What are Unit Trusts?

by Sarath Ranasinghe

The concept of Unit Trusts is relatively new to investors in Sri Lanka, but this investment vehicle is very popular in developed countries. Unit Trust is an effective instrument to generate funds for investment. In the U.S.A., Unit Trusts are known as Mutual Funds whereas in Europe they are known as Unit Trusts. History shows that the first Unit Trust was established in 1860 in Scotland to facilitate the spread of risk of investments. Reports indicate the operation of over 3000 Unit Trusts (Mutual Funds) in the U.S.A.

The economic policies of Sri Lanka since the 1990's emphasized the necessity for privatization of public enterprises in order to improve the efficiency of the institutions and to attract foreign investments to the country. During this period some giants in the public sector were privatized, resulting in the commencement of the growth of Capital Market in Sri Lanka. The Unit Trust provides the opportunity to the large scale as well as small scale investors to enter into the Capital Market with their untapped investible resources.

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A Unit Trust can be described as a pool of money mobilised from small and large investors, which in turn is invested in securities by professional Fund Managers. In common language a Unit Trust is a collective investment vehicle. It is probably the most practical, low risk method for investors to invest in the Capital Market, Bonds and Short Term Call Money Market. (Short-term borrowings by Commercial Banks and Investment Banks). For large scale business investors, the Unit Trust provides the service of taking the often hard-to-make decision regarding which investment to make, while for small investors, it offers an attractive savings scheme. It is mandatory to issue a Unit Certificate to the investor for the investment. The return for the investment is obtainable in the form of capital appreciation of the units issued and the income distribution made annually.

A Unit Trust is established by a Trust Deed and all the assets are held by the Trustee on behalf of the Unitholders. The Trust Deed contains a tripartite relationship amongst the Manager of the Trust, the Trustee and the Investor. The Trustee holds the assets of the Trust while the Manager purchases and manages the assets. The Trust Deed specifies how the money must be re-invested, Unit Prices are calculated, income is to be distributed, etc. No Unit Trust can invest funds in securities other than that specified by the Trust Deed subject to the restriction. imposed by the Securities and Exchange Commission of Sri Lanka. The Fund Managers always analyze risk against incomes in building up their investment portfolio, as they are highly concerned about the investments and the fluctuations in the income levels of the investment.

The regulatory body of the Unit Trust is the Securities and Exchange Commission of Sri Lanka which is an institution under the Ministry of Finance. The Securities and Exchange Commission has been established by an act of Parliament. The Commission monitors the Unit Trusts, to ensure that the Trust is operated in accordance with the provisions of the Trust Deed, Unit Trust Code and any other guidelines issued by the Commission from time to time.

There are a number of advantages that can be enjoyed by Unit Trust investors.

• Investments are managed by Professional Fund Managers who are qualified in Fund Management. These Fund Managers are well trained in their profession. They make investment decisions based on detailed information drawn from in-house and independent research.

• The Trust's funds are spread over fixed income securities, including company and Government bonds and shares of a variety of quoted companies to ensure that the investments are protected from any unexpected movement in the value of any one income source, resulting in the diversification of the risk component.

Unit Trust investors can obtain financial facilities from some recognized Banks by pledging the certificate as collateral

• Investors can liquidate the investment conveniently as the Fund Manager is obliged to buy back the Units which investors wish to sell.

Investors can also enjoy the following tax benefits:

Declared Income

Dividend distribution made by the Unit Trust out of tax exempt profits will be exempt from tax in the hands of the investors.

Capital Gains

Capital Gains arising from the sale of units are exempt from tax in the hands of the Unitholder provided, the units have been held for longer than one year.

A higher return substantially above the average rate of inflation of Sri Lanka could be expected for a medium to long term investment in the Unit Trust.

Unit Trust investments are held in Trust by the Trustee who safeguards the assets of the Trust by ensuring that the Fund is managed in terms of the Trust Deed and the Unit Trust Code.

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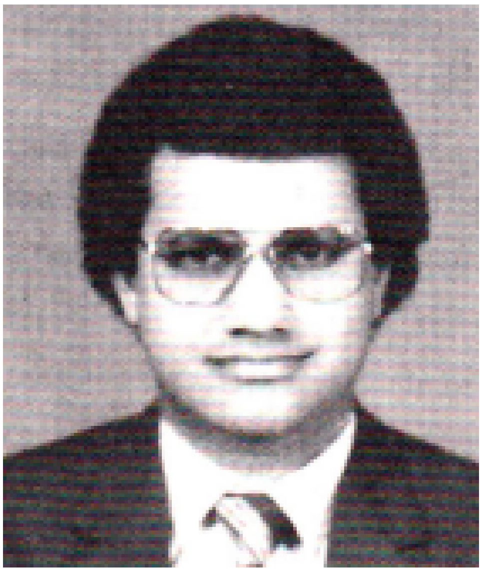
Unit Trust investment could begin with as little as Rs 1,000.

Investments in Unit Trusts are recommended as medium to long- term investments and, is an appropriate instrument for that portion of the savings which is reserved to achieve long-term objectives such as for minors and for retirement, etc.



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