

India's Private Sector Cheers UTI Action

Move to Regulate Manager Suggests Officials Are Serious About Cleaning Up Marketplace

Private Fund Houses Could Also Benefit From Decision

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A regulator never looked so good to the private sector as it does today in India.

To the satisfaction of members of India's private fund management industry, the country's Finance Ministry announced last week the nation's biggest mutual fund manager, Unit Trust of India (UTI), would conform to Securities and Exchange Board of India regulations by the end of 2002.

If it happens, this move will rein in what was essentially an unregulated multibillion-dollar fund, not unlike a free-wheeling hedge fund, in which the managers were given carte blanche by investors to invest their capital without disclosing even the fund's net asset value - ever. For emerging-market investors, it is a sign the Indian government is getting more serious about cleaning up its own house as well as the marketplace.

Moreover, it is good news for private fund management houses, long overlooked in favor of UTI, which carried the security of the government behind it. "Earlier, there was too much image worship of UTI," says Jignesh Shah, strategist at ASK RJ Investment in Bombay. "But now people are looking more at performance. It's a slow and steady psychological shift, but people are getting more enlightened and educated."

The entire industry is behind the changes: "We wholeheartedly support the restructuring measures recommended by the government," says A.P. Kurian, Bombay-based chairman of the Association of Mutual Funds in India, which represents all 35 registered mutual fund companies in the country. "All we ask is that these measures be implemented with time-bound limits, so that by 2003 the corporation (UTI) will be brought back to a healthy position."

That is a tall order, but one the government has been under mounting pressure to fill. Against a tense backdrop of saber-rattling with Pakistan, a terrorist attack on Parliament in December, a weakening rupee and the fallout of various stock market scandals, the government's handling of UTI and its flagship Unit Scheme 64 (US-64) could signal at least some stability in this high risk environment.

UTI was formed by an act of parliament in 1964 and was never answerable to the securities regulator, which was created only in 1992. The quasi-governmental fund company, which only invests in Indian assets, accounts for 40 million investors and half of the Indian mutual fund industry's assets. US-64 fund claims 20

Leading Assets

Top 20 holdings of Unit Trust of India's US-64 Fund, as of Dec. 28, 2001

Name of Issuer	Instrument	Market Value (millions of rupees)	Market value (%of total fund)
Government Securities	Debt	35,697.5	26.16
Reliance Industries	Equity	18,918.1	13.86
ITC	Equity	8,042.2	5.89
Reliance Petroleum	Equity	6,412.3	4.70
Infosys Technologies	Equity	3,117	2.28
Hindustan Lever	Equity	3,108.1	2.28
HFDC	Equity	3,090.4	2.26
Jindal Iron & Steel	Debt	2,869.2	2.10
Bharat Petroleum	Equity	1,915.5	1.40
State Bank of India	Equity	1,840	1.35
Mahanagar Telephone Nigam	Equity	1,736.6	1.27
Larsen & Toubro	Equity	1,697.9	1.24
Tata Iron & Steel	Equity	1,679.9	1.23
Hindalco Industries	Equity	1,500.8	1.10
ICICI	Equity	1,454.1	1.07
Satyam Computers	Equity	1,322	0.97
National Aluminium	Equity	1,036.9	0.76
Indian Petro Chemicals	Equity	948	0.69
IDBI	Debt	804.8	0.59
Jet Airways India	Debt	787.5	0.58

Source: Unit Trust of India

million of those unit holders as its own, with a current asset base of about US\$2.8 billion.

Investors are cautiously optimistic about the proposals, which also include reconstituting the board of directors, separating its trustee functions from its asset management functions, increasing its debt holdings to a ceiling of 75%, and limiting its equities holdings to 55%. Currently, approximately 61% of its holdings are in Indian stocks.

"With SEBI regulating UTI, someone's going to be in charge," says Jon Thorn, managing director at Mauritius-domiciled India Capital Fund, which manages assets of US\$15 million. "The really fundamental thing, apart from the arrogance, corruption and incompetence that has gone on at a massive scale at UTI, is that nobody was mandated to look after it."

The company announced Saturday the net asset value of US-64 for the first time since its inception 37 years ago. Previously, the fund fixed monthly sale and repurchase prices arbitrarily.

That move, if not the net asset value, was welcomed by the industry as a sign of greater transparency. The fund has said it would provide daily net asset values starting this month, and that UTI would restart the sale of US-64 units at NAV. "The announcement of NAV is a good thing because now everyone knows the real value of the investment," says Mr. Kurian.

Unfortunately for unit holders, the NAV was far below even the lowest market expecta-

tions. At 5.81 rupees (12 U.S. cents) per unit, that is 59% below the last sale price of 14.25 rupees in May before UTI froze redemptions in July. **"It's brutal" says Mr. Thorn. "The unit holder has basically had their asset levels crushed by this even further."**

After UTI lifted the partial six-month ban on redemptions Tuesday, fewer than-expected investors took up UTI's offer to repurchase up to 5,000 units per investor of US-64 at 10.50 rupees each. Investors sold 120 million rupees of units, while 25 million rupees flowed into the fund. As an incentive for investors to hold on and not redeem, UTI has said it will raise the repurchase price by 0.10 rupees per month till it reaches 12.20 rupees in May 2003.

But investors with more than 5000 units such as institutions, will have to wait for a staggering stock market recovery to break even, especially since the fund has committed to reducing its higher yielding equity exposure in favor of corporate and government bonds.

Some investors are also wondering how UTI will come up with the extra 10 paise per unit increase monthly, considering the difficult market environment, and especially so for a portfolio that has what some investors say are some companies of dubious quality and transparency.

"Unfortunately it ends up with the government paying out the bill," says Mr. Thorn who recommends that UTI management be privatized. "Taxpayers are going to fund this bailout."