

MEMBER REPORT

Unit Trust Association of Sri Lanka (UTA) consists of five member companies representing fund management companies licensed by the Securities and Exchange Commission of Sri Lanka to operate Unit Trust Funds.

UTA was formed in 1992, soon after the launch of first four balanced funds in the country, in early part of 1992. The five member companies manage twelve funds as on 30th June 2003, with a total funds under management amounting to US \$ 50 million..

UTA is a self regulated body and the member firms follow a high standard of Code of Conduct in their operations. UTA plays a key role in the development of the capital market by recommending important policy changes to the regulatory authorities in Sri Lanka. UTA members are represented in Ceylon Chamber of Commerce, Sri Lanka Association of Securities and Investment Analysts and other task forces set up by the Government to formulate policy changes from time to time.

Type of Funds

There are four main type of funds operating in Sri Lanka namely, balanced funds, growth funds, bond and gilt edged funds and index fund. The balanced funds are mainly focused on income and growth with annual dividend distribution policy with maximum equity limit of 80% per cent of the net asset value. There are four balanced funds operating under this category. There are three growth funds operating in the market which are allowed to expose upto 90% of the net asset value in the stock market. Growth funds are permitted under the Exchange Control Act to accept investment from residents outside Sri Lanka. Investors outside Sri Lanka can invest in growth funds by opening an account with a Commercial Bank operating in Sri Lanka. [referred as Securities Investment External Rupee Account (SIERA)]. Under income fund category three funds are operating now and one is a gilt edged scheme and the other two are bond funds which are primarily focussed to investing in the debt market. There is also one index fund which tracks the Milanka Price Index (MPI) an index published by the Colombo Stock Exchange tracking 30 most liquid stocks in the market.

Statistics pertaining to the Unit Trust Industry.

Type of Funds	Assets Under Management 30.06.03 (USD Mn)	Number of Funds	12 Month Performance ended 30.06.03 (%)
Balanced Funds	37.9	4	53.7
Growth Funds	4.4	3	54.6
Income Funds	8.3	4	11.9
Index Funds	0.1	1	61.6

Trends in the Fund Management Industry

The stock market has been progressive in terms of infrastructure even during the most difficult period in Sri Lanka and stands out as one of the modern exchanges with fully automated scriptless and trading facilities. However, the stock market volume and turnover was affected in the period 1994 -2001 due to the ethnic conflicts and war situation prevailed in the country. The events outside Sri Lanka also contributed to the adverse performance of the market. The peaceful atmosphere prevailing in the country during last one and half years has improved the outlook for the stock market. With improving investor confidence in Sri Lanka more foreign portfolio investments are beginning to flow into the country. The net inflow from foreign investor activities in the first 8 months of 2003 was USD 3 billion.

The Unit Trust Industry performance also improved in this period as highlighted in the table above. The industry is however unable to attract local investors as there is low level of awareness among the people. The industry is now engaged in creating the awareness more aggressively in the outskirts of the main city of Colombo. The interest rates declined from almost 22 percent in 2001 to 7 percent in 2002. Moreover the returns from the equity market exceeded 33 percent in 2002 and more than 40 percent in 8 months this year. The unit trust and fund management industry is more on focus among the investors as a result of the changes in the interest rates and capital market.

Trends Concerning International Investment Funds

The Sri Lankan Stock Market is relatively small with the market capitalization of US Dollar 3 billion having even smaller free float available for investments. The increasing flow of investment from foreign investment funds in Sri Lankan stocks has been witnessed in the recent past. However, the lower free float compared to some of the South Asian markets has limited larger investment flow in the Stock Market. The privatization of public enterprises were geared up with the Sri Lanka Telecom Limited listed last year and some of the larger enterprises are on the pipe line to be listed soon. These companies are expected to offer more liquidity to foreign investment funds to invest in Sri Lanka.

Legal and Regulatory Development

The recent amendment to the Securities and Exchange Commission Act enlarged the power of the Securities and Exchange Commission of Sri Lanka (SEC). Some of the unregulated activities has now been brought under the regulation. The areas include Credit Rating Agency, Margin provider, business of an underwriter, an Investment Manager or a clearing house.

The regulation referred as Unit Trust Code governing the Unit Trusts are expected to be revised soon to enable formation of close ended trusts to operate in the market. Furthermore, this piece of regulation would relax some of the investment restrictions currently in force such as liquidity restrictions, investment in unlisted securities and so on to allow more investment schemes to operate and to create a diversity of products to give better choice to investors.

New Tax Regulations

With effect from 1st April 2003, the Unit Trusts are subject to 10% taxation whereas the investors in units will be exempted from tax on dividend receipts and any capital gains realized from units.

New Products

A capital and income guaranteed scheme was offered in 2001/2003 period where the investors received a guarantee from a bank for capital safety and minimum return while having the upside benefits of better return. Industry is also working towards introducing money market fund and capital guaranteed fund.

Cross Border Distribution

The distribution channels for investment products are not developed to bring in investors, amidst the restrictions imposed on capital flow under the Exchange Control Act.

General Outlook

Sri Lanka is a small and beautiful country regaining its position with the ongoing peace initiatives along with some of the economic reforms. The international community is currently focussed on these developments and expected to effect a major development initiatives in the country. More relaxed economic and investment policies together with building up the most needed infrastructure would attract foreign direct and indirect investments in the future. The recovery of the stock market and increasing tourist arrivals signifies this development to a greater extent.

Moreover, financial sector reforms are being gradually introduced with the ongoing revision of banking and monetary laws. More reforms are also expected in the area of superannuation and pension related schemes to be more focused to develop a better retirement environment for the people.

The financial market is also undergoing many changes in the light of legislative and economic activities in the country. One can be reasonably optimistic of the prospects of the country along with the progress in peace initiatives and economic reforms.

Unit Trust Association of Sri Lanka Sri Lanka