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Investors cheer as India loosens grip on private savings

Edward Luce and **Khozem Merchant e**xplain why the markets welcome the bail-out of UTI, the bankrupt state-owned mutual fund.

India's government appears at long last to be withdrawing from its role of directly managing the country's private savings. Today, New Delhi will transfer the first $1bn - of an eventual $3bn or more - in rescue funds to the United Trust Bank of India, the bankrupt state-owned mutual fund.

The bail-out, which is likely to be followed by a $3bn to $4bn rescue package for the country's two state-owned development banks, will cost India's taxpayers dear. As the largest financial rescue in India's history it will cost roughly 1.5 per cent of gross domestic product.

But private investors, who said have long played junior partners on the state-dominated stock market, welcome the move as a clear signal that they will finally be rid of the distorting influence of government-managed funds.

Under the rescue package, UTI - which accounts for about 40 per cent of India's total mutual funds - will bes plit into two, one half of which will be wound down and the other fully privatized.

"This is an expensive but a very necessary step", said Surgit Bhalla, head of Oxus Fund Management, a hedge fund. " The UTI problem has been hanging over India's markets for years. Now we can finally look forward to a level playing field."

But the saga, which began in 1998 when UTI received its first $700m government bail-out, is by no means over. The net asset value of US64, UTI's bankrupt flagship fund, languishes at about half the redemption price that it has guranteed to its 24m investors. New Delhi's bail-out money will go towards meeting that shortfall when investors are permitted to redeem their units at full value next May. The fund, which has 10 per cent stakes in more than 150 listed companies, must also meet the shortfall through sales of its equity holdings.The unwinding of these stakes, which include strategic holdings in Reliance and ITC, two of India's largest companies, could depress Indian equity prices for months.

"The impact on India's equity prices will depend very much on how the unwinding is conducted," said John Band, a leading investor. "If the government takes the route of strategic sales to specific investors it could actually boost the market. If they dribble out the shares day by day then it would have the reverse effect".

Nevertheless, the winding down of UTI and the impending restructuring of IDBI and IFCI, the two near bankrupt state development banks, sends a positive signal that New Delhi is withdrawing from its role of micro-managing both investment and lending to India's private sector.

Under the restructuring, all investors, including the privatized portion of UTI, will be regulated by India's Securities and Exchange Board. Until now, UTI was regulated by the finance ministry, which was patently ill-equipped to do the job.

In much the same way that politicians and bureaucrats manipulated the development banks to lend to favoured schemes, UTI was a conduit for a string of disastrous and politically inspired investments. India's savers have paid a price. "This nonchalant approach to [lending and investing] has irreparably damaged the interests of savers," said S.S. Tarapore, former deputy governor of the Reserve bank of India.

U.K. Sinha, a senior official at India's finance ministry, says the restructuring of UTI will pave the way for the emergence of a much more efficient and transparent equity market in India.

UTI - or Government - appointies will no longer sit on the board of dozens of private companies. And private saving will be routinely channelled to where the commercial rates of return are highest. "this will be a watershed for India's equity markets," said Mr Sinha. "Savings will from now on be under private management."

The government is also expected to raise significant revenues from its privatization of what remains of UTI - those funds which did not operate under a guaranteed return scheme and which were consistently priced at net asset value.

The new fund, which is expected to be privatized by the end of the year, will account for almost a fifth of India's $20bn mutual fund sector. **"Although it is one of the worst performing institutions of its kind, UTI still has a strong brand name [with India's savers]," said Jon Thorn, who runs an India fund out of Hong Kong.**