



**Fitch**Ratings

# Leverage in U.S. Closed-End Funds Through Recent Market Developments

**Speakers:**

Ian Rasmussen

Yuriy Layvand, CFA

**Capital Link Webcast:**

September 10, 2013



# Fitch Research Reports

- Opt in to receive Fitch's forthcoming research on closed-end funds:

<http://pages.fitchemail.fitchratings.com/FAMCEFBlankOptin>

- Rating Criteria:

Rating Closed-End Fund Debt and Preferred Stock

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=716220](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=716220)

# Agenda and Presentation Outline

## **Performance and Leverage Impact**

1. Bond Funds
2. Loan Funds
3. Equity Funds
4. Investment Grade Muni Funds
5. High Yield Muni Funds

## **Use of Leverage by Taxable CEFs**

1. Current Leverage Snapshot
2. Issuance of Long-term Debt
3. Bank Funding

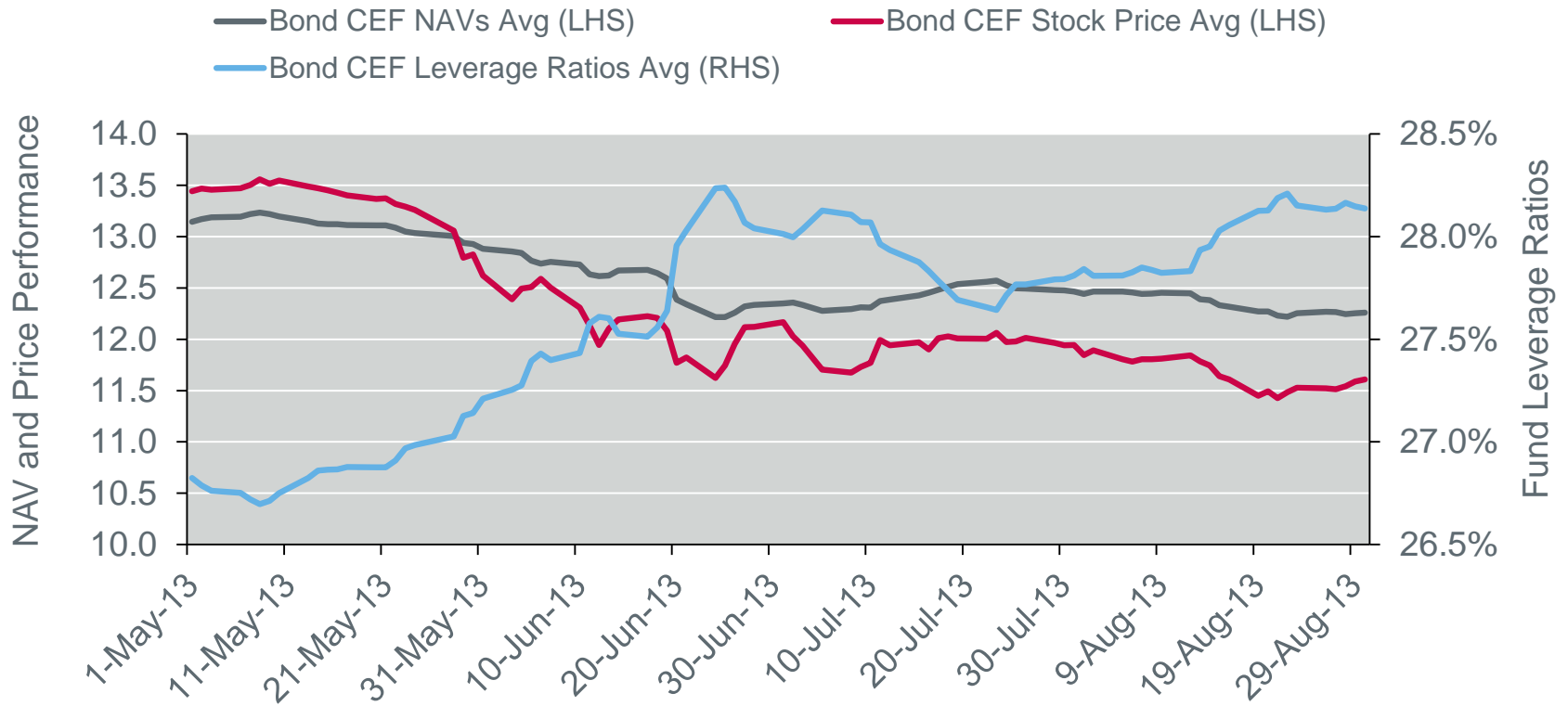
## **Use of Leverage by Municipal CEFs**

1. Current Leverage Snapshot

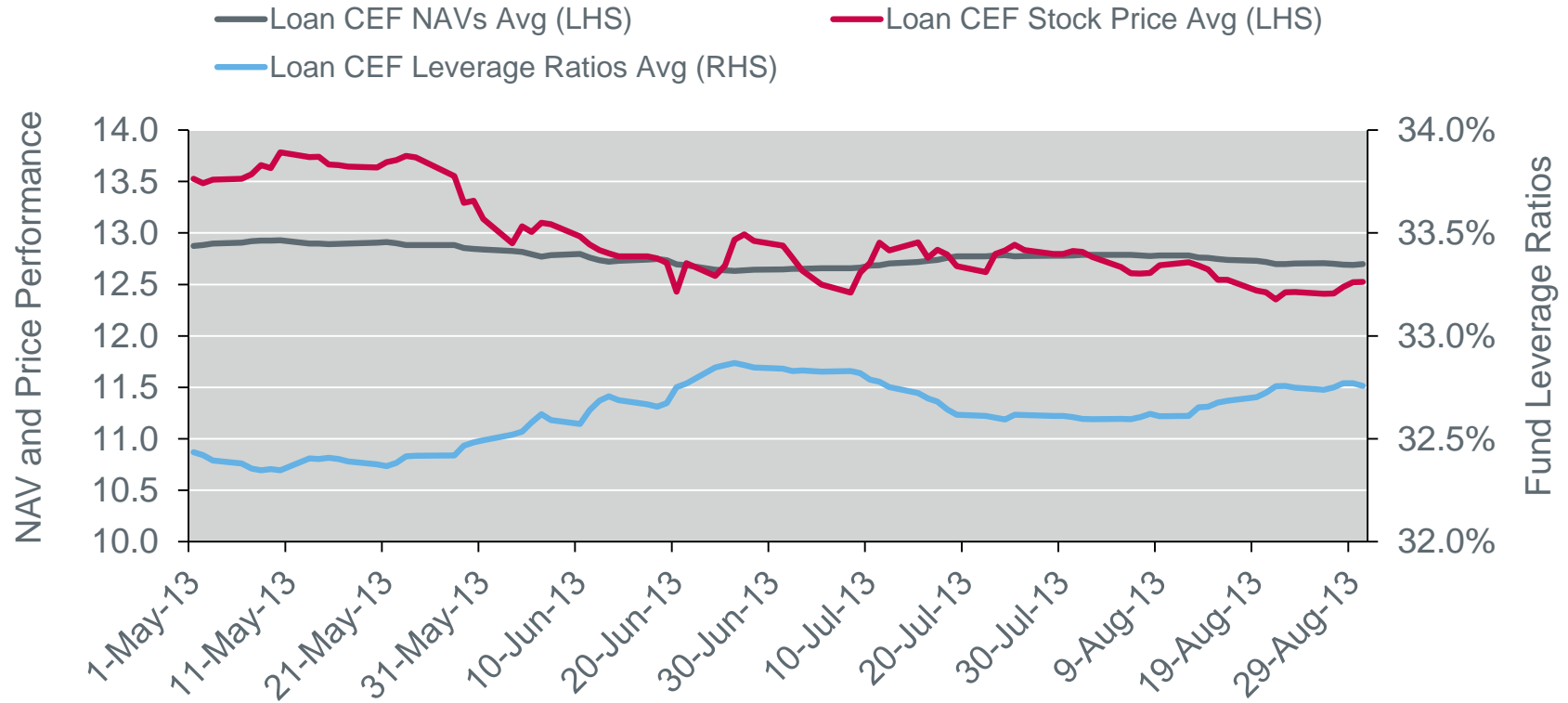
## **Cost of Leverage Across Type and Tenor**

1. Taxable Closed-End Funds
2. Municipal Closed-End Funds

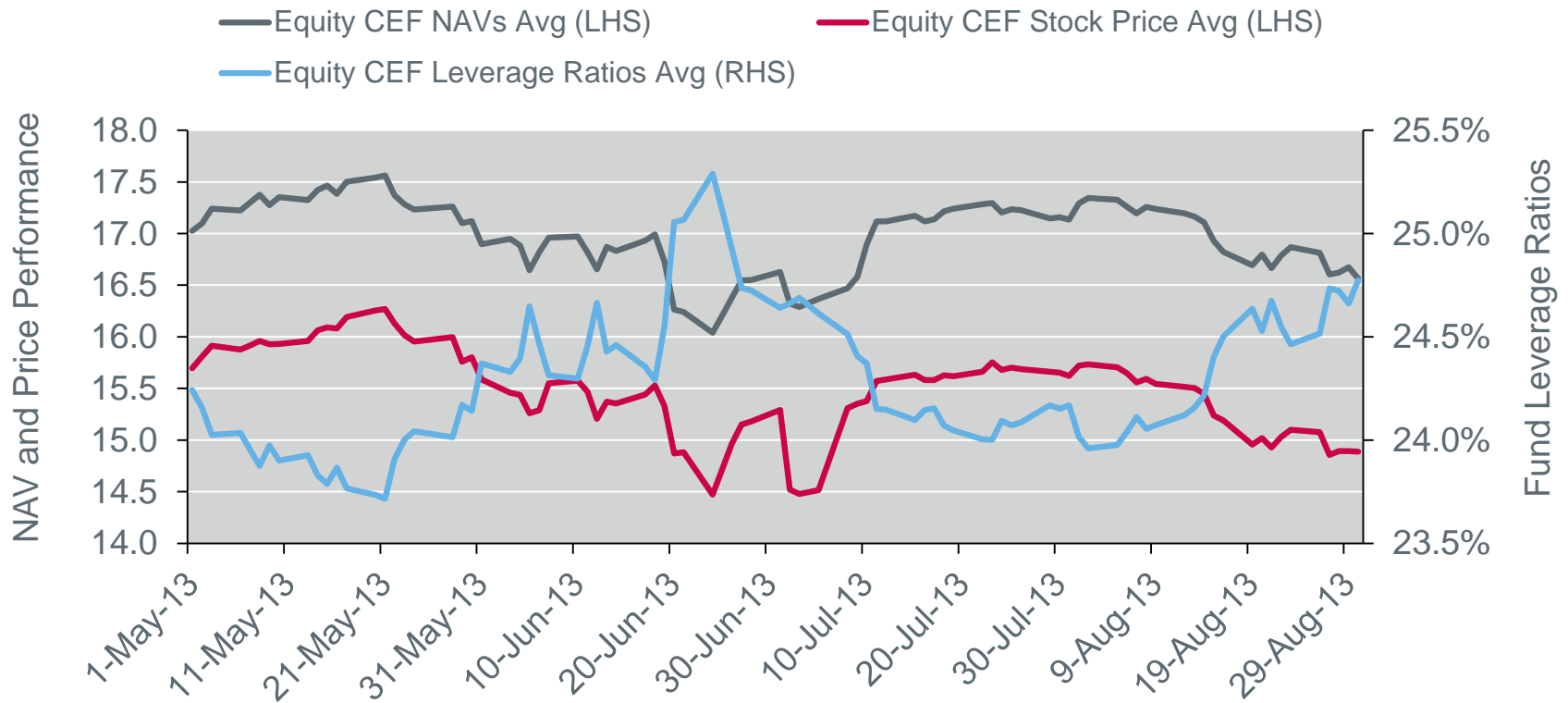
# Corporate Bond Funds: Performance and Leverage Impact



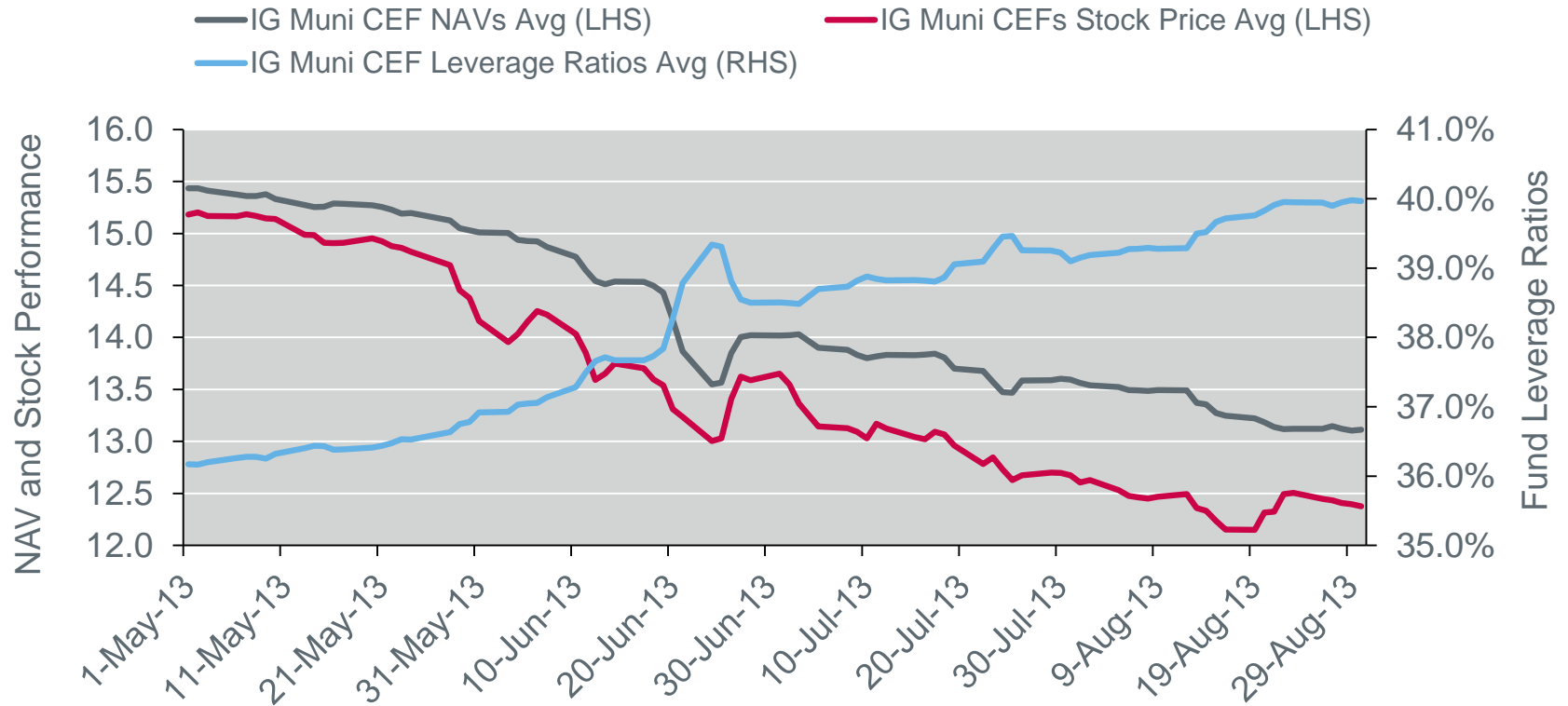
# Corporate Loan Funds: Performance and Leverage Impact



# Equity Funds: Performance and Leverage Impact

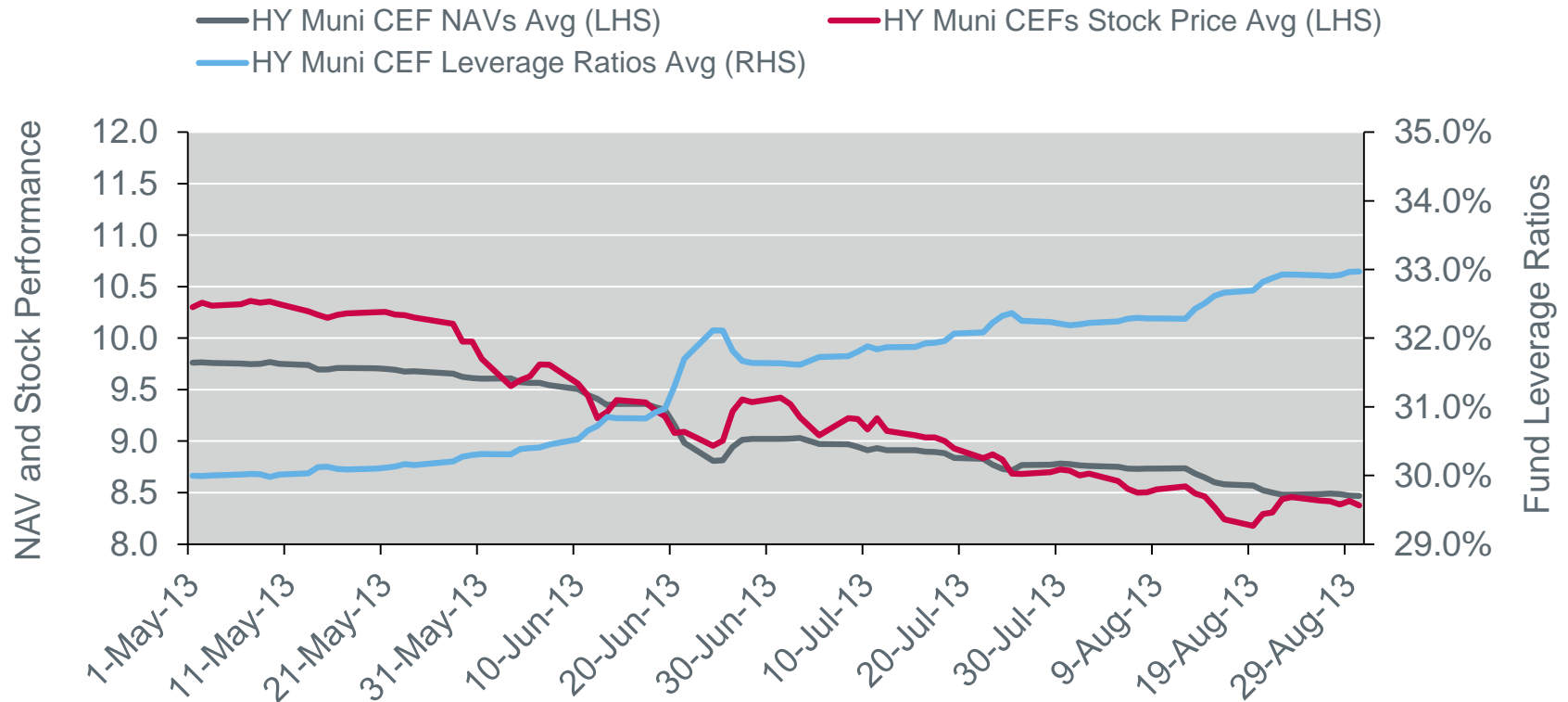


# Investment Grade Municipal Funds: Performance and Leverage Impact



Note: The effect of discontinued funds was removed retroactively

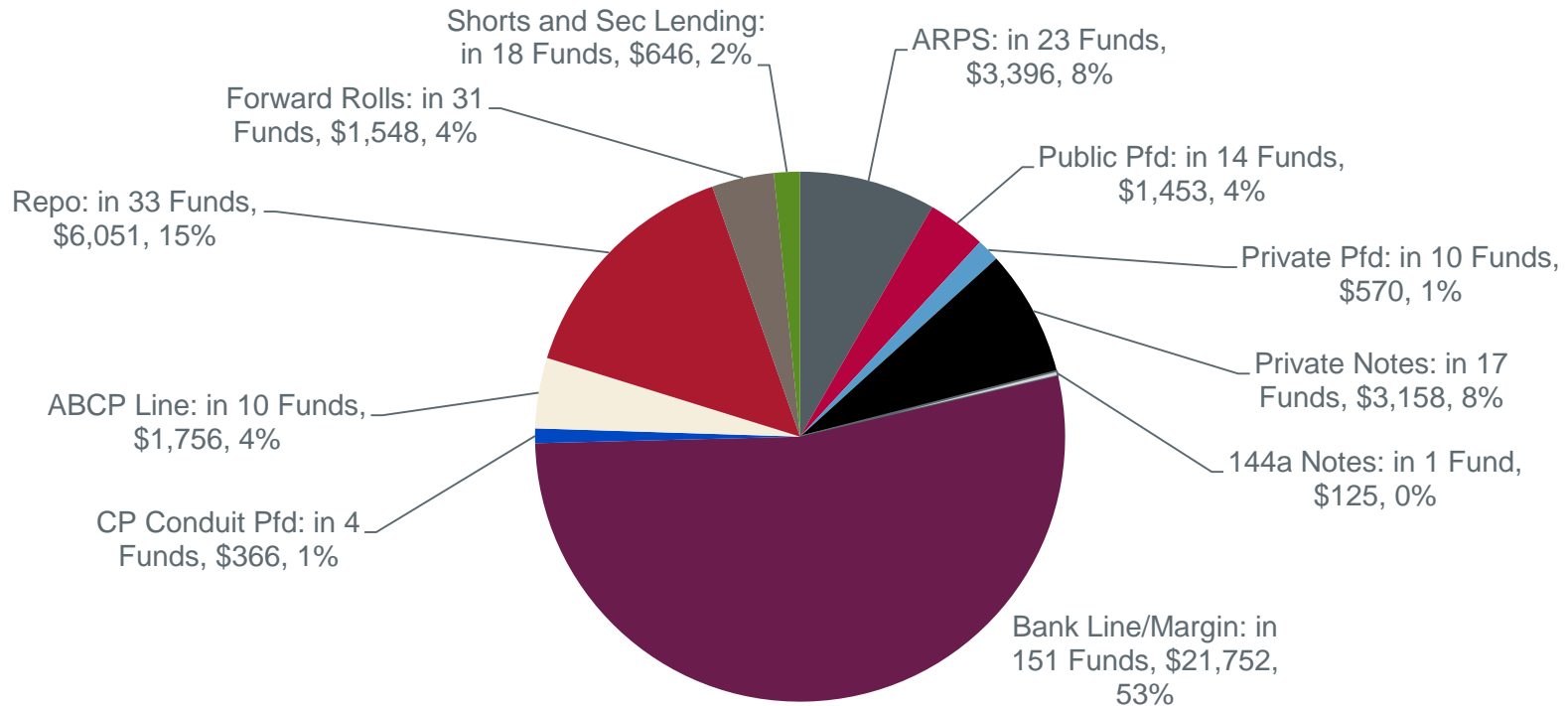
# High Yield Municipal Funds: Performance and Leverage Impact



Note: The effect of discontinued funds was removed retroactively



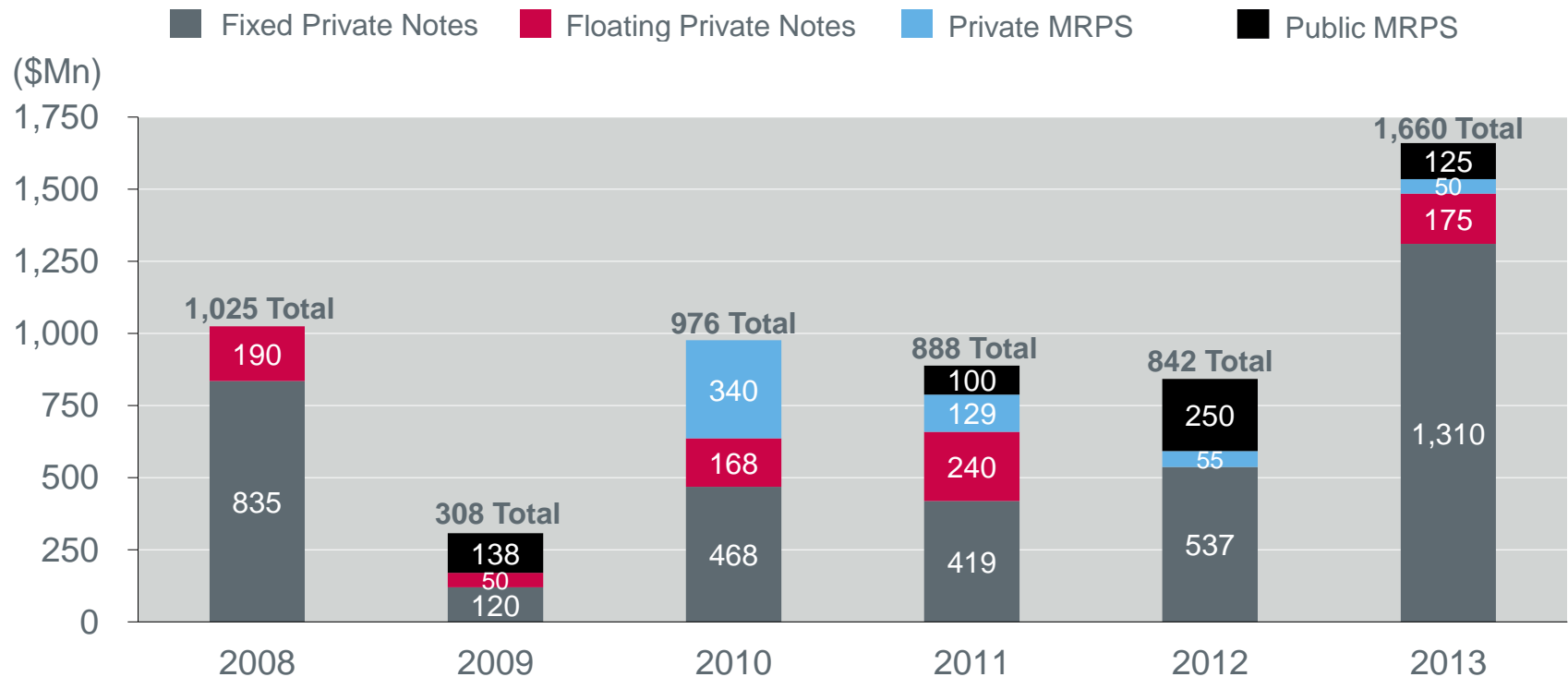
# Taxable Closed-End Fund Sector: Leverage Snapshot



Note: Figures in millions

Source: Fitch. Total leverage was \$40.8 billion. Data includes all leveraged taxable CEFs with latest financial statements and transactions made public.

# Taxable CEF Long-Term Debt and Preferred Issuance (Since 2008)



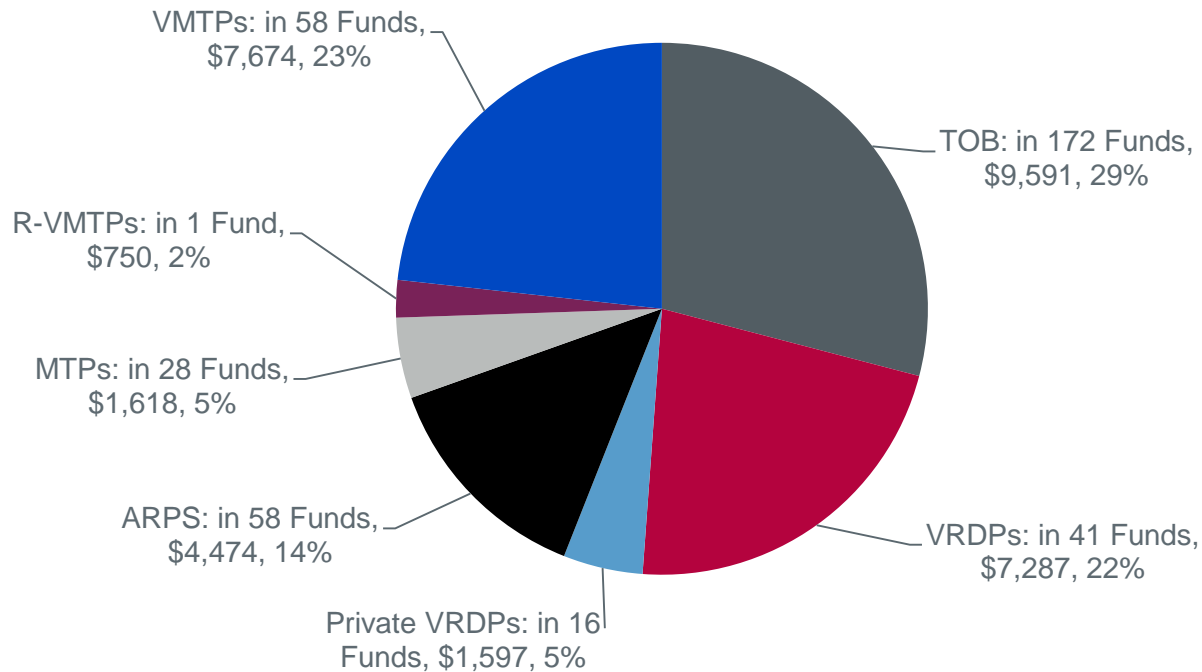
Source: Morgan Stanley Database / Public Financial Statements

# Bank Lending to Leveraged Closed-End Funds

Bank Counterparties	Bank Facility/ Margin (\$mn)	Number of Funds	Reverse Repos (\$mn)	Number of Funds	Total (\$mn)	%
BNP Paribas (A+/F1)	8,228	43	156	6	8,384	30%
State Street Bank (A+/F1+)	2,182	25	61	1	2,243	8%
Credit Suisse (A/F1)	596	4	990	18	1,586	6%
Barclays (A/F1)	–	–	1,401	19	1,401	5%
Bank of America (A/F1)	872	10	377	8	1,248	4%
Deutsche Bank (A+/F1+)	444	2	607	16	1,050	4%
JP Morgan (A+/F1)	400	1	193	9	593	2%
Bank of Nova Scotia (AA-/F1+)	522	8	–	–	522	2%
Other counterparties	594	13	2,197	45	2,791	10%
Undisclosed counterparty exposure	8,068	51	–	–	8,068	29%
<b>Total</b>	<b>21,907</b>	<b>157</b>	<b>5,980</b>	<b>122</b>	<b>27,887</b>	<b>100%</b>

Source: Fitch Ratings, latest public financial statements available.

# Municipal Closed-End Fund Sector: Leverage Snapshot



Note: Figures in millions

Source: Fitch. Total leverage was \$33 billion. Data includes all leveraged municipal CEFs with latest financial statements and transactions made public.

# Leverage Cost: Taxable Closed-End Funds

Leverage	Type	Approximate Cost Across Outstanding	Recent Issuance	Term	Investors
Notes	Private	<b>Floating:</b> LIBOR plus 135–185 bps <b>Fixed:</b> 2.3%–5.9%	<b>Floating:</b> None  <b>Fixed:</b> 2.9% (5 yr mty), 3.1% (7 yr mty), 3.7% (10 yr mty)	3–12 yrs	Insurance Companies
	144A	<b>Floating:</b> LIBOR plus 125 bps	<b>Floating:</b> LIBOR plus 125 bps	3 yrs	Bond Investors
Preferred	Private	<b>Fixed:</b> 3.3%–5.6%	<b>Fixed:</b> 4.1% (10 yr mty)	5–15 yrs	Insurance Companies
	Exchange Traded	<b>Fixed:</b> 3.0%–6.3%	<b>Fixed:</b> 3.5%–4.3% (7 yr mty)	6–15 yrs	Primarily Retail
	VRTP	<b>Floating:</b> CP rate plus 120–145 bps	<b>Floating:</b> CP rate plus 1.20% (3 yr mty)	3 yrs	ABCP conduits
	ARPS	<b>Dividends:</b> 125%–150% times, or 125–150 bps above the ref rate <b>Auction Fee:</b> 5–15 bps	None	Perpetual	Historically retail, now mostly broker-dealers
Bank debts	Bank Facilities/ Margin Loans	<b>Drawn:</b> Libor plus <b>MLP funds:</b> 95 – 125bps <b>Other Sectors:</b> 65–100 bps <b>Undrawn:</b> 10–85 bps	On-going renewals, But spreads have declined 10 – 20 bps since last year for some	6 M–2 yrs	Banks
	Reverse Repos	<b>Interest:</b> Tied to Fed Funds, 35–80 bps	On-going, Fed Funds driven.	30–90 days	Banks / Repo Counterparties

Source: Fitch Ratings, latest public financial statements

# Leverage Cost: Municipal Closed-End Funds

Leverage Type		Approximate Cost Across Outstanding	Recent Issuances	Typical Terms	Investors
Senior Debt	TOB	<b>Interest:</b> Remarketing based; 30–90 bps <b>Liquidity Fee:</b> 10–50 bps <b>Remarketing Fee:</b> 10–15 bps	On-going renewals and money market rates	<b>Final:</b> 5–8 yr <b>Liquidity:</b> 1 yr	Money market funds (banks provide liquidity)
Preferred	VMTP	<b>Dividends:</b> Spread over SIFMA; 115–150 bps	<b>Dividends:</b> SIFMA plus 125-140 bps (3-5 yr mty),	3–5 yr	Banks / TOB trusts
	MTP	<b>Fixed:</b> 2.00%–2.95%	None	3–5 yr	Primarily Retail
	VRDP	<b>Dividends:</b> Remarketing based, 25–40 bps <b>Liquidity Fee:</b> 35–140 bps <b>Remarketing Fee:</b> 10–15 bps	On-going renewals and money market rates	<b>Final:</b> 30 yr <b>Liquidity:</b> 1 yr	Money market funds (banks provide liquidity)
	ARPS	<b>Dividends:</b> 110% or 125% TIMES ref rate; 15–40 bps <b>Auction Fee:</b> 15–25 bps	None	Perpetual	Historically retail, now mostly broker-dealers

Source: Fitch Ratings, latest public financial statements

# Fitch Ratings Contacts

---

Name	Telephone	Email
Analysts:		
Ian Rasmussen	(212) 908-0232	<a href="mailto:ian.rasmussen@fitchratings.com">ian.rasmussen@fitchratings.com</a>
Yuriy Layvand, CFA	(212) 908-9191	<a href="mailto:yuriy.layvand@fitchratings.com">yuriy.layvand@fitchratings.com</a>
Product:		
Greg Hildebrand	(312) 368-5448	<a href="mailto:greg.hildebrand@fitchratings.com">greg.hildebrand@fitchratings.com</a>

---

# Disclaimer

Fitch Ratings' credit ratings rely on factual information received from issuers and other sources. Fitch Ratings cannot ensure that all such information will be accurate and complete. Further, ratings are inherently forward-looking, embody assumptions and predictions that by their nature cannot be verified as facts, and can be affected by future events or conditions that were not anticipated at the time a rating was issued or affirmed.

The information in this presentation is provided "as is" without any representation or warranty. A Fitch Ratings credit rating is an opinion as to the creditworthiness of a security and does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. A Fitch Ratings report is not a substitute for information provided to investors by the issuer and its agents in connection with a sale of securities.

Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch Ratings. The agency does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security.

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS AND THE TERMS OF USE OF SUCH RATINGS AT [WWW.FITCHRATINGS.COM](http://WWW.FITCHRATINGS.COM).





**Fitch**Ratings

**New York**

One State Street Plaza  
New York, NY 10004

**London**

30 North Colonnade  
Canary Wharf  
London E14 5GN