

# **RESEARCH NOTE ON CLOSED ENDED COLLECTIVE INVESTMENT SCHEMES**

**May 2021**

**Research and Market Development, Capital Markets Authority  
Uganda**

## 1.0 Background

Collective Investment Schemes (CIS) have been one of the most significant developments in financial intermediation during the past few decades. They allow people to participate in a wider range of investments than would be feasible for most individual investors and increase economies of scale in order to reduce investment costs. CIS refer to investment funds that pool together savings from a wide range of investors both retail and institutional to be invested in a number of different financial assets.<sup>1</sup> The CISs offer flexible, simple and convenient means of investing in companies and their growth. They offer investors expert investment advice and participation in investment opportunities.<sup>2</sup> This allows specifically retail investors to invest relatively small amounts and diversify their risk exposures because their funds are invested across a variety of industries and asset classes.

Various types of CIS could be launched for use by investors depending on the opportunities in an economy and the investment needs of investors. The nature and form of any CIS is dependent on the legal, operational and management structures. Legally a CIS can take the form of a company, trust, contractual pool or partnership. Operationally it can either be an open-ended, interval or closed-ended CIS and in terms of management structure, the CIS can either be internally or externally managed.<sup>3</sup> The structure any given CIS takes will vary from country to country depending on the legal and regulatory framework in a particular country.

The objective of this note is to delineate the features of closed-ended CIS, explore the regulatory framework for closed-ended CIS in other jurisdictions and the feasibility of closed-ended CIS in Uganda.

## 2.0 Closed-Ended CIS

A closed-ended CIS is a type of CIS model with a fixed number of shares (units). It can be formed as a trust with units or a company with shares and is typically listed on a stock exchange or traded in an over-the-counter market. The assets of a closed-ended CIS are professionally managed in accordance with the fund's investment objectives and policies and may be invested in equities, bonds, and other securities.<sup>4</sup>

### 2.1 Features of Closed-Ended CIS

A closed-ended CIS is created by issuing a fixed number of shares (units) to investors during a New Fund Offering. Subsequent issuance of shares (units) can occur through secondary offerings, at-the-market offerings, rights issues, or

---

<sup>1</sup> International Organization of Securities Commissions. (n.d.). *Collective Investment Schemes in Emerging Markets*.

<sup>2</sup> International Organization of Securities Commissions. (n.d.). *Collective Investment Schemes in Emerging Markets*.

<sup>3</sup> Capital Markets Authority Uganda. (2010). *The Development of Collective Investment Schemes in Uganda*

<sup>4</sup> Investment Company Institute. (2011). *A Guide to Closed-End Funds*

dividend reinvestments. Although some closed-ended CIS may adopt stock repurchase programs or periodically tender for shares (units), once issued, shares (units) of a closed-ended CIS generally are not purchased or redeemed directly by the fund. Rather, shares (units) are bought and sold by investors in the open market. Because a closed-ended CIS 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-ended CIS may invest in unlisted securities, municipal bonds that are not widely traded, or securities traded in countries that do not have fully developed securities markets. Closed-ended CIS have the ability, subject to strict regulatory limits, to use leverage as part of their investment strategy. The use of leverage by a closed-ended CIS can allow it to achieve higher long-term returns, but also increases risk and the likelihood of share price volatility.<sup>5</sup> Notably, there are several distinguishing features between open-end and closed-ended CIS. Table 1 below indicates the differences between closed-ended and open-ended CIS.

Table 1: Differences Between Open-Ended and Close-Ended CIS

<b>Parameter</b>	<b>Open-Ended CIS</b>	<b>Close-Ended CIS</b>
Buy-in period	Investors can buy-in or buy-out any time they wish	Investors can buy-in only during a limited period
Investment tenure	These are perpetual funds with no fixed maturity date	The investment tenure is between three years to five years
Listing	No listing on any stock exchange	Listed on recognized stock exchange
Pricing	Net Asset Value divided by the number of outstanding shares (units)	Determined by the supply and demand of the shares (units)
Number of shares (units) issued	No limit	Limited and fixed
Trading	The fund house manages the trading of the shares (units)	The shares (units) are traded on the stock exchange they are listed on.
Fund lock-in period	There is no lock-in period and investors can exit at any point in time	Once entered, investors have to stay invested for the entire tenure

Source: <https://www.angelbee.in/mutual-funds-comparison/open-ended-funds-vs-close-ended-funds>

<sup>5</sup> [https://www.ici.org/cef/background/bro\\_g2\\_ce](https://www.ici.org/cef/background/bro_g2_ce)

The following are the advantages of closed-ended CIS:<sup>6</sup>

i) Stable portfolio management

Unlike open-ended CIS managers who must worry about constant inflows and outflows of cash, closed-ended CIS managers are responsible for a stable pool of capital. Although fund shares trade actively, that doesn't affect the fund manager because no assets are flowing into or out of the portfolio. Therefore, closed-ended CIS managers can put capital to work in a long-term strategy, without worrying whether their fund will have enough liquidity to pay back investors who suddenly sell (redeem) shares. This can lead to superior investment results. It also makes the closed-ended CIS structure advantageous for investing in specialized areas such as less liquid securities or markets, venture capital opportunities, real estate, and private placements. Regardless of the trading volume or market price fluctuations in such areas, closed-ended fund managers are never forced to sell securities in a declining market to meet redemptions. Conversely, in a bull market, closed-ended fund managers aren't inundated with new cash they must invest at rising prices.

ii) Leverage potential

Closed-ended CIS may issue senior securities (preferred stock or debentures) or borrow money to "leverage" their investment positions. This gives portfolio managers of closed-ended CIS the opportunity to enhance yield and provide investors with superior performance. It also gives them more flexibility to take advantage of timely market opportunities. The use of leverage, of course, increases the likelihood of share price volatility and market risk.

iii) Low cost of investing

Investors pay one commission to buy closed-ended CIS shares and another to sell them which are the only transaction-related costs. Closed-ended CIS generally do not impose 'trail commissions' which are assessed against the account annually, as many open-ended CIS do. Furthermore, closed-ended CIS do not incur ongoing costs associated with distributing their shares or units as do open-ended CIS; thus, the expense ratios of closed-ended funds are sometimes less than those of open-ended CIS. Over time, a lower expense ratio provides a boost to investment performance.

---

<sup>6</sup> Closed-End Fund Association, Inc. (2006). *Understanding the Advantages of Closed-End Funds*

iv) Purchases and sales

Unlike traditional open-ended CISs, which are only priced at the end of each day, closed-ended CIS are priced and can be purchased and sold throughout the trading day. Furthermore, you can typically buy or sell closed-ended shares on a stock exchange much like the purchase or sale of any other listed stock.

The following are the disadvantages of closed-ended CIS:

i) Investment and market risk

The value of the securities within a closed-ended CIS, like other market investments, may increase or decrease in value, sometimes rapidly and unpredictably. The shares at any point in time may be worth more or less than the original investment, even after taking into account any reinvestment of dividends and distributions.

ii) Management risk

The selection of securities and other investment decisions made by the closed-ended CIS manager might produce losses or cause the closed-ended CIS to underperform compared to other funds with similar investment goals. If one or more key individuals leave the management team, the manager may not be able to hire qualified replacements, which could prevent the closed-ended CIS from achieving its investment objectives.

iii) Market price risk

Since a closed-ended CIS trades in the secondary market and essentially has a fixed amount of shares outstanding, the market price may display more volatility than the Net Asset Value, potentially subjecting an investor to wider losses than the Net Asset Value.

iv) Leverage risk

Most, but not all, closed-ended CIS have the ability to use leverage in an attempt to enhance returns. Industry regulations limit the amount of leverage that a fund can assume, but some funds use leverage much more aggressively than others. When used, the leverage is typically created through bank loans or the issuance of preferred stock. The use of leverage by a fund will likely add to the volatility of the fund's Net Asset Value, which would likely add to the volatility of the fund's market price. Leverage will magnify any losses in the fund's portfolio.

v) Liquidity risk

No assurance can be given that an active trading market will be available for any particular fund. The fact that a fund is listed on a stock exchange does not necessarily mean that sufficient liquidity will always be available. Trades that are large relative to a fund's average daily volume could have an impact on the market value.

vi) Illiquid securities risk

Closed-ended CISs are allowed to invest a greater portion of their assets in illiquid investments than are open-ended CISs. Due to their more stable pool of investable capital, some closed-ended CISs may take advantage of that ability. Illiquid securities typically are more difficult to value and may be impossible to sell at any point in time. As a result, closed-ended CISs that hold a higher percentage of portfolio assets in illiquid securities may be more volatile than their peers.

## **2.2 How Closed Ended CIS can be used to finance the Real Economy<sup>7</sup>**

Closed-ended CIS offer investors an array of benefits unique in the investment world. They offer investors numerous ways to generate capital growth and income through portfolio performance, dividends and distributions, and through trades in the marketplace at different prices. Additionally, unlike open-ended CIS managers who must worry about constant inflows and outflows of cash, closed-ended CIS managers are responsible for a stable pool of capital. Where fund shares trade actively, that doesn't affect the fund manager because no assets are flowing into or out of the portfolio. Therefore, closed-ended CIS managers can put capital to work in a long-term strategy, without worrying whether their fund will have enough liquidity to pay back investors who suddenly sell (redeem) shares. It also makes the closed-ended CIS structure advantageous for investing in specialized areas such as less liquid securities or markets, private equity, venture capital opportunities, private placements, real estate and infrastructure projects. Regardless of the trading volume or market price fluctuations in such areas, closed-ended fund managers are never forced to sell securities in a declining market to meet redemptions.<sup>8</sup> This further implies that closed-ended CISs can invest in private companies, as opposed to companies whose shares are traded on stock exchanges. They can do this either by buying shares in private companies directly, or investing in private equity funds (known as limited partnerships) that themselves acquire stakes in private companies. To this end, in illiquid markets such as Uganda where the range of equities or bonds available is limited and these instruments are infrequently traded, the development of closed-ended funds

---

<sup>7</sup> The real economy is that part of the economy which produces goods and services, and actually contributes to the real wealth of the country. The real economy excludes those activities involved with transactions on the financial markets.

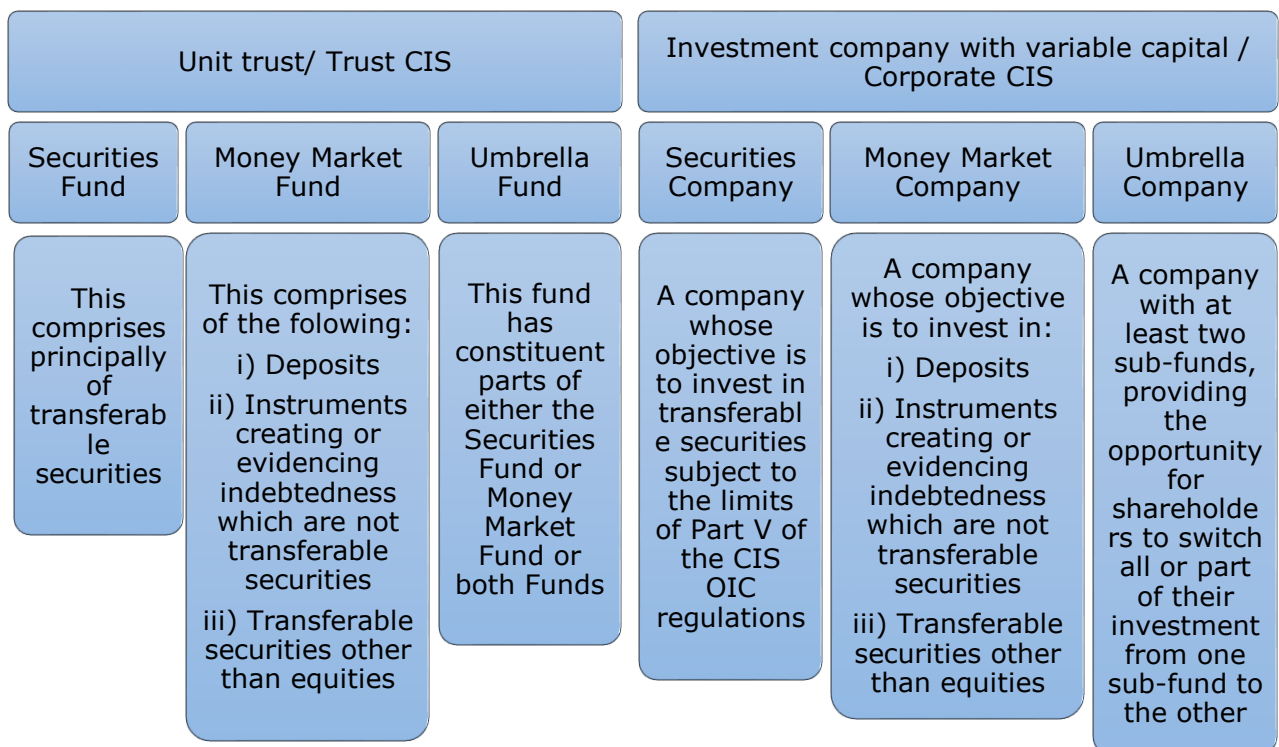
<sup>8</sup> Closed-End Fund Association, Inc. (2006). *Understanding the Advantages of Closed-End Funds*

should be encouraged. It is also worth noting that the development of closed-ended CIS will help counter the problem of liquidity management that the current CIS managers in Uganda are facing.

### 3.0 Collective Investment Schemes in Uganda

In Uganda CIS were established under the Collective Investment Schemes Act 2003 which came into force in 2003. The CIS Act makes provisions for open ended CISs which can take the form of a Unit Trust Schemes or an investment company with variable capital which is formed under corporate law. Only CIS's that are approved by the Capital Markets Authority may be offered for sale in Uganda. Such schemes must comply with the CIS Act, 2003 and the various CIS regulations. Despite having provision of two forms of CISs in Uganda, all existing CIS in Uganda are structured as unit trust schemes. A Unit Trust Scheme is a CIS that is professionally managed by a Unit Trust Manager and is usually established by a unit trust deed. Both the scheme and the manager (as a fund manager) must be licensed by the CMA.

Figure 1. Different Types of Collective Investments Schemes Permitted in Uganda



Source: *The Collective Investment Schemes Open-Ended Investment Companies (OIC) Regulations, 2003 and the Collective Investment Schemes (Unit Trusts) Regulations, 2003.*

It is important to note that the current CIS regulations do not include closed-ended CISs within the definition of a Collective Investment Scheme, and thus law relating to CIS in Uganda does not apply to closed-ended CISs. To this end, the CMA should consider developing closed-ended unit trust regulations.

#### 4.0 Closed-Ended CIS in Africa

In jurisdictions such as Nigeria, Malawi and Mauritius, there are closed-ended funds that have been set up to finance the real economy. The table below highlights the closed-ended CIS in the above-mentioned jurisdictions.

Table 2. Closed-Ended CIS in Selected African Jurisdictions

<b>Name of Fund</b>	<b>Country of Origin</b>	<b>Areas in which funds are invested</b>	<b>Target Amount to be Raised</b>
The Nigeria Energy Sector Fund	Nigeria	Energy sector	
ValuAlliance Value Fund	Nigeria	Listed and unlisted Nigerian equities as well as other securities as approved by the SEC	US\$ 7 million
Chapel Hill Denham Nigeria Infrastructure Debt Fund	Nigeria	Infrastructure projects such as solar power generation units, telecom tower sites, Processing and distribution of compressed natural gas	US\$ 485 million
The National Investment Trust Plc	Malawi	Equity investments, bonds, property and equity of property companies and money market investments	US\$ 178 million
Novare Africa Property Fund I	Mauritius	Real estate	US\$ 81 million
Novare Africa Property Fund II	Mauritius	Real estate	US\$ 351 million
Warwyck Phoenix Global Invest Fund 6	Mauritius	Equities, fixed income, currencies, derivatives, mutual funds, ETFs, commodities and precious metals	

Sources: *The National Investment Trust Limited Prospectus, Chapel Hill Denham Nigeria Infrastructure Debt Fund Prospectus, <https://valualliance.com/value-fund/#eluidc71392fd>, <https://novare.com/real-estate-development/>, <https://www.warwyck.com/en/phoenix-pcc/our-fund-offering/an-innovative-range-of-in-house-funds/warwyck-phoenix-global-invest-fund-6>*

## 4.1 Nigeria

The regulatory body is the Securities and Exchange Commission (SEC) of Nigeria. The SEC derives its powers from the Investments and Securities Act (ISA) No. 29 of 2007. The ISA 29 stipulates that the Commission may approve a Collective Investment Scheme which is administered as: a unit trust scheme (open-ended and closed-ended); open-ended investment company; venture capital funds; specialized funds; or real estate investment company or trust. The regulations also note that all securities of a public company and all securities or investments of a collective investment scheme shall be registered with the Commission under the terms and conditions stipulated therein and as may be supplemented by regulations prescribed by the Commission from time to time.<sup>9</sup> Unit trusts are formed by a trust deed between a fund management company and a licensed corporate trustee. The trustee must be completely legally independent of the operator of the fund. The fund management company is responsible for operating the fund while the trustee is responsible for safeguarding the assets of the scheme.<sup>10</sup> The following are examples of closed-ended funds in Nigeria.

### a) The Nigeria Energy Sector Fund

The Nigeria Energy Sector Fund which was the first closed-ended unit trust was set up in 1998. It is a closed-ended investment vehicle constituted under a Trust Deed and is quoted on the Nigerian Stock Exchange. The fund is managed by SCM Capital Asset Management Limited with United Capital Trustee Ltd as the trustees. The fund was created by the Nigerian Energy Sector Fund PLC to bridge the funding gap in the energy sector of the Nigerian economy. It was established by mobilising investible funds from individuals, institutional investors, and foreigners. The fund has a primary objective of achieving long-term capital appreciation as well as returning a competitive income to its unit-holders through the mobilization of investible funds from individuals and corporate entities for investment in the energy sector of the Nigerian economy.<sup>11</sup>

### b) The ValuAlliance Value Fund

The ValuAlliance Value Fund which commenced operations in 2011 is a closed-ended CIS registered and regulated by the SEC of Nigeria. Its units are listed on the main board of the Nigerian Stock Exchange. The fund operates with a total return objective and aims to provide investors with capital growth over the long term by investing in listed and unlisted Nigerian equities as well as other securities as approved by the SEC. The fund adheres to a pragmatic value investment philosophy; investing in securities that are sufficiently undervalued relative to their intrinsic value. As a first step, the fund screens for securities trading at a low price to earnings multiples, low price to book ratios, as well as an acceptable

---

<sup>9</sup> Securities and Exchange Commission of Nigeria. (2007). *The Investments and Securities Act*

<sup>10</sup> Securities and Exchange Commission of Nigeria. (2007). *The Investments and Securities Act*

<sup>11</sup> <https://assetmanagement.scmcapitalng.com/services/mutual-fund/nigeria-energy-sector-fund-nesf/>

margin of safety relative to the fund manager's assessment of fair value.<sup>12</sup> It is important to note that the CIS regulations permit funds to invest in unlisted securities of a public company that is traded on a registered over-the-counter market.<sup>13</sup>

### **c) The Chapel Hill Denham Nigeria Infrastructure Debt Fund**

The Chapel Hill Denham Nigeria Infrastructure Debt Fund (NIDF) is an infrastructure debt fund. The fund's units are listed on the FMDQ Over the Counter Securities Exchange. The NIDF is a close-ended fund, domiciled in Nigeria and denominated in Naira. The fund is structured to enable investors to access the infrastructure asset class while providing benefits of predictable returns available from long-dated infrastructure debt investments. The investment focus of NIDF is on the traditional infrastructure sectors, primarily transport, power, renewable energy, utilities, energy infrastructure (e.g. storage terminals), logistics and other public-private-partnership type investments. To be financially viable, these projects require long-dated senior debt, which is increasingly not available from commercial banks. By creating permanent capital, NIDF is able to support these projects with long-term financing, in the process generating superior, risk-adjusted returns for its investors, almost entirely in the form of running yield. Besides delivering attractive returns, the NIDF is also at the core of Nigeria's economic transformation by adding to the country's infrastructure stock, channelling institutional capital into productive assets, and supporting sustainable economic growth.<sup>14</sup>

## **4.2 Malawi**

The regulatory body is the Reserve Bank of Malawi. Investment funds are regulated under the Capital Markets Development Act and other regulations made therein governing the establishment and operation of Collective Investment Schemes. The Financial Services (Establishment and Operations of a Collective Investment Schemes) Directive, 2015 stipulates that a CIS may be established either as an open-ended investment scheme or a closed-ended investment scheme. An open-ended investment scheme is defined as any CIS which offers for sale on a continuous basis or has outstanding any securities or units which are redeemable at the option of the holder. On the other hand, a closed-ended fund investment scheme is defined as any collective investment scheme which is not an open-ended investment scheme.<sup>15</sup> The following is the only closed-ended fund in Malawi.

---

<sup>12</sup> <https://valualliance.com/value-fund/#eluidc71392fd>

<sup>13</sup> Securities and Exchange Commission of Nigeria. (2007). *The Investments and Securities Act*

<sup>14</sup> <https://www.chapelhilldenham.com/what-we-do/investment-management>

<sup>15</sup> The Reserve Bank of Malawi. (2015). *The Financial Services (Establishment and Operations of a Collective Investment Schemes) Directive*

### **a) The National Investment Trust Plc**

The National Investment Trust Plc (NITL) manages a closed-end fund that is listed on the Malawi Stock Exchange. The fund invests in both shares listed on the Malawi Stock Exchange and unlisted private securities. NITL is licensed by the Reserve Bank of Malawi in terms of the powers vested in it by Section 35 of the Capital Market Development Act. NITL was set up to provide a vehicle for the public to participate in equity investment in Malawi. The principal objective of the company is to provide a vehicle to facilitate broad public participation in a diverse portfolio of equity investments, bonds, property and equity of property companies and money market investments in Malawi. The fund is a product of Malawi's privatisation policy and provides income and capital growth opportunities for investors. Financial gain from investments are tax-free if held for more than a year. The company's investment portfolio is managed by an independent fund manager, NICO Asset Managers Limited, whose management is subject to the overall direction of the Board of Directors of the company.<sup>16</sup>

### **4.3 Mauritius**

The regulatory body is the Financial Services Commission (FSC) of Mauritius. Funds registered with the FSC are incorporated under the Companies Act 2001 and are licensed under the Financial Services Act 2007 and the Securities Act 2005 as amended. Such funds should also need to hold a Global Business License (GBC) besides a CIS license. Funds can be classified either as open-ended or closed-ended. A closed-ended fund is mostly used for Private Equity or Property / Real Estate Fund.<sup>17</sup> Mauritius also has Special Purpose Funds (SPF) which were introduced by the FSC under the Financial Services (Special Purpose Fund) Rules in 2013. These type of funds are set up under domestic law and are tax-exempt in Mauritius. The objective of the SPF rules is to attract international fund promoters who want to use Mauritius as an international hub that offers modern securities laws and overall fund logistics. SPFs may be established as either open-ended or closed-ended funds. The following are examples of closed-ended funds in Mauritius.

### **a) Novare Africa Property Fund I and II**

Novare launched its first Fund, the Novare Africa Property Fund I in July 2010, raising US\$81 million from institutional investors. The Fund's mandate is to develop commercial real estate in Sub-Saharan Africa excluding South Africa and it was particularly attractive to investors given its longer-term horizon, as well as expected above-average returns. Strong demand to participate in the African growth story as well as the additional portfolio diversification benefits were but

---

<sup>16</sup> <https://www.nitlmw.com/nitl-profile/>

<sup>17</sup> The Financial Services Commission of Mauritius. (2005). *The Securities Act*

some of the other benefits to pension funds investors who made an allocation to the fund.

The Novare Africa Property Fund II was launched due to continued demand investors demonstrated for opportunities managed by reputable and knowledgeable professionals on the sub-continent. The fund closed on 30 June 2016 and raised \$351 million. Both the Novare Property Funds I and II are domiciled in Mauritius and are listed on the Mauritian Stock Exchange.<sup>18</sup>

## **b) Warwyck Phoenix Global Invest Fund 6**

Warwyck Phoenix Global Invest Fund 6 is organised as a closed-ended fund and is categorised as an expert fund<sup>19</sup> pursuant to the Securities Act 2005 and relevant regulation. The fund commenced its operations on 10 February 2015 and was listed on the official market of the Stock Exchange of Mauritius Ltd on 14 November 2016.<sup>20</sup> The investment objective of Warwyck Phoenix Global Invest Fund 6 is to generate long-term absolute returns using a top-down and directional investment approach to identify investment opportunities and trends throughout the world, including both developed and emerging markets. The Fund can invest globally across a wide range of asset classes, including equities, fixed income, currencies, derivatives, mutual funds, ETFs, commodities and precious metals to meet its investment objective. The Fund employs tactical allocation from time to time by investing in low-risk instruments to diversify the portfolio and minimize volatility and losses. The Fund has a medium-term investment horizon and is suitable for investors with a high-risk tolerance.<sup>21</sup>

## **5.0 Conclusion**

It is worth noting that variations exist in Collective Investment Schemes from jurisdiction to jurisdiction because of a combination of different factors, such as legal histories, cultural preferences, pension systems, and fiscal treatment.

Collective Investment Schemes in Nigeria can be formed as a unit trust scheme; open-ended investment company; venture capital funds; specialized funds; or real estate investment company or trust. It is important to note that the regulations provide for both open-ended and closed-ended unit trust schemes. Nigeria's CIS model is similar to that of Uganda although in the latter's case the regulations do not expressly provide for closed-ended CIS. Notably, Nigerian has been able to take advantage of the closed-ended CIS structure by creating funds that are having an impact on the real economy.

---

<sup>18</sup> <https://novare.com/real-estate-development/>

<sup>19</sup> These Funds are restricted to 'Expert Investors' or 'Sophisticated Investors'

<sup>20</sup> Warwyck Phoenix Global Invest Fund 6. (2019). *Annual Report*

<sup>21</sup> <https://www.warwyck.com/en/phoenix-pcc/our-fund-offering/an-innovative-range-of-in-house-funds/warwyck-phoenix-global-invest-fund-6>

In a bid to further grow the CIS sector in Uganda and have an impact on the real economy, there is a need to encourage the development of closed-ended unit trusts. To this end, the CMA should consider developing closed-ended unit trust regulations. Given that closed-ended CISs do not have to redeem their shares or units, they do not need liquid underlying assets. Thus these funds can be used for investment in unlisted securities, private equity, venture-capital opportunities, real estate and infrastructure projects.

Furthermore, closed-ended CISs can invest in private companies, as opposed to companies whose shares are traded on stock exchanges. They can do this either by buying shares in private companies directly, or investing in private equity funds (known as limited partnerships) that themselves acquire stakes in private companies. Notably, if the closed-ended unit trusts are permitted to invest in unlisted securities, private equity, venture-capital opportunities, real estate and infrastructure projects then in order to adequately protect investors, there will be a need to enhance regulatory supervision for such investments since they carry higher risks.

The following are the next steps:

- i) CMA to engage the CIS managers on the viability of closed-ended CIS. The discussion should happen during the quarterly market forums organised by CMA that focus on developing the CIS sub-sector.
- ii) CMA to consider developing closed-ended unit trust regulations to provide for closed-ended CIS. These regulations shall expressly define closed-ended funds and stipulate the offer process for closed-ended Collective Investment Schemes. Additionally, the asset and spread regulations for CIS will also require amendments to provide for investments in other assets classes such as unlisted securities.
- iii) CMA to engage both the Uganda Securities Exchange and the ALTX exchange on the idea of developing rules for listing closed-end unit trusts on the respective exchanges.