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Investment Management Alert

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Neuberger Berman Alleges Saba Capital Violating 1940 Act To Win Proxy Fights; Saba Investors on Notice, Should Consider Own Duties

As recently noted, Saba Capital Management, L.P. (Saba) has begun to escalate its attacks on the closed-end fund asset class, at the expense of retail fund shareholders.[1] Saba continues its offensive against closed-end funds, having engaged a Neuberger Berman-managed closed-end fund in a proxy contest, where Saba is seeking board seats, to terminate the fund's advisory contract and to request that the board consider a self-tender offer for all outstanding common stock of the fund, where if more than 50% of fund shares are tendered, the fund will instead liquidate or convert to an open-end fund.

On August 12, 2019, the Neuberger Berman-managed fund filed a preliminary proxy statement alleging that Saba is violating the Investment Company Act of 1940 (1940 Act). Specifically, the proxy statement alleges that Saba knowingly fails to comply with regulatory requirements designed to ensure the fair and efficient operation of the exchange-traded fund that it subadvises, Saba Closed-End Funds ETF (Saba ETF). According to the proxy statement, the Saba ETF relies on an exemptive order from the Securities and Exchange Commission (SEC) requiring that the daily creation basket published by the Saba ETF "will correspond pro-rata to the positions in the [f]und's portfolio ..." except in very limited and narrow circumstances. The proxy statement alleges that the Saba ETF "has blatantly disregarded that Exemptive Relief requirement as the creation baskets deviate drastically from the [Saba] ETF's actual portfolio holdings," and that Saba's "improper management of the [Saba] ETF creation basket process has also allowed Saba the flexibility to retain, and in some instances aid in obtaining, ownership stakes in certain closed-end funds so that Saba can exert additional influence on closed-end funds." Separately, the proxy statement alleges that this mismanagement of the Saba ETF constitutes a joint transaction prohibited by Section 17(d) of the 1940 Act as well as a "serious conflict of interest."

Notably, in its own proxy statement, Saba does not robustly dispute the fund's allegations (saying only that "Saba believes the [Saba] ETF remains in compliance with its obligations under the 1940 Act") but rather dismisses the allegation as irrelevant to the matter at hand. Regardless of which party prevails on the merits of the allegation, we could not disagree more with the proposition that the allegation is irrelevant to the matter at hand. We believe it is in fact central to the matter at hand. The 1940 Act is, in large part, devoted to the mission of ensuring that funds can operate for the benefit

[1] See our June 7, 2019, client alert, "Class Action Proxy Litigation Highlights Need for Corporate Defense Strategies in Closed-End Funds," and our June 19, 2019, client alert, "Activists Take Another $290 Million Bite Out of Vulnerable Closed-End Fund Asset Class."

of retail investors free from interference and manipulation by financial "players." To date, institutional opportunists like Saba have not been held to the rigors of that mission, including most importantly the regulation of large shareholders' abuse of fund investors for their own benefit. We reject the notion that somehow, these essential protections for retail investors have become irrelevant to the will of powerful industry opportunists.

We urge Congress as well as members of the SEC and its staff to take note that, perhaps as a result of lack of historic enforcement, these opportunists have become so emboldened as to assert that their violation of the laws designed to protect shareholders in the funds they seek to coerce is simply not relevant to that very coercion.

Regulated institutions with or considering investments in Saba's closed-end fund "arbitrage" strategy for themselves or their clients, particularly registered investment advisers, should also take note and decide on appropriate action. Saba assets invested in closed-end funds have more than doubled, from approximately $633 million in June 2018 to approximately $1.4 billion in June 2019, according to Saba's filings with the SEC, fueling its ability to pressure target funds to accept Saba's demands. According to one publication, this type of growth represents a strong demand for Saba's closed-end fund "arbitrage program," and Saba is actively fundraising for such a program.[2] Neuberger Berman's allegations put investors on notice that the gains of this strategy potentially are founded on a business model operated in violation of law, to the detriment of investors in the funds Saba targets. This raises serious issues of whether continued or new investment in Saba's closed-end fund "arbitrage program" is consistent with such institutional investors' own obligations under federal and state law. Knowingly or recklessly funding illegal activity raises aiding-and-abetting and conspiracy issues as well as Investment Advisers Act Section 206, Section 203(e)(6) and Rule 204A-1 issues. Some will recall for example that sponsors of Madoff "feeder funds" faced breach of fiduciary duty and other claims from investors and regulators. Even if Saba does not take Neuberger Berman's allegations seriously, institutional investors need to do so.

[2] "Strong Demand for Saba Strategy," Hedge Fund Alert (July 10, 2019).