Editorial

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THE HINDU BUSINESS LINE

Will US-64 survive beyond May '03?

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AFTER enjoying the 'confidence' of the investing community — including millions of small investors — for decades, the Unit Trust of India (UTI), India's largest mutual fund, has fallen by the wayside. While new investors are not too keen to invest in the schemes offered by it, those who already put in their hard-earned money want to exit.

To understand the genesis of the problem, let us look at some hard facts. An investor joins US-64, the UTI's flagship scheme, in July 1999, buying the units at Rs 14 (face value Rs 10 per unit). In 1999-2,000, he gets a dividend of 13 per cent, or Rs 1.3 per unit. In 2000-01, he gets dividend of 10 per cent, or Rs 1.0 per unit. In 2001-02, he gets nothing.

On the money 'actually' invested by him, the effective return works much lower, at 9.28 per cent during 1999-2000 and 7.14 per cent during 2000-01. And, taking into account 2001-02 when, no dividend was paid, the average return during the three years works out to a meagre 5.47 per cent per annum. This is just about half the return he would have earned on a bank deposit.

The above still does not fully reflect the ground reality. The intrinsic worth of the unit, represented by the NAV, is about Rs 6. This is Rs 8 lower than the money he spent on buying the unit. Even adjusting for the dividend of Rs 2.3 received so far, he has incurred a loss of Rs 5.7. Had he put Rs 14 in a three-year bank deposit, he would have earned Rs 4.62 (at 11 per cent per annum).

Under a special plan announced last year, the UTI promised to buy back units from the investors at a pre-determined price. If the investor exercises the option under this plan, he will get Rs 11.0 per unit. Including the dividend of Rs 2.3, the total recovery of Rs 13.3 will still fall short of his initial investment by Rs 0.7. And he would still lament having invested his savings in US-64! The facility of redemption at the pre-determined price is available to investors only up to May 2003. In May 2003, while small investors (units up to 5,000) can sell units to the UTI at Rs 12 per unit, large investors (over 5,000 units) will get Rs 10 per unit. In view of this, almost every member of the family will exit, and this will lead to a virtual collapse of the flagship.

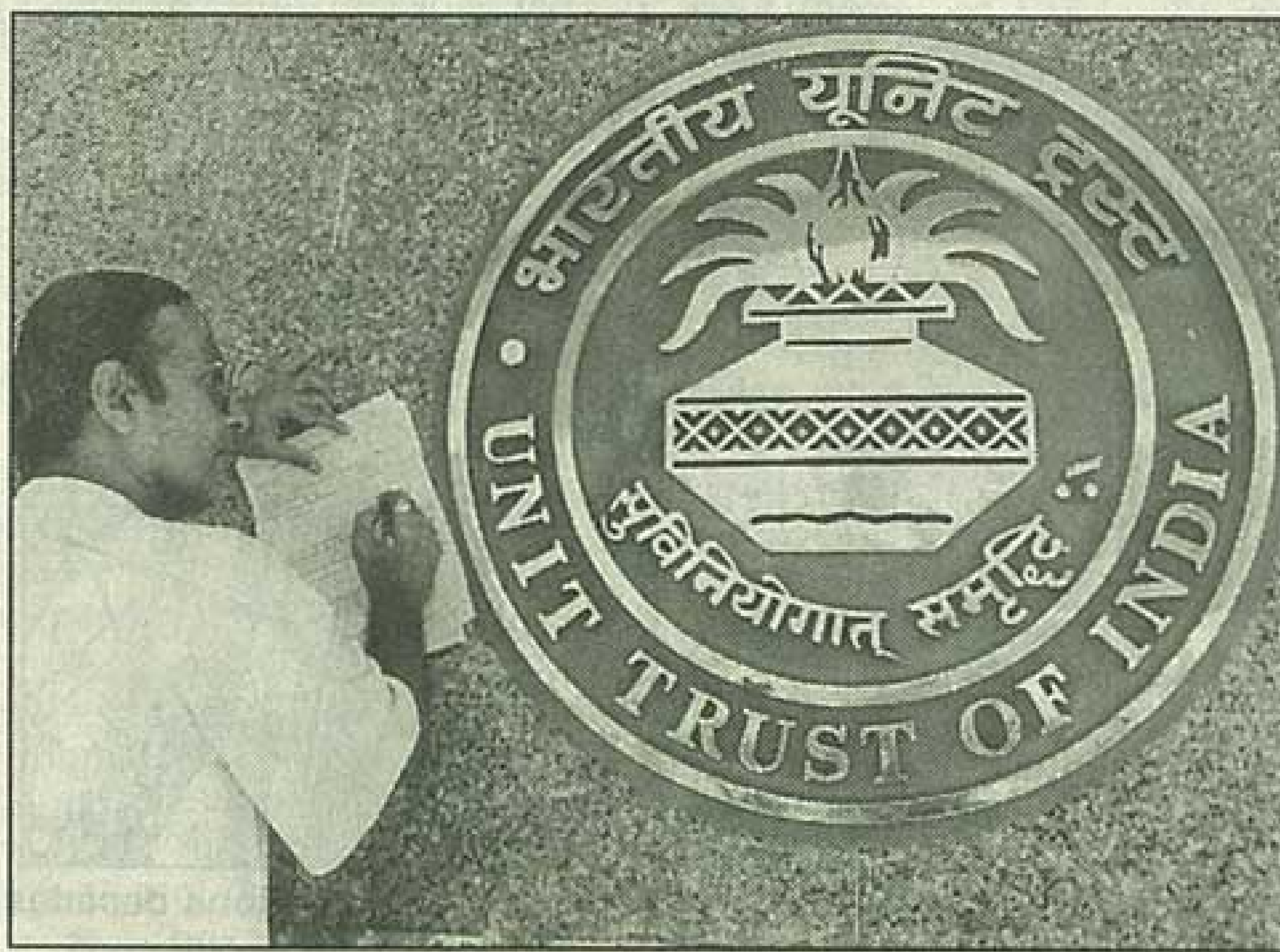
This can be averted only if the UTI decides to continue the re-purchase plan at a pre-determined price beyond May, 2003. However, this is only tantamount to postponing D-Day.

Undoubtedly, the plan will help investors escape a major disaster. However, this is at a huge cost to the tax-payer. The Government will have to shell out around Rs 5,500 crore to cover the gap between the current NAV and the assured price. This will be in addition to Rs 300 crore already spent under the plan during 2001-02. It is a typical case of robbing Peter to pay Paul.

Besides, the rescue plan would have done little to restore the confidence of the investor. He knows the scheme has been salvaged by support from an external source. Considering that the Government will not come forward to lend support in the future, he will think several times before putting his savings in the Trust.

This brings us to the most critical issue. The UTI not only mismanaged the portfolio under US-64, but also conducted its operations in a totally non-transparent manner. For instance, it did not share with investors the most vital information about the progressive reduction in the NAV. Worse, it kept selling units to new investors at an artificially inflated price.

The UTI also resorted to selective leakage of the information about the widening gap between the NAV, on the one hand, and the redemption price, on the other. This enabled corporate bigwigs (besides some financial institutions and banks) redeem their holdings in March/April 2001. This, indeed, was the trigger for an unprecedented cash flow crisis that the UTI faced.



Will it be curtains down for US-64 come May 2003?

Small investors were made to bear the brunt of the measures implemented by the UTI to combat it. For instance, they were affected the most by the temporary freeze on the sale and re-purchase of units.

Apart from US-64, the assured return schemes, including the MIP (monthly income plan), also suffer from serious mismatches between the NAV and the repayment obligations. As per the calculations done by the Finance Ministry, for all the '21' such schemes taken together, the shortfall works out to about Rs 14,000 crore.

What is being done to rejuvenate the UTI's sagging image? The strategy adopted by the Government is two-fold. First, it has declared its commitment to back the UTI in meeting its obligations. Second, it has promised to repeal the UTI Act and restructure to bring it on par with any other mutual fund.

Neither of the two pillars of the action plan will help revive confidence. The restructuring *per se* will be of little help unless the investors see clinching evidence that their money is in safe hands and is being managed well. Let us not forget that the UTI lost hundreds of crores of rupees by taking patently unviable investment decisions. This could happen even in the new structure!

The only way the Government can restore the UTI's credibility is by putting its management to test. The latter should demonstrate that it is capable of generating resources on its own by properly managing the portfolio and showing good performance as a basis for seeking funds from investors.

Fearing a backlash on the stock market in the event of large-scale unloading of shares by the UTI (to meet redemption obligations by May 2003), the powers-that-be are keen to ensure that, somehow, investors are prevented from exiting *en masse*. A proposal has been mooted to swap the entire the US-64 portfolio with Government bonds.

As a result, this will become a pure debt scheme. Having effectively taken over the US-64 portfolio on its books, the Government will have to carefully manage it. The cash flows from this should ensure timely servicing of the bonds in full. Efforts should be made to maximise the proceeds from sale of the shares.

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