larger funds associated with economies of scale. We merged a number of funds last year in the preferreds and the loans space, and we think it's beneficial obviously, lower expenses, better access to leverage, and better leverage terms. Just to build on what Stephen was saying, we've taken steps this year to address discounts, in addition to share buybacks we've increased distributions to essentially increase the demand for the fund shares, that's had a dramatic effect. If you look at discounts generally this year, all funds have narrowed in, but those funds that have increased their distributions and returned some capital in their distribution have narrowed more, and we think that's beneficial to shareholders. Of course an element of that is to stave off some activism, but this somewhat ties in with our outlook to do with rates as well, we think that declining leverage costs should reduce any reliance on return of capital in a distribution. We think those dynamics are in our favor, and of course share price returns have been good.

AMY CHARLES: Right, right. I'm going to put my hat back on. I have a question for, I think the whole panel. When we do at Raymond James our national conferences, and I sit in a BlackRock meeting or a Nuveen meeting or a Destra meeting, I know Rosey is here so I'm going to throw her under the bus a little bit, no one ever talks about closed-ends, not one person that the firm sent to our meetings talk about closed-ends. There's not research on the tables, there's not giveaways that say closed-end funds, so a lot of the times the only way someone at [inaudible 0:27:18] is hearing about closed-ends is when there's a new issue, and that's the only time that the wholesaler will talk about closed-ends at a conference. Is there anything that we can do to fix that? I'm at my conferences talking about closed-ends. If there's a Raymond James financial advisor in here that does not know we have closed-end fund research, meet me outside because I'm going to beat you up. So I think that closed-ends are sold, not bought, right? We all know that. So how do we get it to where people understand what value the product brings? I always say that it's the clearance rack of the investment world, right? You go to the back of the store, [inaudible 0:28:03] on sale, closed-ends are on sale, the alpha that you can generate from your clients I think is much better, and it's the same portfolio managers, right? So is there a way to where you can at least just have a 32-second plug, or have the people who are going to the conferences that are speaking talk about it in some capacity? Not everybody answer at once.

STEPHEN DAVIS: I can start off. Like I said earlier on, we pride ourselves on giving the best resources to shareholders. Our website, Nuveen.com website has a ton of resources from closed-end fund 101 to understanding managed distributions, understanding leverage. Myself and a number of colleagues support our teams, our sales teams, so we want to educate the wealth advisors on closed-end funds, we obviously believe in closed-end funds, we live and breathe them, we think they are an incredibly attractive product for investors looking for reliable high income. So yeah, it's something, the secondary market is important and we do everything we can to educate and support.

AMY CHARLES: And I think everybody that uses closed-end funds know about CEF, everybody. But if they don't use closed-end funds, they have no idea what it is, they don't know. And BlackRock's the same way, there's great information if they start looking, but how do we tell them to look there? That's the question. How do we get more people to look there?

ANDREW HALL: Yeah, NASDAQ tries to support all its new listings and continued listings. We have a very nice facility there in Midtown where companies ring the bell, but not only that, we have a full PR team to set up interviews with that new listing's CEO, so the same could be applied to that closed-end fund. And then some great event space in terms of them doing an investor meeting or even having a forum on closed-end funds, and that's all part of the listing experience, we're not adding additional costs to the issuer there. And then in addition to some investor relation tools that come at no costs for the first couple of years with the listing to help with investor targeting as well, and all that's for any issuer regardless, common stock, BDC, closed-end fund.

AMY CHARLES: When I first started, I literally looked in the paper for the previous week's NAV through the media, so things have grown so much, but it's more of just I think what maybe 25% of the financial advisors even know what a closed-end fund is. Because they're never going to hear, "I heard about this great closed-end fund at a cocktail party last week, what can you tell me about it?" So I think it's out of sight out of mind, and I think that's just getting into the branch offices, how do we do that? The best bet is to have your wholesaler just leave a tear sheet. If nothing else, they don't have to talk about it, just leave a tear sheet, and so I do think that that would help matters. I know they're not going to get paid on stuff, I get it. You get paid once, but it might open a conversation with that corner office guy they didn't have before, so it could be profitable all the way around, but that's just me. All right, we're getting close to time. Anybody have questions?

AUDIENCE QUESTION: Product development question for the three panelists. Let's say a year from now or five years from now we're talking about closed-end funds 3.0 instead of 2.0, and you had to limit it to just one additional key feature that was added to that 3.0 product, what would be one thing we're talking about four or five years from now if we're talking about closed-end funds 3.0? [inaudible 0:32:55]

STEPHEN MINAR: I think we're still assessing the impact of this, but I do think some sort of regular liquidity mechanism at NAV more frequently than 12 years is something that you'll see in the product.

STEPHEN DAVIS: Yeah, I would agree with that. I think some kind of liquidity measure, we're probably going to follow the path of the London market which has been more robust in its discount control mechanisms from the get go, from the IPO stage. Shareholders have come to expect some kind of discount control, whether it's a tender offer that's triggered at a certain discount level, but if there is a 3.0, I think that's what it would be.

AMY CHARLES: 2.5.

STEPHEN MINAR: How about lower underwriter fees?

AMY CHARLES: We're not a nonprofit business. It's not a nonprofit.

AMY CHARLES: Yes. Anyone else?

AUDIDENCE QUESTION: I think the industry should lobby the SEC to get rid of the prohibition on performance fees, because I think a lot of the top managers that we read about in *The Wall Street Journal* [inaudible] running hedge funds, they're not so restricted, and that's why Bill Ackman moved his hedge fund to Amsterdam to maybe get a performance fee. So I think, I don't really understand why you cannot put a performance fee, but I think that would attract these high-profile managers, and that might be, maybe not $50 billion dollars, but to start a fund where they really have the reputation and the publicity as people who think outside of the box and can perform [inaudible] closed-end fund might jumpstart the IPO market. So that's my two cents [inaudible]. Does anybody know why you can't have a performance fee? [inaudible].

AMY CHARLES: I think because it's a 40 Act retail product, and so we don't have any of those complications around it, so anybody can buy it.

STEPHEN MINAR: Yeah, you would have to be qualified client.

AMY CHARLES: Yeah, that's the word.

AMY CHARLES: All right, I think our time is up. Thank you, and thank you, audience.

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