

Government ETFs seen stoking arbitrage play

Shrinking asset base suggests only a few investors come for the long haul

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Mumbai, 28 November

While exchange traded funds (ETFs) have proved to be successful avenues for disinvestments, they are feared to be used as arbitrage vehicles by investors. So far, the government has mobilised ₹343 billion through the route by introducing the CPSE and Bharat-22 ETFs. In other words, it has issued units worth ₹343 billion during the new and follow-on fund offerings (NFOs and FFOs). However, at the end of last month, nearly 75 per cent of the units were redeemed by investors.

Currently, assets under management (AUM) for the CPSE ETF stand at ₹38 billion, as against ₹115 billion mobilised through its NFO and two FFOs. Similarly, the AUM for Bharat-22 ETF is around ₹52 billion, 77 per cent lower than the ₹228 billion worth of units issued during the NFO in 2017-18, and the subsequent FFO this fiscal.

Part of the reason for the fall in AUM is the decline in value of underlying securities. However, the fall is largely on account of redemptions from investors, especially institutional. Industry players say most of the institutional investors who apply in fresh offerings exit their holdings within weeks of listing. Often, the units are offered at a discount of up to 5 per cent on the prevailing market rate of the underlying securities, and thus investors end up making arbitrage gains.

"Government ETFs have become arbitrage vehicles. Bulk of investors exit immediately after the NFO or FFO," said an investment banker requesting anonymity. "While the discount is a draw, certain investors have to participate to provide support to these government offerings."

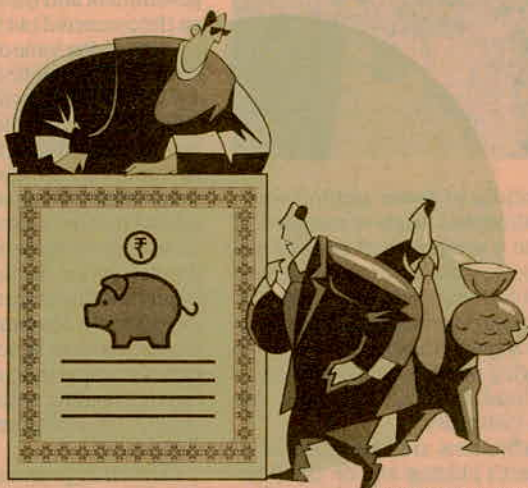


ILLUSTRATION: BINAY SINHA

Interestingly, it is the institutional investors who are seen flipping their units more than retail investors. "It is observed that retail investors largely stay put. The institutional investors are the ones who remain invested only for a few weeks. They exit by pocketing whatever gains are available," said an industry official.

An analysis of ownership data shows foreign funds, pension funds, insurance companies and even actively-managed mutual funds (MFs) are among investors that apply for units during the public offering.

"Institutional investors, such as MFs, prefer betting on individual securities instead of holding a basket of 10 or 20 securities without any common theme. Perhaps, actively managed MFs shouldn't be investing in such a product in the first place," said the official quoted above.

Market players say this trend, in which the ETFs are heavily subscribed but soon get redeemed, isn't good for the stock price performance of the underlying securities. "To honour the redemption requests, the ETF manager has to liquidate the holdings, which directly weighs on the share price of the underlying stocks in the secondary market," explained a fund manager.

IN IT FOR THE DISCOUNT?

Current AUM of both the ETFs is just a fraction of what the Centre had mobilised

CPSE ETF

Current AUM ₹3.83 trillion
(As of October 2018)

		Amt mobilised (₹ trn)	Discount* (%)
NFO	FY14	3.0	5.0
FFO1	FY17	6.0	5.0
FFO2	FY17	2.5	3.5
FFO3**	FY19	14.0	4.5

Bharat-22 ETF

Current AUM ₹5.19 trillion
(As of October 2018)

		Amt mobilised (₹ trn)	Discount* (%)
NFO	FY18	14.5	3.0
FFO1	FY19	8.3	2.5

*Offered during the NFO/FFO; **Still open
Source: Dipam, Reliance MF, IICI Prudential MF

For instance, an investor submits a request to redeem ₹1 billion worth of units of the CPSE ETF. Assuming there is no fresh demand, the asset manager has to sell ₹1 billion worth of shares of the underlying stocks according to their weightage.

The ETF route for disinvestment was first introduced in 2013-14 through the launch of the CPSE ETF. Last fiscal, the government introduced Bharat-22 ETF and raised ₹145 billion through its NFO. A fourth tranche of the CPSE ETF worth ₹140 billion is currently open for subscription.

The CPSE ETF has generated annualised returns of 8.2 per cent since inception. However, annualised returns since its first and second FFOs are in negative territory. The returns for Bharat-22 ETFs since its NFO in November 2017 and FFO in June 2018 are in the negative zone.