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Support NYSE's Proposal—End Unnecessary Annual Meetings for Listed Closed-End Funds

The New York Stock Exchange's (NYSE) annual shareholder meeting requirement for listed closed-end funds (CEFs) is creating an end-run around the investor protections of the Investment Company Act of 1940 (1940 Act), the landmark law governing mutual funds and other registered investment companies.

To protect long-term shareholder interests, the Securities and Exchange Commission (SEC) should adopt the NYSE's recent proposal to eliminate this requirement, as it provides little benefit to long-term shareholders, costs them millions of dollars in expenses, and exposes their money to the impacts of bad actors.

A Little History

When formulating the 1940 Act, lawmakers expressed concerns that a fund shareholder with an outsized minority interest could control the shareholder vote and potentially harm long-term investors in a fund. The harm that a controlling shareholder could cause by electing different directors—who in turn could change the fund's investment management contract or investment policies—was thought to be too great to retail shareholders, who generally invested based on a fund's investment strategy, relied on continuity of the fund's management, and were less likely to participate in annual meetings. Thus, in lieu of an annual meeting, Congress built in itemized protections for retail shareholders in registered funds, including listed CEFs.

Despite Congress' intent, CEFs are still forced to hold annual shareholder meetings due to the listing rules of the NYSE. The NYSE's meeting requirement, which no other type of registered fund is subject to, dates back to 1909, 20 years before the exchange listed its first investment company and long before the protections of the 1940 Act.

Costly Meetings for No Benefit

Recent data on contested proxies shows that retail investors directing their own vote held 59% of outstanding CEF shares but only accounted for 37% of the votes cast. Further, when these shareholders did vote, they leaned heavily toward supporting management, with 84% of voting accounts—and over a majority of the total directed retail shares voting—voting in favor of management.

What's more, cost estimates across 145 proxy campaigns between 2012 and 2019 totaled a whopping $373 million, according to ICI data. Those costs compound over time and are ultimately borne by funds and their shareholders.

The Activist Issue

Not only are annual meetings an unnecessary cost that has historically drawn limited retail participation, but they provide an outlet for harmful activist maneuvers. Listed CEFs trade at market price, which is often less than the fund's net asset value (NAV). This *discount* is representative of financial theories related to unaccrued expenses, such as liquidating the portfolio, unwinding a leveraged position, or perceived tax liabilities, in addition to investor sentiment. The discount can present a buying opportunity as investors are able to buy listed CEF shares or reinvest dividends at a bargain relative to the fund's NAV, which in turn boosts the dividend yield and allows for the potential of enhanced total returns. However, instead of investing for long-term value, activist investors are exploiting the NYSE's annual meeting rules to take over listed CEFs, typically with the primary goal of arbitraging their way to short-term profits.

Emerging Activist Playbook—Case Study

The activist takeover of the Voya Prime Rate Trust is a textbook example of exploitative arbitrage strategies, embodying the danger that Congress tried to steer the industry clear of in 1940.

In April 2020, an activist firm used its control of 24.6% of the fund's outstanding shares to institute a proxy battle that changed all eight of the fund's directors. Of approximately 147 million shares outstanding, 39% voted for the activist's board slate, 25% voted for the existing board directors, and 34%—presumably retail investors—did not vote, meaning the activist was able to replace directors with only 14% of outstanding shares that it did not otherwise control.

The new board terminated the existing investment adviser and appointed the activist, with shareholder approval, as the new adviser. During that time, the fund engaged in two tender offers (i.e., share buybacks). While the activist secured a nice profit for itself, the tenders resulted in a significant loss in economies of scale for remaining shareholders.

Further, several of the fund's investment restrictions were ultimately changed and the fund's portfolio was dramatically altered, making it a different strategy than what long-term shareholders had originally signed up for.

The fund previously held approximately 96% of its assets in senior loans. But by October 2023, following the activist takeover, it had only 10% exposure to the senior loan sector, as the activist had reallocated toward other CEFs, crypto trusts, private funds, and special-purpose acquisition companies (SPACs) while incurring new expenses related to costly short sale exposure. The quantified harms of those actions are explained and visualized here.

The Bottom Line

To the extent anyone can claim annual meetings provide a *benefit*, it is activist investors operating for their own financial gain. With the annual meeting requirement eliminated, costs to CEF shareholders will be reduced and activists will find it much harder to prey on CEFs. Investors and stakeholders should tell the SEC to approve NYSE's proposed rulemaking.