

US Closed-End Funds

Closed-end funds are one of four types of investment companies, along with mutual (or open-end) funds, exchange-traded funds (ETFs), and unit investment trusts. Closed-end funds generally issue a fixed number of shares that are listed on a stock exchange or traded in the over-the-counter market. The assets of a closed-end fund are professionally managed in accordance with the fund's investment objectives and policies and may be invested in stocks, bonds, and other securities. Because a closed-end fund does not need to maintain cash reserves or sell securities to meet redemptions, the fund has the flexibility to invest in less-liquid portfolio securities. Total assets of closed-end funds were \$252 billion at year-end 2022.

IN THIS CHAPTER

- 63 What Is a Closed-End Fund?
- 64 Total Assets and Net Issuance of Closed-End Funds
- 66 Closed-End Fund Distributions
- 67 Closed-End Fund Leverage
- 70 Characteristics of Households Owning Closed-End Funds

What Is a Closed-End Fund?

A closed-end fund is a type of investment company whose shares are listed on a stock exchange or traded in the over-the-counter market. The assets of a closed-end fund are professionally managed in accordance with the fund's investment objectives and policies and may be invested in stocks, bonds, and other securities. The market price of a closed-end fund share fluctuates like that of other publicly traded securities and is determined by supply and demand in the marketplace.

A closed-end fund is created by issuing a fixed number of common shares to investors during an initial public offering. Subsequent issuance of common shares can occur through secondary or follow-on offerings, at-the-market offerings, rights offerings, or dividend reinvestments. Closed-end funds are also permitted to issue one class of preferred shares in addition to common shares. Holders of preferred shares are paid dividends, but do not participate in the gains and losses on the fund's investments. Issuing preferred shares allows a closed-end fund to raise additional capital, which it can use to purchase more securities for its portfolio.

Once issued, shares of a closed-end fund are generally bought and sold by investors in the open market and are not purchased or redeemed directly by the fund—although some closed-end funds may adopt stock repurchase programs or periodically tender for shares. Because a closed-end fund does not need to maintain cash reserves or sell securities to meet redemptions, the fund has the flexibility to invest in less-liquid portfolio securities. For example, a closed-end fund may invest in securities of very small companies, municipal bonds that are not widely traded, or securities traded in countries that do not have fully developed securities markets.

**LEARN
MORE**

Closed-End Fund Resource Center
www.ici.org/cef



Total Assets and Net Issuance of Closed-End Funds

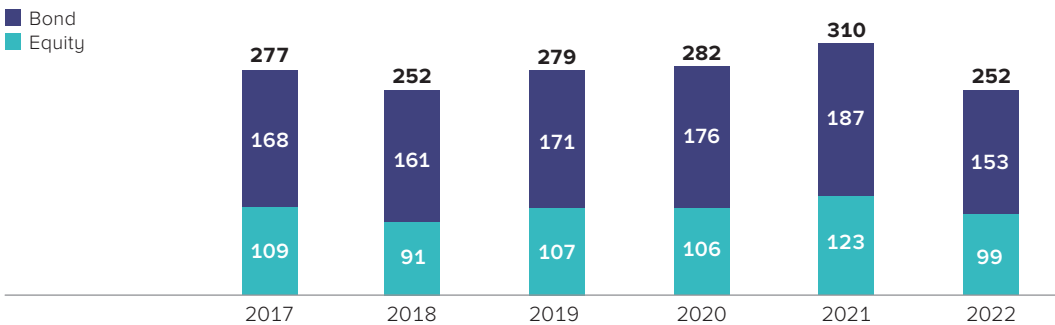
At year-end 2022, 441 closed-end funds had total assets of \$252 billion (Figure 5.1)—a decrease of 19 percent from year-end 2021. The decrease in closed-end fund assets in 2022 reflected market returns and negative net share issuance.

Historically, bond funds have accounted for the majority of assets in closed-end funds. At year-end 2022, bond closed-end funds accounted for 61 percent of all closed-end fund assets, the same as at year-end 2017 (Figure 5.1). These shares have remained relatively stable, in part, because of two offsetting factors. Cumulative net issuance of bond closed-end fund shares exceeded that of equity fund shares—offsetting the total returns on US stocks,* which exceeded those of US bonds† during this time.

The number of closed-end funds available to investors decreased again in 2022 (Figure 5.1). In recent years, more closed-end funds were liquidated, merged, or converted into open-end mutual funds or ETFs than were launched.

FIGURE 5.1
Total Assets of Closed-End Funds Declined in 2022

Billions of dollars, year-end



Number of closed-end funds	2017	2018	2019	2020	2021	2022
Bond	335	325	320	316	293	278
Equity	197	179	180	176	169	163

Note: *Total assets* is the fair value of assets held in closed-end fund portfolios funded by common and preferred shares less any liabilities (not including liabilities attributed to preferred shares).

Source: ICI Research Perspective, “The Closed-End Fund Market, 2022”

* As measured by the Wilshire 5000 Total Market Index.

† As measured by the S&P US Aggregate Bond Index.

LEARN
 MORE

The Closed-End Fund Market, 2022
www.ici.org/files/2023/per29-05.pdf

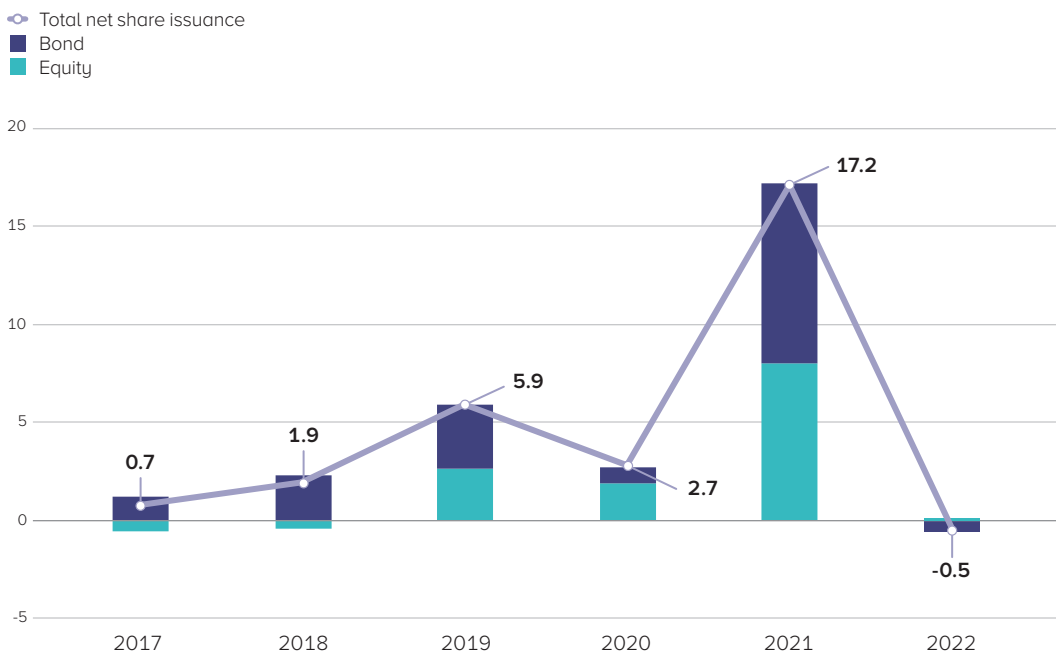


Closed-end funds had negative net share issuance of \$489 million in 2022, compared with positive net issuance of \$17.2 billion in 2021 (Figure 5.2). In 2022, equity closed-end funds had positive net issuance of \$135 million, while bond closed-end funds had negative net issuance of \$623 million. Negative returns on stocks around the world and capital losses on bonds likely contributed to the weakened demand for closed-end funds in 2022.

FIGURE 5.2

Closed-End Fund Net Share Issuance Weakened Substantially in 2022

Billions of dollars, annual



Note: Net share issuance is the dollar value of gross issuance (proceeds from initial and additional public offerings of shares) minus gross redemptions of shares (share repurchases and fund liquidations).

Source: ICI Research Perspective, "The Closed-End Fund Market, 2022"

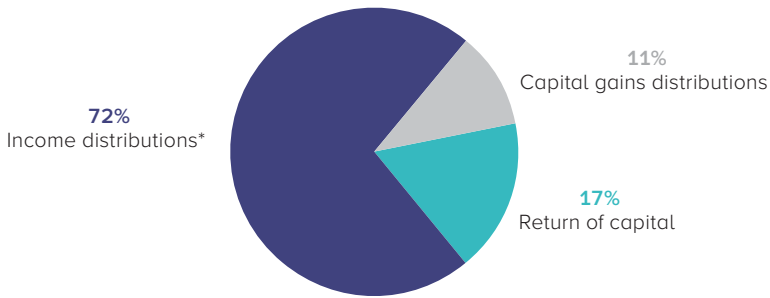
Closed-End Fund Distributions

In 2022, closed-end funds distributed an estimated \$16.7 billion to shareholders (Figure 5.3). Closed-end funds may make distributions to shareholders from three possible sources: income distributions, which are payments from interest and dividends that the fund earns on its investments in securities; realized capital gains distributions; and return of capital. Income distributions accounted for the majority (72 percent) of closed-end fund distributions. Capital gains distributions accounted for 11 percent of closed-end fund distributions and return of capital for 17 percent.

FIGURE 5.3

Most Closed-End Fund Distributions Are from Income Distributions

Percentage of closed-end fund distributions, 2022



Total closed-end fund distributions: \$16.7 billion

* Income distributions are paid from interest and dividends that the fund earns on its investments in securities.

Source: ICI Research Perspective, "The Closed-End Fund Market, 2022"

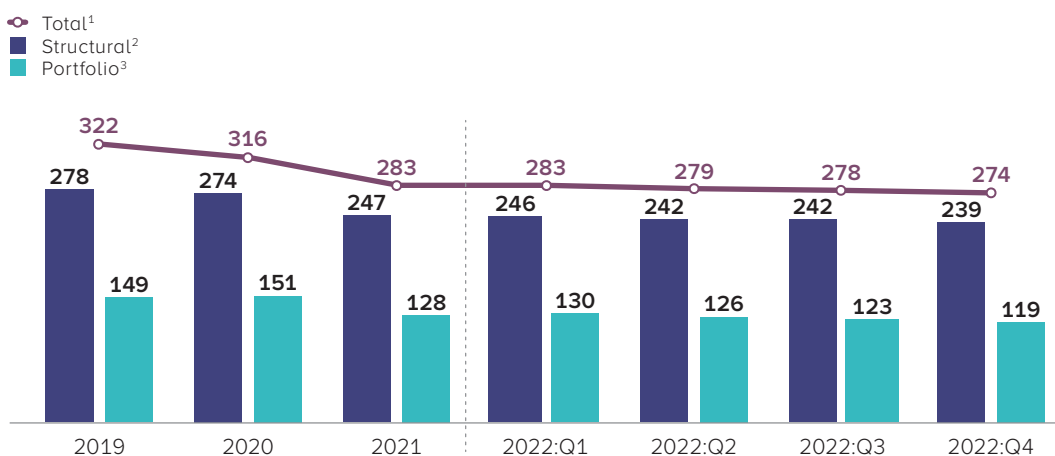
Closed-End Fund Leverage

Closed-end funds have the ability—subject to strict regulatory limits—to use leverage as part of their investment strategy. The use of leverage by a closed-end fund can allow it to achieve higher long-term returns, but also increases risk and the likelihood of share price volatility. Closed-end fund leverage can be classified as either structural leverage or portfolio leverage. At year-end 2022, 274 funds, accounting for 62 percent of closed-end funds, used structural leverage, some types of portfolio leverage (i.e., tender option bonds or reverse repurchase agreements), or both as a part of their investment strategy (Figure 5.4).

FIGURE 5.4

Closed-End Funds Are Employing Structural Leverage and Portfolio Leverage

Number of funds, end of period



¹ Components do not add to the total because funds may employ both structural and portfolio leverage.

² Structural leverage affects the closed-end fund's capital structure by increasing the fund's portfolio assets through borrowing and issuing debt and preferred shares.

³ Portfolio leverage is leverage that results from particular types of portfolio investments, including certain types of derivatives, reverse repurchase agreements, tender option bonds, and other investments or types of transactions. Data are only available for reverse repurchase agreements and tender option bonds. Given data collection constraints, and the continuing development of types of investments/transactions with a leverage characteristic (and the use of different definitions of leverage), actual portfolio leverage may be materially different from what is reflected above.

Source: ICI Research Perspective, "The Closed-End Fund Market, 2022"

LEARN
MORE

Frequently Asked Questions About Closed-End Funds and Their Use of Leverage

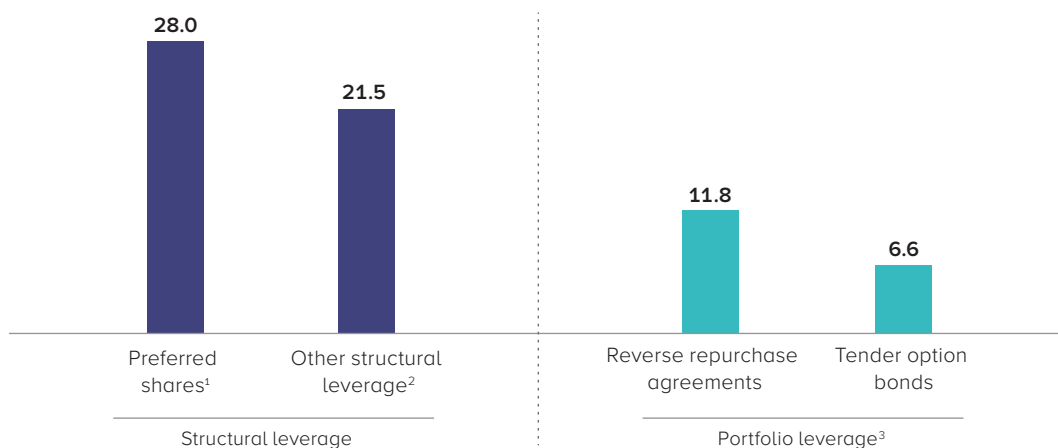
www.ici.org/faqs/faq/other/faqs_closed_end

Structural leverage affects the closed-end fund's capital structure by increasing the fund's portfolio assets. Types of closed-end fund structural leverage include borrowing capital and issuing debt and preferred shares. At the end of 2022, 239 funds had a total of \$49 billion in structural leverage, with \$28 billion from preferred shares and \$21 billion from other structural leverage, which includes bank borrowing and other forms of debt (Figures 5.4 and 5.5). The average leverage ratio* across those closed-end funds employing structural leverage was 30 percent at year-end 2022. Among closed-end funds employing structural leverage, the average leverage ratio for bond funds was somewhat higher (32 percent) than that of equity funds (26 percent).

Portfolio leverage is leverage that results from particular portfolio investments, such as certain types of derivatives, reverse repurchase agreements, and tender option bonds. At the end of 2022, 119 closed-end funds had \$18 billion outstanding in reverse repurchase agreements and tender option bonds (Figures 5.4 and 5.5).

FIGURE 5.5
Closed-End Funds Use Leverage

Billions of dollars, year-end 2022



¹ A closed-end fund may issue preferred shares to raise additional capital, which can be used to purchase more securities for its portfolio. Holders of preferred shares are paid dividends, but do not participate in the gains and losses on the fund's investments.

² *Other structural leverage* includes bank borrowing and other forms of debt.

³ Portfolio leverage is leverage that results from particular types of portfolio investments, including certain types of derivatives, reverse repurchase agreements, tender option bonds, and other investments or types of transactions. Data are only available for reverse repurchase agreements and tender option bonds. Given data collection constraints, and the continuing development of types of investments/transactions with a leverage characteristic (and the use of different definitions of *leverage*), actual portfolio leverage may be materially different from what is reflected above.

Source: ICI Research Perspective, "The Closed-End Fund Market, 2022"

* The *leverage ratio* is the ratio of the amount of structural leverage to the sum of the amount of common share assets and structural leverage.

Closed-End Fund Discounts

More than 95 percent of exchange-listed closed-end funds calculate the value of their portfolios every business day, while the rest calculate their portfolio values weekly or on some other basis. The net asset value (NAV) of a closed-end fund is calculated by subtracting the fund's liabilities (e.g., fund borrowing) from the current market value of its assets and dividing by the total number of shares outstanding. The NAV changes as the total value of the underlying portfolio securities rises or falls, or the fund's liabilities change.

Because an exchange-listed closed-end fund's shares trade based on investor demand, the fund may trade at a price higher or lower than its NAV. A closed-end fund trading at a share price higher than its NAV is said to be trading at a "premium" to the NAV, while a closed-end fund trading at a share price lower than its NAV is said to be trading at a "discount." Funds may trade at discounts or premiums to the NAV based on market perceptions or investor sentiment. For example, a closed-end fund that invests in securities that are anticipated to generate above-average future returns and are difficult for retail investors to obtain directly may trade at a premium because of a high level of market interest. In contrast, a closed-end fund with large unrealized capital gains may trade at a discount because investors will have priced in any perceived tax liability. Closed-end fund price deviations widened somewhat in 2022. Although discounts fluctuated over the course of the year, they averaged 5.7 percent for equity funds and 5.0 percent for bond funds in 2022.

FIGURE 5.6

Closed-End Fund Discounts Widened in 2022

Percent, month-end



Note: The premium/discount rate is the simple average of the percent difference between share price and NAV at month-end.

Source: Investment Company Institute calculations of Bloomberg and Refinitiv data

Characteristics of Households Owning Closed-End Funds

An estimated 3.8 million US households owned closed-end funds in 2022 (see Figure 7.1). These households tended to include investors who owned a range of equity and fixed-income investments (Figure 5.7). More than nine in 10 households owning closed-end funds also owned mutual funds, and more than six in 10 also owned ETFs. Six in 10 households owning closed-end funds also invested in individual stocks.

FIGURE 5.7

Closed-End Fund Investors Owned a Broad Range of Investments

Percentage of closed-end fund–owning households holding each type of investment, 2022

Equity mutual funds, individual stocks, or variable annuities (total)	88
Bond mutual funds, individual bonds, or fixed annuities (total)	56
Mutual funds (total)	91
Equity	79
Bond	40
Hybrid	39
Money market	59
Exchange-traded funds (ETFs)	62
Individual stocks	60
Individual bonds	16
Fixed or variable annuities	23
Investment real estate	28

Note: Multiple responses are included.

Source: ICI Research Perspective, “The Closed-End Fund Market, 2022”

Because households that owned closed-end funds often also owned individual stocks and mutual funds, the characteristics of each group were similar in many respects. For instance, households that owned closed-end funds (like households owning individual stocks and mutual funds) tended to have household incomes and financial assets above the national median or tended to own retirement accounts (Figure 5.8). Nonetheless, households that owned closed-end funds exhibited certain differences. For example, 39 percent of closed-end fund–owning households were retired from their lifetime occupations compared with about one-third of those owning individual stocks or mutual funds. Households owning closed-end funds also expressed more willingness to take financial risk, as 49 percent were willing to take above-average or substantial risk, compared with 34 percent of mutual fund–owning households.

FIGURE 5.8

Closed-End Fund Investors Had Above-Average Household Incomes and Financial Assets

2022

	All US households	Households owning closed-end funds	Households owning mutual funds	Households owning individual stocks
Median				
Age of head of household ¹	52	50	54	53
Household income ²	\$69,000	\$100,000	\$100,000	\$125,000
Household financial assets ³	\$87,500	\$323,000	\$250,000	\$375,000
Percentage of households				
Household primary or co-decisionmaker for saving and investing				
Married or living with a partner	64	69	71	72
College or postgraduate degree	39	50	54	61
Employed (full- or part-time)	56	59	64	64
Retired from lifetime occupation	32	39	34	33
Household owns				
IRA(s)	42	71	67	69
DC retirement plan account(s)	57	78	81	79
Household's willingness to take financial risk				
Substantial risk for substantial gain	5	12	6	7
Above-average risk for above-average gain	19	37	28	37
Average risk for average gain	39	33	47	44
Below-average risk for below-average gain	11	11	11	8
Unwilling to take any risk	26	7	8	4

¹ Age is based on the sole or co-decisionmaker for household saving and investing.

² Total reported is household income before taxes in 2021.

³ Household financial assets include assets in employer-sponsored retirement plans but exclude the household's primary residence.

Source: ICI Research Perspective, "The Closed-End Fund Market, 2022"

LEARN
MORE

A Guide to Closed-End Funds

www.ici.org/cef/background/bro_g2_ce