New man in a position of Trust

Meleveetil Damodaran is a relieved man after investors remain faithful to flagship scheme of India's major mutualfund group

By Khozem Merchant in Bombay

Meleveetil Damodaran, the new chairman of Unit Trust of India, is a relieved man. "Islept peacefully last night; our investors remain faithful," says the head of the country's biggest mutual fund group.

Only a few thousand of the 20m investors in UTI's troubled US-64 flagship scheme sold units on Wednesday, when redemptions resumed after a month-long freeze that has provoked financial and political scandal.

The absence of panic redemptions was the first piece of good news for Mr Damodaran – a civil servant whose previous post was fixing insolvent banks – since he was parachuted into India's most important asset management job two weeks ago.

UTI manages assets of about $13bn, equivalent to about two-thirds of India's mutual fund industry.

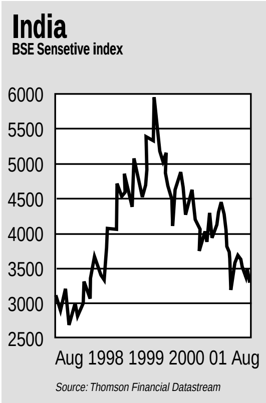
It has been described by Jon Thorn, of India Capital Fund PCC, as "the combined Calpers and Fidelity of India" – a reference to two of the world's largest fund managers.

Mr Damodaran'a first challenge is to reverse the pattern of asset allocation that lies at the heart of US-64's underperformance.

Yet in trying to change this situation, Mr Damodaran's hands are tied by the very factors that helped bring US 64 to its present position.

About 70 per cent of the scheme, which accounts for about 25 per cent of UTI's assets, was invested in equities – much of that in technology stocks. The scheme has consequently suffered from both the global technology sell-off and the down-turn in Indian stocks.

India's equities markets are trapped in a selling wave, reflecting global trends but also recent stock market scandals.



Bombay's Sensitive index has lost about 20 per cent of its value since March, when an inside trading scandal was exposed. US-64's current heavy weighting in equities flouts the recommendations of an official enquiry into a similar crisis in 1998, which led to a government bail-out. As Mr Damodaran says: "US-64 has more equity than is necessary. We want to make it a more balanced portfolio but the market cannot absorb such a large sale."

His second task is to reform a body that was created by parliament and remains beyond the policing powers of the regulator.

Many of UTI's 87 schemes comply with regulatory norms but the bigger ones, including US-64, do not because they were set up before India's market watchdog was created in the early 1990s. UTI says it is committed to regulatory compliance, notably on its pricing mechanisms.

The fund's mechanism of "administered pricing" meant that valuations were not based on market realities and allowed handsome dividends for many years.

Sustaining these payments was important not only because many unit-holders regarded the fund as a proxy bank deposit; but also because the vast majority of unit-holders are small retail investors – an important political constituency.•

Of US-64's 20m investors, 90 per cent hold fewer than 3,000 units.

Meleveetil Damodaran: parachuted into India's most important asset management job

Artificial pricing will be abandoned next January, in favour of a market-based system that reflects net asset value but many analysts are sceptical about the shift to NAV.

"The quality of some assets on UTI's books is suspect. The level of confidence in UTI can only be restored if a declared NAV is accompanied by full asset disclosure," says Rukhshad Shroff, equity strategist at JP Morgan in Bombay.

Mr Damodaran also wants to end the widespread habit of "inter-scheme transfers"– an artificial support mechanism that, in effect, subsidised poorly performing schemes using the profits of the better performing ones.

He is also determined to make each fund individually accountable and the poorly performing schemes are likely to be sold off.

The final challenge, he says, is to tackle "the perception that UTI is a sort of savings bank for the government. This is something that I would like to change," – an apparent reference to the political interference that has dogged UIT's performance.

Analysts have welcomed Mr Damodaran's appointment, seeing it as an opportunity to hasten broader reform of India's financial sector.

For example, US-64's likely shift from equities could be used to hasten legislation allowing conservative Indian provident funds, which invest mostly in fixed-income assets, to shift into shares. Such institutional investments would lend stability to India's volatile markets, analysts say.

The timetable of change is unclear because of market volatility. But what is clear is UIT's ultimate status, which will "remain a public sector body," says Mr Damodaran.

"I do not subscribe to privatisation for the sake of privatisation. We have an opportunity to change things. We won't get another chance."